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COMMENTS

PROTECTING AGAINST THE GRAY MARKET IN THE NEW ECONOMY

I. INTRODUCTION

A gray market good is a lawful product that is protected by intellectual property laws and intended for sale outside of its manufacturing country.¹ Despite the manufacturer's intent that its product be consumed abroad, "gray marketeers" lawfully acquire the product abroad, import it back into the manufacturing country, and sell the product to consumers at a cost lower than the non-gray market product's cost.² Manufacturers are concerned about the gray market, especially because recent court rulings have practically eviscerated manufacturers' use of intellectual property rights to protect products from entering the gray market. Additionally, the growing presence of electronic commerce (e-commerce) heightens manufacturers' concerns about the gray market due to the Internet's ease of use, accessibility, and ability to connect consumers with product suppliers worldwide.³

The purpose of this Comment is to discuss the gray market concerns manufacturers face in the new economy, explain how e-commerce amplifies these concerns, and suggest measures manufacturers may take to prevent their products from entering the gray market economy. Part II provides an overview of the

1. See John C. Cozine, Casenote, *Fade to Black? The Fate of the Gray Market After L'Anza Research International, Inc. v. Quality King Distributors, Inc.*, 66 U. CIN. L. REV. 775, 777-778 (1998); see also Paul Lansing & Joseph Gabriella, *Clarifying Gray Market Areas*, 31 AM. BUS. L.J. 313, 314 (1993).

2. See Bryan P. Stanley, Note, *Preventing the Import of Gray Market Goods in Light of Quality King Distributors, Inc. v. L'Anza Research International, Inc.*, 38 WASHBURN L.J. 871, 871 (1999). See also, e.g., *Parfums Givenchy, Inc. v. Drug Emporium, Inc.*, 38 F.3d 477, 479 (9th Cir. 1994) (Givenchy perfume); *Societe Des Produits Nestle, S.A. v. Casa Helvetia, Inc.*, 982 F.2d 633, 635 (1st Cir. 1992) ("Perugina" chocolate); *Original Appalachian Artworks, Inc. v. Granada Elec., Inc.*, 816 F.2d 68, 70 (2d Cir. 1987) ("Cabbage Patch Kid" dolls). Although gray markets may include fake or fraudulent goods, this Comment focuses solely on authentic products.

3. See *infra* Parts III.C.1-3 (discussing the Internet's effect on gray marketing).

gray market and how e-commerce facilitates gray marketing. Parts III and IV outline legal and other methods manufacturers may employ to prevent their products from entering the gray market. Finally, Part V argues that non-intellectual property rights protections, such as contract law, branding, and/or cannibalism,⁴ may be the most effective methods available to keep products out of the gray market.

II. BACKGROUND: AN OVERVIEW OF THE GRAY MARKET AND E-COMMERCE

Gray market products are genuine products protected by intellectual property rights.⁵ Gray market products are usually sold by product manufacturers or authorized resellers via either sales contracts or licensing agreements.⁶ Somewhere in this chain of distribution, however, some of these genuine products are re-imported into the United States for resale against the manufacturers' and resellers' wishes. Gray marketeers typically purchase genuine products abroad at a discount and re-import them back into the United States for gray market consumption. Gray marketeers then profitably sell the gray market products for less than consumers would pay had they purchased the products through authorized distribution channels.⁷ The discounted price may stem from fluctuations in currency exchange rates, advertisement costs, manufacturers' multi-tiered pricing schemes, tax differences, or differing consumer preferences.⁸

Under traditional retail sales methods, consumers are often at a disadvantage when making purchasing decisions because they do

4. See Jerry Useem, *Internet Defenses Strategy: Cannibalize Yourself*, FORTUNE, Sept. 6, 1999, at 124. "Cannibalism" occurs when a firm decides to close its traditional establishment—"mortar-and-brick or catalog"—and open an e-commerce website. David A. Griffith & Jonathan W. Palmer, *Leveraging the Web for Corporate Success*, 42 BUS. HORIZONS 3, 7 (1999). An example of a firm that cannibalized itself is Egghead Software (www.egghead.com), which closed its existing retail locations and established a web-only presence after facing declining sales and operating losses from its traditional establishments. See *id.* at 7-8.

5. See Doris R. Perl, Comment, *The Use of Copyright Law to Block the Importation of Gray Market Goods: The Black and White of It All*, 23 LOY. L.A. L. REV. 645, 646 (1990).

6. See *id.*

7. See Daniel A. De Vito & Benjamin Marks, *Preventing Gray Marketing Imports after Quality King Distributors, Inc. v. L'Anza Research International, Inc.*, 10 J. PROPRIETARY RTS. 2, 2 (1998).

8. See Lansing & Gabriella, *supra* note 1, at 315.

not have the same information about products as do manufacturers and resellers. Consequently, manufacturers and resellers often maintain large profit margins because consumers remain unaware of facts such as products' wholesale costs or competitors who carry the desired products.⁹ The Internet is changing such pricing practices. Today, consumers increasingly control retail sales because the Internet provides information that promotes national and, in the future, global competition between manufacturers and retailers.

E-commerce allows consumers to purchase a wide variety of goods twenty-four hours a day, seven days a week,¹⁰ usually at prices lower than retailers, who do not engage in e-commerce, offer. Because of these benefits, e-commerce is growing at a remarkable rate.¹¹ Although e-commerce provides consumers with a larger distribution of goods and lower prices, product manufacturers in developed countries, such as the United States and United Kingdom, are concerned about their products being sold on the burgeoning gray market via the Internet because gray marketers undercut manufacturers' prices on their own products.¹²

A. *The U.S. and U.K. Markets: How Big Is the Problem?*

The annual U.S. and U.K. gray market economies exceed \$10 billion and £1.63 billion, respectively, and are driven by the countries' relatively open economic markets and their peoples' insatiable appetites for consumer products.¹³ In the United Kingdom, gray market products are so popular that some U.K. residents cross the North Sea to purchase new automobiles in the Netherlands for lower prices.¹⁴ Individuals who engage in this

9. See Dhruv Grewal & Larry D. Compeau, *Pricing and Public Policy: A Research Agenda and an Overview of the Special Issue*, 18 J. PUB. POL'Y & MARKETING 3, 3 (1999).

10. See *Click Here to Shop*, FORTUNE, Dec. 1, 1999, at 248, 249.

11. Rob Turner, *Shopping on the Internet: Eight Rules You Can't Afford to Ignore*, MONEY, Dec. 1, 1999, at 223 (stating that Internet sales are on the increase: "\$4 billion in online sales [in 1999], compared with [1998's] \$1.5 billion.").

12. See De Vito & Marks, *supra* note 7, at 2.

13. See Patricia J. Stirling, Comment, *Demystifying the Grey Market: A Practitioner's Guide*, 28 GONZ. L. REV. 291, 292 (1992-1993); see also Saeed Shah, *Parallel Traders Choose to Play Role of Consumers' Favourite*, TIMES (London), Feb. 26, 1999, at 35, available in 1999 WL 7975681.

14. See Brandon Mitchener, *Tax Arbitrage: For a Good Deal on a British Car, You'll Need a Boat*, WALL ST. J. EUR., July 19, 1999, at AB; Rhoda Koenig, *Shhh! Bargains for*

practice can save almost £8,000, including travel expenses incurred, on a five-door Land Rover Discovery sport utility vehicle, which sells for approximately £30,000 in the United Kingdom.¹⁵ This creates a gray market because individuals can purchase automobiles intended for foreign markets at low cost and thereby create competition in the domestic market. The popularity of such consumer practices spawns “car-cruises” and websites allowing U.K. citizens to purchase new automobiles at a fraction of the U.K. prices.¹⁶

B. Opponents of Gray Markets

Manufacturers dislike the gray market economy because it destroys their professional goodwill, brand image,¹⁷ and profit margin. They contend that gray market products’ popularity arises from manufacturers’ or authorized dealers’ established reputations and the protection intellectual property rights provide.¹⁸ Gray marketers derive profits by taking advantage of a product’s reputation without investing the capital associated with establishing such a reputation.¹⁹

Gray marketers’ business practices erode consumer goodwill because a product slated for foreign distribution often differs materially from the same product designed for domestic

Britons, WALL ST. J. EUR., Aug. 28, 1998, at 11.

15. See Mitchener, *supra* note 14.

16. See *id.* In January 1999, a British entrepreneur launched prices.com, a website devoted to the sale of gray market automobiles in the United Kingdom—the number of website visits “soared to 28,000 hits in [the first] two weeks.” *Id.* The website traffic became so voluminous that the phone company disconnected service because the website’s telephone lines “jammed an entire London telephone exchange with 10,500 calls in just 48 hours.” *Id.*

17. See Lansing & Gabriella, *supra* note 1, at 315–316.

18. See De Vito & Marks, *supra* note 7, at 2.

19. See Brian W. Peterman, Note, *The Gray Market Solution: An Allocation of Economic Rights*, 28 TEX. INT’L L.J. 159, 174 (1993). See also generally Lucinda Schmidt, *Parallel Lines Could Meet Within the Law*, BUS. REV. WKLY., Mar. 16, 1998, at 34, available in 1998 WL 11771889 (discussing the experiences of John Dunphy, owner of Dunphy Sports Fishing, who spent seventeen years building a \$17 million business). Mr. Dunphy is the exclusive distributor of “Shimano” brand fishing rods and reels in Australia. See *id.* He claims he spent approximately \$10 million promoting Shimano products in Australia: “[n]obody really knew [Shimano products] in Australia . . . I built something from nothing, it has been my life.” *Id.* If others were allowed to import Shimano rods and reels, Mr. Dunphy would have to decrease his staff and reduce the \$700,000 he spends on advertising annually because he would be unable to recoup his costs from the sale of Shimano products. See *id.*

consumption.²⁰ For example, goods manufactured for foreign consumption are frequently tailored to comply with different health and safety codes, regional tastes, or languages.²¹ Such differences erode consumer goodwill because the products' differences disappoint consumers.²² For these reasons, manufacturers suffer injuries from the gray market economy.²³

Gray market products also create consumer animosity toward authorized resellers and manufacturers because they appear to profit excessively from legitimate sales.²⁴ Goodwill is further damaged when consumers perceive manufacturers as offering substandard customer service by refusing to honor gray market products' warranties.²⁵

Product manufacturers are also concerned about the gray market's effect on brand image.²⁶ The "brand image" of a product is the emotional or psychological connection between consumers and the manufacturers' products.²⁷ Manufacturers, particularly luxury products manufacturers, spend millions of dollars annually

20. See Donna K. Hintz, Comment, *Battling Gray Market Goods with Copyright Law*, 57 ALB. L. REV. 1187, 1189 (1994).

21. See Lansing & Gabriella, *supra* note 1, at 316; see also, e.g., *Original Appalachian Artworks, Inc. v. Granada Elec., Inc.*, 816 F.2d 68, 73 (2d Cir. 1987).

22. See Lawrence M. Friedman, *Business and Legal Strategies for Combating Gray-Market Imports*, 32 INT'L LAW. 27, 40 (1998).

23. See *Original Appalachian Artworks*, 816 F.2d at 73 (involving the importation of "Cabbage Patch Kid" dolls into the United States by defendant, a company that purchased the dolls at issue from an authorized manufacturer in Spain). See *id.* The dolls produced in Spain contained adoption papers in a foreign language as well as several other idiosyncratic characteristics that reflected the manufacturer's intent that the dolls only be sold in Spain. See *id.* Importation of the dolls into the United States created consumer confusion as to their true origin because, although the dolls contained the Cabbage Patch Kid trademark, the dolls were not genuine because they differed from the dolls sold in the United States and were, in fact, unauthorized. See *id.*

24. See Jakki J. Mohr et al., *Communicating for Better Channel Relationships; Using Intensive Communications that Signal Collaborative Intent to Dealers May Enhance Channel Outcomes*, *MARKETING MGMT.* (Chicago, Ill.), Summer 1999, at 39, available in LEXIS, News Library, Mktmgmt File.

25. See Grewal & Compeau, *supra* note 9, at 6. See also Turner, *supra* note 11, at 224.

26. See Lansing & Gabriella, *supra* note 1, at 315. A "brand" is "the means by which a company aims to differentiate its products from competition and . . . protect its position in the market, profitably, over time." Roderick White, *What Can Advertising Really Do for Brands?*, 18 INT'L J. ADVERTISING 3, 3-4 (1999).

27. See White, *supra* note 26, at 4 ("A product is something that is made in a factory; a brand is something that is bought by customers. A product can be copied by a competitor: a brand is unique. A product can be quickly outdated: a successful brand is timeless." (citation omitted)).

on branding their products as prestigious.²⁸ Brand image, however, deteriorates when a luxury product is sold in the gray market because the product sells without its emotional appeal.²⁹ Consequently, manufacturers lose millions of dollars annually in sales and advertising because their products' brand images lose effectiveness.

Gray marketeers justify their business practices on numerous grounds. First, they claim that the products' license holders are not harmed by gray market practices because the gray market allows consumers to reap the benefits of lower prices and a larger selection of products.³⁰ Second, gray market proponents contend that the gray market prevents manufacturers from discriminating against wealthy consumers, such as those in the United States and the United Kingdom, because the gray market gives those consumers the option to purchase the goods' gray market versions at lower prices.³¹

C. *The Internet's Effect on Gray Marketing*

The Internet allows consumers to play proactive roles in obtaining gray market products. Traditionally, a consumer would experience difficulty in finding vendors who regularly receive products through the gray market. By using the Internet, however, customers actively search for and find vendors who carry gray market goods without leaving the comfort of their homes. Furthermore, Internet offerings, such as electronic bulletin boards and on-line auction houses, promote consumer participation in gray marketeering.³²

28. See Ira P. Schneiderman, *For Internet Shoppers, the Future Is (Almost) Now, New Study Predicts Online Purchasing by Consumers and Manufacturers Will Be Routine By 2002*, DAILY NEWS REC., Aug. 23, 1999, at 94; see also White, *supra* note 27, at 14.

29. See White, *supra* note 26, at 4 (stating that brands with weak emotional ties to consumers are vulnerable to the competition).

30. See DeVito & Marks, *supra* note 7, at 2.

31. See Christopher A. Mohr, Comment, *Gray Market Goods and Copyright Law: An End Run Around K Mart v. Cartier*, 45 CATH. U. L. REV. 561, 563 (1996); David Smith & Jessica Berry, *Revenge of the Shopper*, TIMES (London), June 20, 1999, at 13. For example, the cost of books in the United Kingdom has dropped significantly since the advent of e-commerce: "[A] full-fledged price war is in progress, led by [I]nternet booksellers such as Amazon.com and BOL (Bertelsmann on-line). 'The high street shops are tearing their hair out,' said Steve Blackburn, BOL's marketing manager." Smith & Berry *supra*, at 13.

32. See Barney Lehrer, *Strategies for International Trade on the Internet* (Oct. 1998) <<http://www.fita.org/aotm/1098.html>>.

The Internet provides a virtual marketplace allowing gray marketeers to reach buyers and undermine manufacturers' profits.³³ The Internet also allows gray marketeers to exploit the vast information available on the Internet to obtain competitive pricing information.³⁴ Gray marketeers can then use pricing information to determine products' market prices and undercut manufacturer and authorized reseller prices.³⁵ Electronic bulletin boards, on-line auctions, and intelligent agents are features on the Internet that facilitate gray marketeering.³⁶

1. Electronic Bulletin Boards

Electronic bulletin boards on the Internet facilitate gray marketeers' ability to locate buyers and sellers in overseas markets.³⁷ These bulletin boards provide buyers and sellers with "easy and low cost access to the [Internet] and the immediacy of reaching business all over the world" in hopes of streamlining international commerce.³⁸ There is a recent proliferation of "vertical marketplaces," which are "bulletin-board and auction-oriented sites that render intra-industry transactions faster, cheaper and smarter by gathering buyers and sellers into one virtual locale."³⁹ For example, the Federation of International Trade Association website offers electronic bulletin boards in an attempt to establish a true global marketplace.⁴⁰ In theory, electronic bulletin boards provide a common trading ground for gray marketeers to purchase and sell gray market products.⁴¹ Whether gray marketeers and consumers actually accept electronic bulletin boards as a means of facilitating trade remains unsettled.

33. See *Marketing News & Resources*, MARKETING DEP'T MGMT. REP. (Inst. of Mgmt. & Admin., New York, N.Y.), Sept. 1999, at 8, available in LEXIS, News Library, Marketing Department Management File.

34. See Grewal & Compeau, *supra* note 9, at 3.

35. See *Marketing News & Resources*, *supra* note 33.

36. Michael Krantz, *The Next E-volution Business Bots Could Transform Corporate Commerce, Just as the Web Transformed Consumer Shopping*, TIME, July 12, 1999, at 47, 47.

37. See Lehrer, *supra* note 32.

38. *Id.*

39. Krantz, *supra* note 36, at 47 (providing examples of vertical directories, such as Ariba and Commerce).

40. See *id.*

41. See *id.*

2. On-line Auctions

On-line auction houses, such as eBay, are enormously popular on the Internet.⁴² These auction houses streamline the gray market economy, further the Internet's arbitrage function,⁴³ and provide a common gathering place where buyers and sellers with similar interests congregate and conduct sales.⁴⁴ On-line auction houses also provide an impetus for individuals who are not in the import/export business to sell wares purchased abroad at significant discounts. Consequently, manufacturers not only face professional gray marketeers, but also entrepreneurial laypersons who purchase high-demand products intending to sell them on the gray market.⁴⁵

For example, on-line auction houses are brimming with people selling Reebok products,⁴⁶ Dallas Cowboys' warm-up suits,⁴⁷ and Nike athletic shoes.⁴⁸ These auction houses pose a threat to product manufacturers because on-line auction house transactions typically involve two private parties. As a result, fraudulent transactions abound and quality guarantees and product warranties are scarce. The development of "intelligent agents," which provide consumers with a direct connection to resellers, pose a greater threat to manufacturers.

42. See Miguel Helft, *Toward a Perfect Market*, INDUSTRY STANDARD (S.F., Cal.), Nov. 22, 1999, at 133, 133 (noting that eBay.com has registered over 7.7 million users).

43. "Arbitrage" is the "[s]imultaneous purchase and sale of the same or equivalent security, commodity contract, insurance, or foreign exchange on the same or different markets in order to profit from price discrepancies" WEBSTER'S THIRD INTERNATIONAL DICTIONARY 110 (1986).

44. See Helft, *supra* note 42.

45. See Shah, *supra* note 13, at 35.

46. See Bernhard Warner, *Reebok to Give the Boot to Renegade Vendors*, INDUSTRY STANDARD (S.F., Cal.), (Apr. 15, 1999) available at <<http://www.thestandard.com/article/display/0,1151,4248,00.html>> (mentioning Reebok International's plans to select specific on-line vendors through which to sell its products). The threat posed by the sale of gray market products over the Internet is significant enough to catch the attention of Reebok International, a \$3.2 billion sporting goods manufacturer. See *id.* Reebok is concerned with the combination of e-commerce and the gray market, which has the potential to dilute Reebok's brand image and profits.

47. See *id.*

48. See *id.*

3. Intelligent Agents

The Internet empowers consumers by providing them with useful information to guide purchasing decisions.⁴⁹ Yet, the Internet's explosive growth has left consumers confused by the information overload.⁵⁰ Computer programs called "intelligent agents," however, organize and present information to guide consumer purchasing decisions in order of importance.⁵¹

These intelligent agents or "bots" sift through vast amounts of information, make it discernible to consumers,⁵² streamline e-commerce activities, and reduce transaction costs for both buyers and sellers.⁵³ First generation bots compared the prices of specified products only.⁵⁴ This led many on-line vendors to ban bots from on-line storefronts because the bots examined prices only, without taking into account the level of service, quality, or other important factors.⁵⁵ Second generation bots, such as Frictionless, now take into account numerous criteria and are more personalized than were their predecessors.⁵⁶ They allow consumers to input specifics such as product, brand, price, color, size, and warranty, and instruct the bot to automatically purchase

49. See Andrew Zolli, *Where the Net Economy Is Going On-line Shopping Change Dramatically in Coming Years*, S.F. EXAMINER, Apr. 18, 1999 at C5, available in 1999 WL 6871840.

50. See *id.*

51. See Jim Kerstetter, *'Bots' Add Value to Web Searches*, PC WEEK, Aug. 16, 1999, at 10, available in LEXIS, News Library, Eweek File.

52. See Rob D. Kaiser, *Finding the Right Price Web Robots Connect Buyers to Vendors*, CHI. TRIB., May 24, 1999, at 1, available in 1999 WL 2876539 (quoting Marcus Zillman, Chief Executive Officer of BotTechnology.com, Inc., who described a "bot" as an "information butler" that retrieves data from the far reaches of the Internet and displays the information in a format that is easy for consumers to understand).

53. See *id.*

54. See Phil Patton, *Buy Here, and We'll Tell You What You Like*, N.Y. TIMES, Sept. 22, 1999, § G, at 22, 22 (noting that most first generation bots searched solely by price, which caused many on-line retailers to prohibit the bots' access to their price lists).

55. See Kerstetter, *supra* note 51, at 10. See also *E-Commerce Introduces Price Wars in Cyberspace*, NAT'L BUS. REV. (Auckland, N.Z.), May 28, 1999, available in 1999 WL 12336757.

56. See Kerstetter, *supra* note 51, at 10 (stating how second generation bots factor in concepts such as quality and service in searching for products on the Internet). See also Patton, *supra* note 54, at 22 (describing how a person interested in buying a notebook computer could select from a list of features, such as screen size and memory, in searching for and comparing notebook computers). The website for Frictionless Commerce Incorporated is located at <www.frictionless.com>.

the product, negotiate with the on-line storefront, or merely send the search results to the consumer.⁵⁷

Currently, large technology companies, such as Microsoft, are purchasing smaller companies that create bot technology.⁵⁸ Forecasts predict that consumer use of bots will become routine by 2002.⁵⁹

In the future, bots may lead consumers to a global bazaar where the bots search the Internet for the best values in user-specified products.⁶⁰ For example, BusinessBots, a software startup company launched in 1997, aspires to create a "market of markets" using bots through which users can instantaneously act on industry data and make purchasing decisions.⁶¹ Theoretically, consumers may also be able to program a bot to search for gray market products.⁶² The bot will search the Internet for the specified gray market products and perhaps even take into account exchange rate arbitrage in determining the final price consumers pay.⁶³ In essence, bots will facilitate gray market transactions by matching buyers with sellers.

57. See Schneiderman, *supra* note 28, at 94; see also Patricia Riedman, *Portals Rethink Retail Strategies, Shopping Agents: Bots Can Create Advertiser Tensions*, ADVERTISING AGE (Chicago, Ill.), Feb. 1, 1999 at 28, available in 1999 WL 8763050 ("Even the search and directory sites admit the shopping bots are flawed and need to be transformed into more comprehensive tools that not only search for price but also provide comparative information about retail brands, shipping information, availability and product reviews.").

58. See Chris Taylor, *Bot Till You Drop*, TIME, Oct. 11, 1999, at 52, 53. For example, Microsoft purchased Firefly, a first generation bot for an undisclosed sum in 1998; Excite purchased Jango.com, a second generation bot, for \$35 million in stock; and Amazon.com purchased Jungle.com, another bot, for \$180 million and used its virtual database to create Amazon.com's "All Product Search." *Id.* at 53.

59. See *id.* at 53.

60. See Koenig, *supra* note 14, at 11.

61. Krantz, *supra* note 39, at 47. The bots link to many sites in a given business sector and automate the "very human process, such as haggling, quality estimation and reputation management . . ." *Id.*

62. Jennifer L. Schenker, *Silicon Valet Intelligent Agents: Roam the Web Helping People and Hawking Products. Would You Buy a Used Car From One?*, TIME INT'L, Oct. 11, 1999, available in 1999 WL 25725938.

63. Anand Nandkumar, *Intelligent Agents in Transforming Commerce*, HINDU (Madras, India), Mar. 31, 1999, available in 1999 WL 5630335.

III. METHODS OF PROTECTING AGAINST GRAY MARKETS IN THE UNITED STATES

Product manufacturers traditionally invoke four statutes to protect their products from gray market consumption:⁶⁴ (1) the Tariff Act of 1930,⁶⁵ (2) the Lanham Act,⁶⁶ (3) the Patent Act,⁶⁷ and (4) the Copyright Act.⁶⁸

A. Trademark Law

A trademark is "any word, name, symbol, or device, or any combination thereof . . . used by a person . . . to identify and distinguish his or her goods . . . from those manufactured or sold by others and to indicate the source of the goods . . ." ⁶⁹ The objectives of U.S. trademark law are to: (1) prevent consumer confusion over the origin of particular goods or services and (2) "protect businesses from unfair competition."⁷⁰

The Tariff Act of 1930 prohibits the import of any foreign-made product bearing a trademark registered by any U.S. citizen or entity.⁷¹ The Tariff Act also protects product manufacturers from "unfair methods of competition in the importation or sale of products that infringe a U.S. intellectual property right causing substantial injury to a U.S. industry."⁷²

The Lanham Act contains several provisions that protect manufacturers' trademarked products from the gray market economy. One pertinent provision is section 1114(1)(a), which prohibits the use of any trademark likely to confuse consumers.⁷³ In addition, section 1124 prohibits admitting products into the United States if the products copy or simulate U.S.-manufactured

64. See James L. Bikoff et al., *Trademarks May Thwart Gray Market Importers: Manufacturers Hurt by Recent Supreme Court Copyright Ruling May Turn to Trademark Laws*, 10 INT'L Q. 214, 215 (1998).

65. 19 U.S.C. § 1337 (1994).

66. 15 U.S.C. §§ 1051-1127 (1999).

67. 35 U.S.C. §§ 1-374 (1995).

68. 17 U.S.C. §§ 101-1101 (1995).

69. 15 U.S.C. § 1127.

70. Jacob Jacoby & Maureen Morrin, "Not Manufactured or Authorized by . . .": *Recent Federal Cases Involving Trademark Disclaimers*, 17 J. PUB. POL'Y & MARKETING 97, 98 (1998).

71. See 19 U.S.C. § 1526 (1999); see also Bikoff et al., *supra* note 64, at 215.

72. Bikoff et al., *supra* note 64, at 215.

73. See 15 U.S.C. § 1114(1)(a).

products⁷⁴ and section 1125(a)(1) prohibits the use of trademarks that falsely designate a product's origin.⁷⁵

A manufacturer can bring claim under the Lanham Act for "infringement, importation of goods bearing infringing marks, and unfair competition" if its product enters the gray market economy.⁷⁶ Under the Lanham Act, if the U.S. trademark owner establishes that the gray market goods are "materially different"⁷⁷ from those intended for domestic distribution, it can either prevent their importation at the border⁷⁸ or seek civil damages for trademark infringement.⁷⁹

Section 1114(1)(a) of the Lanham Act protects trademark owners against "any reproduction, counterfeit, copy, or colorable imitation of a registered mark . . . [if such] use is likely to deceive consumers or cause confusion"⁸⁰ More importantly, if the

74. *See id.* § 1124.

75. *See id.* § 1125(a)(1).

76. Arif S. Haq, Note, *Martin's Herend Imports, Inc. v. Diamond & Gem Trading USA Co.: Gray Market Goods; Reason Makes a Run for the Border*, 23 N.C. J. INT'L L. & COM. REG. 381, 391 (1998).

77. *Societe Des Produits Nestle, S.A. v. Casa Helvetia, Inc.*, 982 F.2d 633, 641 (1st Cir. 1992) (stating that a material difference is presumed to exist where consumers would likely consider such a difference relevant to the decision of whether or not to purchase the product).

78. *See* 15 U.S.C. § 1124. *See also, e.g.*, *Lever Bros. Co. v. United States*, 981 F.2d 1330 (D.C. Cir. 1993) (granting an injunction because Lever's U.K. and U.S. deodorant soaps were materially different); *Original Appalachian Artworks, Inc. v. Granada Elec., Inc.*, 816 F.2d 68 (2d Cir. 1987) (granting an injunction because the "Cabbage Patch Kid" dolls manufactured abroad materially differed from their U.S. counterparts because, among other things, the dolls' adoption papers were printed in Spanish); *Fender Musical Instruments Corp. v. Unlimited Music Ctr., Inc.*, 35 U.S.P.Q.2d (BNA) 1053, 1056 (D. Conn. 1995) (granting an injunction because the Japanese-made guitar, which included a Japanese-language owner's manual, was materially different from its U.S.-made counterpart); *PepsiCo, Inc. v. Nostalgia Prods. Corp.*, 18 U.S.P.Q.2d (BNA) 1404, 1407 (N.D. Ill. 1991) (granting an injunction because the Pepsi products bottled in Mexico were materially different than those bottled in the United States); *Osawa & Co. v. B&H Photo*, 589 F. Supp. 1163 (S.D.N.Y. 1984) (granting an injunction because the gray market cameras contained instruction manuals in a foreign language and therefore materially differed from their U.S. counterparts). *But see CPC Int'l, Inc. v. Blandito Food Distrib. Corp.*, 835 F. Supp. 636, 638 (S.D. Fla. 1993) (denying an injunction because no material difference existed between the corn oil sold in the United States and that sold in Puerto Rico).

79. *See* 15 U.S.C. § 1114 (1)(a).

80. *Id.* § 1114, which provides, in pertinent part:

(1) Any person who shall, without the consent of the registrant—

(a) use in commerce any reproduction, counterfeit, copy or colorable imitation of a registered mark in connection with the sale, offering for sale, distribution, or advertising of any goods or services on or in connection with

gray market products are materially different from the products available through authorized channels of distribution, section 1114 enables the U.S. trademark owner to enjoin the products' sale.⁸¹

The "material difference" standard will likely become less relevant to protecting gray market products in the near future. As global e-commerce becomes fully realized, manufacturers will be reluctant to customize (i.e., materially alter) their products for different cultures because of the increased costs of altering products. Instead, manufacturers will likely change products only slightly to make them easily and inexpensively adaptable to various cultures. Doing so, however, may preclude manufacturers from using the Lanham Act's "material difference" standard to protect their products from entering the gray market economy.

B. Patent Law

The Patent Act, which protects products from gray marketeering as long as the products are patentable, provides: "whoever without authority . . . offers to sell, or sells any patented invention, within the United States or imports into the United States any patented invention during the term of the patent therefore, infringes the patent."⁸² Despite the Patent Act's broad language, it is constrained by the Exhaustion of Rights Principle. Similar to copyright law's First Sale Doctrine,⁸³ the Exhaustion of

which such use is likely to cause confusion, or to cause mistake, or to deceive; or

(b) reproduce, counterfeit, copy, or colorably imitate a registered mark and apply such reproduction, counterfeit, copy, or colorable imitation to labels, signs, prints, packages, wrappers, receptacles or advertisements intended to be used in commerce upon or in connection with the sale, offering for sale, distribution, or advertising of goods or services, on or in connection with which such use is likely to cause confusion, or to cause mistake, or to deceive,

shall be liable in a civil action by the registrant for the remedies hereinafter provided. Under subsection (b) hereof, the registrant shall not be entitled to recover profits or damages unless the acts have been committed with knowledge that such imitation is intended to be used to cause confusion, or to cause mistake, or to deceive.

Id. § 1114(1)(a)-(b).

81. *See id.* § 1114(1). *See also Lever Bros.*, 981 F.2d at 1331 (holding a material difference existed between the deodorant soap that sold in the United States and that sold in the United Kingdom because the soap sold in the United Kingdom smelled different and produced less lather than its U.S. counterpart).

82. 35 U.S.C. § 271(a) (1999).

83. *See Bikoff et al.*, *supra* note 64, at 225-226. The First Sale Doctrine "provides that

Rights Doctrine provides that the first lawful sale of a good exhausts the license holder's rights as to subsequent sales of that good.⁸⁴ For example, if a product manufacturer lawfully sells a patented product, the manufacturer loses its patent protection as to subsequent sales of that product and must exercise other means of protection to prevent its product from entering the gray market such as trademark law,⁸⁵ copyright law,⁸⁶ or other means.⁸⁷ In addition, patent law provides limited protection from the gray market because many products, such as clothing, perfume, and chocolate, are not patentable.⁸⁸

C. Copyright Law

Although it seems counterintuitive to employ copyright law to protect products such as food and shampoo from entering the gray market, manufacturers use the Copyright Act, rather than trademark law, to protect against the gray market economy.⁸⁹ Manufacturers and authorized resellers invoke the Copyright Act to protect their creative product packaging and labeling efforts.⁹⁰

the sale of a 'lawfully made' copy terminates the copyright owner's right to prevent further sales or distribution of the copy." *Id.*

84. See Darren E. Donnelly, Comment, *Parallel Trade and International Harmonization of the Exhaustion of Rights Doctrine*, 13 SANTA CLARA COMPUTER & HIGH TECH. L.J. 445, 450 (1997).

85. See *supra* Part III.A.

86. See *infra* Part III.C.

87. See *infra* Parts III.D–III.E, IV–V. See also *United States v. Univis Lens Co.*, 316 U.S. 241, 250 (1942) (regarding the Exhaustion of Rights Doctrine, the Court stated that "[the patent holder's] monopoly remains so long as he retains ownership of the patented article. But sale of it exhausts the monopoly in that article . . .").

88. See 35 U.S.C. § 101 ("Whoever invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof, may obtain a patent therefor, subject to the conditions and requirements of this title.").

89. See 17 U.S.C. § 102(a)(1)–(8) (1999) (indicating that there are eight broad categories of copyrightable works: (1) literary works; (2) musical works; (3) dramatic works; (4) pantomimes and choreographic works; (5) pictorial, graphics, and sculptural works; (6) motion pictures; (7) sound recordings; and (8) architectural works).

90. See *id.* § 102, which provides:

(a) Copyright protection subsists, in accordance with this title, in original works of authorship fixed in any tangible medium of expression, now known or later developed, from which they can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device. . . .

(b) In no case does copyright protection for an original work of authorship extend to any idea, procedure, process, system, method of operation, concept, principle, or discovery, regardless of the form in which it is described, explained, illustrated, or embodied in such work.

Product manufacturers use copyright law to prohibit the importation of gray market products into the products' originating country.⁹¹ Section 106 of the Copyright Act grants the copyright holder the exclusive right to use the copyright in any manner the copyright holder sees fit, subject to the exceptions in sections 107 through 120.⁹²

Court interpretations of the Copyright Act have been inconsistent, particularly with regard to the First Sale Doctrine in section 109.⁹³ The First Sale Doctrine exhausts the copyright holder's exclusive distribution rights (granted pursuant to section 106), permitting the owner of a lawfully-made and copyrighted work to dispose of it in any manner the owner so chooses.⁹⁴ Exhaustion of the distribution right, however, only divests the

Id.

91. See *Columbia Broad. Sys., Inc. v. Scorpio Music Distrib., Inc.*, 738 F.2d 424 (3d Cir. 1984) (involving a copyright holder of phonorecords who filed a copyright infringement action to prevent importation of the phonorecords into the United States), *aff'g* 569 F. Supp. 47 (E.D. Pa. 1983); *BMG v. Perez*, 952 F.2d 318, 319 (9th Cir. 1991) (involving a copyright holder of sound recordings who brought an action against an individual who purchased the recordings abroad and attempted to sell them in the United States).

92. See 17 U.S.C. § 106 (1994 & Supp. I), providing:

Subject to sections 107 through 120, the owner of a copyright under this title has exclusive rights to do and to authorize any of the following:

- (1) to reproduce the copyrighted work in copies or phonorecords;
- (2) to prepare derivative works based upon the copyrighted work;
- (3) to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending;
- (4) in the case of literary, musical, dramatic, and choreographic works, pantomimes, and motion pictures and other audiovisual works, to perform the copyrighted work publicly; and
- (5) in the case of literary, musical, dramatic, and choreographic works, pantomimes, and pictorial, graphic, or sculptural works, including the individual images of a motion picture or other audiovisual work, to display the copyrighted work publicly; and
- (6) in the case of sound recordings, to perform the copyrighted work publicly by means of a digital audio transmission.

Id.

93. *Id.* § 109. See *Bikoff et al.*, *supra* note 64, at 226. Compare *Sebastian Int'l, Inc. v. Consumer Contacts (PTY) Ltd.*, 847 F.2d 1093 (3d Cir. 1988) (holding that section 109 supersedes section 602) with *Parfums Givenchy, Inc. v. Drug Emporium, Inc.*, 38 F.3d 477 (9th Cir. 1994) (holding that section 602 supersedes section 109).

94. See *Bikoff et al.*, *supra* note 64, at 225–226; *Quality King*, 523 U.S. at 154 (Ginsburg, J. concurring) (holding that section 109 supersedes section 602, except with respect to products manufactured overseas).

copyright owner's right to sell, rent, or lease that particular work — it does not divest the other rights granted under copyright laws.⁹⁵

Section 602(a) of the Copyright Act forbids the unauthorized commercial importation of copyrighted works acquired abroad.⁹⁶ Under this section, any unauthorized importation of works acquired outside the United States is a violation of the copyright holder's exclusive distribution right.⁹⁷ Therefore, while "section 602 gives [a] copyright owner[] the right to prohibit the unauthorized importation of copies,"⁹⁸ section 109 "unambiguously states that such an owner 'is entitled, without the authority of the copyright owner, to sell' that item."⁹⁹

In *L'Anza Research International, Inc. v. Quality King Distributors, Inc.*,¹⁰⁰ the U.S. Supreme Court resolved the inconsistent interpretations of sections 109 and 602. L'Anza Research manufactured and sold hair care products with copyrighted labels affixed to the containers.¹⁰¹ L'Anza's U.S. marketing strategy entailed creating an exclusive image for the product by mass promotion, mass advertising, and training hair stylists to use L'Anza products.¹⁰² L'Anza also arranged for foreign sale of its products through a U.K. distributor in hopes of expanding the products' market base.¹⁰³ L'Anza, however, did not implement a separate product marketing campaign for its products' European launch.¹⁰⁴ As a result, L'Anza sold its products at lower prices overseas than it did in the United States.¹⁰⁵ The price difference provided gray marketeers an opportunity to purchase L'Anza products abroad and sell them in the United States for a price lower than that offered by authorized U.S. distributors.¹⁰⁶ Quality King was among the retailers that

95. Steve Lauff, Note, *Decompilation of Collective Works: When the First Sale Doctrine Is a Mirage*, 76 TEX. L. REV. 869, 878 (1998).

96. See 17 U.S.C. § 602 (1999).

97. See *id.*

98. *Quality King*, 523 U.S. at 135.

99. *Id.* at 136.

100. 523 U.S. 135.

101. See *id.* at 138.

102. See *id.*

103. See *id.* at 139.

104. See *id.*

105. See *id.*

106. See *id.*

acquired L'Anza products through the gray market and sold them at a substantial discount.¹⁰⁷

L'Anza filed suit, claiming that Quality King violated L'Anza's exclusive distribution rights under sections 106, 501, and 602 of the Copyright Act.¹⁰⁸ Quality King responded by arguing that L'Anza's exclusive right to distribute its products, pursuant to section 106, was limited by the First Sale Doctrine in section 109.¹⁰⁹ The Supreme Court held in favor of Quality King, stating that the First Sale Doctrine supersedes section 106 for U.S.-made products exported for foreign consumption.¹¹⁰ Consequently, a gray marketeer can lawfully import and sell a gray market product in the United States without infringing on the copyright owner's rights.¹¹¹ Hair care industry sources estimate that, as the result of *L'Anza*, in the future the industry will lose more than \$80 million in sales annually to the gray market economy.¹¹²

The Supreme Court, however, did not address whether the copyright holder has exclusive distributorship rights if the product was "lawfully made" under another country's laws.¹¹³ In other words, the question as to whether gray marketeers unlawfully importing products into the United States can use section 109 as a defense to a section 602 infringement claim remains unresolved.¹¹⁴

D. *The International Trade Commission Remedy*

The International Trade Commission (ITC) is an independent federal governmental agency.¹¹⁵ A manufacturer can obtain a general exclusion order, a cease and desist order, or a forfeiture against imports, by filing a complaint with the ITC under section 1337 of the Tariff Act of 1930,¹¹⁶ which proscribes unfair competition in import trade. If the ITC determines that a violation of section 1337 exists, it may: (1) order the Customs Service to exclude the product from the United States; (2) issue a

107. *See id.*

108. *See id.* at 140 (Ginsburg, J. concurring).

109. *See id.*

110. *See id.* at 154.

111. De Vito & Marks, *supra* note 7, at 4.

112. *See* Chantal Tode, *Diverters Win Battle, But the War Rages On*, WOMEN'S WEAR DAILY, Mar. 13, 1998, at 10.

113. DeVito & Marks, *supra* note 7, at 4.

114. *See id.*

115. *See* Friedman, *supra* note 22, at 40.

116. 19 U.S.C. § 1337 (1999); *see also* Friedman, *supra* note 22, at 41.

preliminary exclusion order; (3) issue a cease and desist order; or (4) order seizure of the products.¹¹⁷ Although section 1337 is predominantly used to combat patent infringement, it also protects "all forms of domestic intellectual property from unfair competition"¹¹⁸ Section 1337 declares unlawful "any unfair methods of competition and unfair acts in the importation of articles into the United States, the intent of which is to destroy or substantially injure an industry in the United States."¹¹⁹ "Unfair acts constituting violations of section 1337 are often based on violations of other statutes and [infringements on] common law rights"¹²⁰

A recent example of a section 1337 lawsuit involved Brown & Williamson Tobacco Corporation's (B&W) plea to the ITC requesting a ban on importation of B&W cigarettes intended for overseas distribution.¹²¹ The complaint alleged that the respondent gray marketed "Kool" and "Lucky Strike" brand cigarettes in the United States.¹²² B&W sought a permanent order banning the distribution of the cigarettes in the United States, as well as fines for violations of "up to \$100,000 a day or twice the value of the imported articles."¹²³ The ITC held that the respondent's conduct constituted, among other things, trademark infringement in violation of section 1337.¹²⁴ The ITC determined that "a general exclusion order be issued, that a cease and desist order against [respondent] be issued, and that a bond of \$7 per carton of repatriated Kool and Lucky Strike cigarettes imported during the [period at issue] be imposed."¹²⁵

117. See Friedman, *supra* note 22, at 41.

118. Margo Bagley, Comment, *Using Section 337 of the Tariff Act of 1930 to Block Materially Different Gray Market Goods in the Common Control Context: Are Reports of Its Death Greatly Exaggerated?*, 44 EMORY L.J. 1541, 1554 (1995).

119. 19 U.S.C. § 1337 (A)(i).

120. Bagely, *supra* note 118, at 1554.

121. See David McGinty, *B&W Attacks Re-import Cigarettes "Gray Market" Sales Hurt U.S., Complaint Says*, COURIER-J. (Louisville, Ky.), Aug. 19, 1999, at 1D. See also *In re Certain Cigarettes & Packaging Thereof*, USITC Pub. 2095, Inv. No. 337-TA-424 (June 22, 2000) (initial determination & recommended determination) [hereinafter *Certain Cigarettes*].

122. See McGinty, *supra* note 121, at 1D.

123. *Id.*

124. See *Certain Cigarettes*, USITC Pub. 2095, Inv. No. 337-TA-424, at 78.

125. *Id.*

IV. PRIVATE MEANS OF PROTECTING AGAINST THE GRAY MARKET ECONOMY

A manufacturer may preempt gray marketeers by raising the price of its products intended for foreign distribution.¹²⁶ This decreases the products' profitability on the gray market, especially when considering import tariffs and distribution costs.¹²⁷ Product manufacturers may also avoid distribution in foreign markets they know gray marketeers utilize to obtain legitimate products.¹²⁸ This method, however, may not be desirable because the markets may be too profitable for manufacturers to forego even when taking gray market losses into account.

A. *Differentiating Between Products Intended for Domestic and Foreign Consumption*

Manufacturers may also differentiate between products intended for domestic and foreign consumption by using different packaging, labels, product names, and formulations. If manufacturers so differentiate, U.S. Customs is authorized to block gray market goods at the U.S. border because of trademark law's "material difference" standard.¹²⁹ For example, in *Lever Brothers Co. v. United States*,¹³⁰ the court held that Lever Brothers' "Shield" and "Sunlight" brand soaps separately slated for respective U.K. and U.S. distribution differed materially because they had different formulations as well as distinct packaging.¹³¹

126. See Maureen M. Cyr, Note & Comment, *Determining the Scope of a Copyright Owner's Right to Bar Imports: L'Anza Research International, Inc. v. Quality King Distributors*, 73 WASH. L. REV. 81, 101 (1998).

127. See Shubha Ghosh, *An Economic Analysis of the Common Control Exception to Gray Market Exclusion*, 15 U. PA. J. INT'L BUS. L. 373, 377 (1994).

128. See Cyr, *supra* note 126, at 101.

129. See *Lever Bros. Co. v. United States*, 981 F.2d 1330, 1331 (D.C. Cir. 1993). For a discussion of what constitutes a material difference, see *Societe Des Produits Nestle, S.A. v. Casa Helvetia, Inc.*, 982 F.2d 633, 638 n.6, 639-640 (1st Cir. 1992) (presuming that if consumers would consider a difference between the gray market and legitimate product as relevant when buying the product, the difference is material). A defendant can rebut the material difference presumption only if she can show, by a preponderance of the evidence, the differences are not the type an average consumer considers. See *id.* at 641; see also Bikoff et al., *supra* note 64, at 221.

130. 981 F.2d 1330.

131. See *id.* at 1331, 1338-1339.

B. Causes of Action Based on Tort and Contract Law

Product manufacturers may use the tort theory of intentional interference with contract to prevent their products from entering the gray market economy.¹³² This theory, however, may fail in practice.¹³³ A successful tortious interference with contract claim of has four elements: (1) a valid contract between the plaintiff and a third party; (2) defendant's knowledge of that contract; (3) defendant's intentional procuring of its breach; and (4) damages.¹³⁴ Proving damages, though, either by demonstrating that the contract value diminished or the manufacturer's contractual performance became burdensome, is difficult to accomplish in a gray market context.¹³⁵

In *Railway Express Agency, Inc. v. Super Scale Models, Ltd.*,¹³⁶ the plaintiff sued the defendant for intentional interference with contract.¹³⁷ The plaintiff, however, failed to establish it suffered damages because it could not prove the value of its contract had actually diminished.¹³⁸ Consequently, use of intentional interference with contract may be limited because of the difficulty with establishing the damages element.

Fraudulent inducement to contract may also be utilized to prevent gray marketeers from selling illegitimate products in the United States.¹³⁹ This cause of action applies when the manufacturer seeks assurances from its purchaser that the purchaser will not sell the products intended for foreign consumption in the U.S. market.¹⁴⁰ If the product intended for foreign consumption is later found in the United States and the manufacturer verifies that the vendor intended to sell it in the United States, a cause of action may lie in fraudulent inducement to contract.¹⁴¹

132. See Friedman, *supra* note 22, at 47; see also RESTATEMENT (SECOND) OF TORTS § 766A (1979).

133. See Stanley, *supra* note 2, at 887.

134. See *G.K.A. Beverage Corp. v. Honickman*, 55 F.3d 762, 767 (2d Cir. 1995); see also *Houbigant, Inc. v. ACB Mercantile, Inc.*, 914 F. Supp. 964, 991 (S.D.N.Y. 1995).

135. See Stanley, *supra* note 2, at 887.

136. 934 F.2d 135 (7th Cir. 1991).

137. See *id.* at 137.

138. See *id.* at 140.

139. See Friedman, *supra* note 22, at 48.

140. See *id.*

141. See *id.*; see also *Johnson & Johnson Prods., Inc. v. Dal Int'l Trading Co.*, 798 F.2d 100 (3d Cir. 1986) (involving allegations by a manufacturer contending that it was

Additionally, contract law is another avenue that may shelter a manufacturer's products from the gray market economy.¹⁴² For example, a manufacturer may include geographical restrictions in its agreements with retail distributors.¹⁴³ Manufacturers, however, should exercise caution because they may expose themselves to antitrust litigation for implementing vertical restraints.¹⁴⁴

Product manufacturers may decrease the possibility of their products entering the gray market economy by requiring that distributors sign agreements containing liquidated damages clauses or marking their products with serial numbers identifying specific distributors.¹⁴⁵ The products may be stamped with serial numbers which are then input into databases that track the serial numbers and the corresponding distributors.¹⁴⁶ A manufacturer can then utilize the Internet to track the lot numbers as the products move through each link in the distribution chain.¹⁴⁷ If a product enters the gray market, a manufacturer can identify the distributor who sold the product to the gray marketeers by researching the last point of sale in the database.¹⁴⁸ The manufacturer can then enforce the liquidated damages clause against the distributor responsible for supplying the gray marketeers with the product.¹⁴⁹ This strategy may be difficult to enforce, however, if the manufacturer cannot prove the gray marketeers were aware of the geographical distribution restrictions in the contract.¹⁵⁰

fraudulently induced to sell goods to the buyer based on the buyer's oral misrepresentation that the products would be distributed solely in Poland, when in fact, the products were subsequently distributed in the United States at prices lower than those the manufacturer charged).

142. See Friedman, *supra* note 22, at 48.

143. See Cyr, *supra* note 126, at 101.

144. A manufacturer's control of its products' resale prices, throughout the distribution chain (i.e., its use of vertical restraints) may violate section 1 of the Sherman Antitrust Act, 15 U.S.C. § 1 (1994), if it is established that the pricing arrangement arises from a contract, "combination or conspiracy." E. THOMAS SULLIVAN & JEFFREY L. HARRISON, UNDERSTANDING ANTITRUST AND ITS ECONOMIC IMPLICATIONS 153 (1994).

145. See Friedman, *supra* note 22, at 49-50.

146. See *id.*

147. See *id.* at 50.

148. See *id.*

149. See *id.*

150. See Cyr, *supra* note 126, at 101.

V. METHODS OF PROTECTING AGAINST GRAY MARKET PRODUCTS IN E-COMMERCE

As transnational commerce and dissemination of consumer information over the Internet grows, gray market goods will pose a greater threat to manufacturers.¹⁵¹ Trademark, patent, and copyright laws do not adequately protect manufacturers against the gray market economy. Therefore, product manufacturers must implement novel, creative strategies to prevent their products from falling victim to the gray market economy.

A. *Enacting Internet Consumer Laws Similar to State Consumer Laws*

Certain states, such as New York and California, have enacted gray market consumer protection laws requiring that third-party sellers of gray market products post numerous disclosures.¹⁵² These disclosures must be posted conspicuously and must include all of the following, if applicable: (1) the inapplicability of the manufacturer's warranty; (2) the incompatibility of electric current or broadcast frequencies with U.S. standards; (3) the unavailability of replacement parts; (4) the unavailability of product manuals in English; and (5) any other relevant product nonconformities known to the seller.¹⁵³ A dealer who sells gray market products without making such disclosures is liable to the consumer for a refund or credit.¹⁵⁴

The scope of these types of consumer protection laws should be extended to include products purchased through e-commerce. An on-line storefront selling gray market products should be required to conspicuously post all pertinent disclosures in a new window before the sale is finalized—this product disclosure window should include “I agree” and “I disagree” buttons allowing a consumer to decide whether to purchase the product after reading the disclosures. Only after the consumer decides should the on-line storefront finalize the deal and bill the consumer. Similar to California consumer protection laws,¹⁵⁵ a failure to

151. See Donnelly, *supra* note 84, at 486.

152. See N.Y. GEN. BUS. LAW § 218-aa (McKinney 1997); CAL. CIV. CODE §§ 1797.8–1797.82 (West 1998). See also De Vito & Marks, *supra* note 7, at 6.

153. See CAL. CIV. CODE § 1797.81.

154. See *id.*

155. See, e.g., *id.* §§ 1797.8–1797.82.

disclose gray market information should entitle the purchasing consumer a refund, credit, or rescission of sale if he or she so chooses.

B. Cannibalism¹⁵⁶

The advent and popularity of e-commerce makes cannibalism a practical defensive strategy to combat the gray market.¹⁵⁷ Manufacturers who control product distribution either by selling exclusively over the Internet or via a “click-and-mortar business”¹⁵⁸ are more effective at preventing their products from entering the gray market economy because they control the majority, if not all, channels of distribution. First, the manufacturer is the sole distributor and decides where, and under what conditions, the product enters the stream of commerce. Consequently, importers are unable to legally purchase gray market products for re-import and the manufacturer retains control over both distribution and price.

An example of a corporation that controls all of its products’ channels of distribution is Dell Computer Corporation (Dell), a manufacturer of personal computers. Dell conducts business exclusively on-line and via telephone purchasing.¹⁵⁹ The Dell website, www.dell.com, is consistently voted among the top 100 best websites and generates over six million dollars of sales daily.¹⁶⁰ Because Dell controls all channels of distribution, it presumably encounters no gray market problems.

Dell’s business model is so successful that its rivals began scrapping their own business models and adopting Dell’s.¹⁶¹ In November 1998, Compaq announced that it was broadening its on-line sales program, DirectPlus.¹⁶² Although Compaq temporarily suspended the rights of some third-party on-line businesses to sell Compaq products, it helped resellers establish on-line storefronts and paid “agent fees” to businesses for referring customers to

156. For a definition of “cannibalism,” as used herein, see *supra* note 4.

157. See Useem, *supra* note 4, at 122, 124.

158. A “click-and-mortar” business is one that operates both on-line and traditional storefronts.

159. Dell Computer Corporation, *Who We Are* (visited Aug. 31, 2000) <http://www.dell.com/us/en/gen/corporate/factpack_000.htm>

160. See Donn Wilmott, *The Top 100 Web-sites*, PC MAG., Mar. 1999, at 118.

161. See Useem, *supra* note 4, at 132.

162. See *id.*

DirectPlus.¹⁶³ Compaq's revised business model, in all likelihood, makes it difficult for importers to purchase and resell Compaq products on the gray market because they can only purchase the products through Compaq or an authorized reseller website. Neither channel of distribution, therefore, is fruitful for the gray marketeer because there is no arbitrage from which the gray marketeer can profit.

Likewise, Lands' End, a company that produced over one billion dollars in sales in 1999,¹⁶⁴ is another example of a manufacturer with virtually no gray market problems. Lands' End is a direct merchant of casual clothing, soft luggage, and home furnishings.¹⁶⁵ Lands' End's products are offered through mail-order catalogs, its on-line storefront (www.landsend.com), and twenty-four retail stores.¹⁶⁶ Lands' End thereby maintains control of all channels of distribution, which makes it difficult for gray marketeers to introduce Lands' End products to the gray market economy.¹⁶⁷ Also, Lands' End has greater control over pricing and branding because it controls all means of its products' sales.

A manufacturer that takes exclusive control of its products' distribution channels, could, theoretically, sell its products at lower prices, thereby passing the savings to consumers. For example, when Compaq first opened its on-line storefront, its products' prices were eight to nine percent less than the prices Compaq resellers charged.¹⁶⁸ This type of savings is the reason Lands' End is able to offer superior products at lower prices—it omits the middlemen.¹⁶⁹ Because it is an effective strategy to prevent manufacturer products from entering the gray market, cannibalism should be adopted before consumers fully embrace global e-commerce.

C. Branding and Customer Support

Often, the products entering the gray market economy are extremely popular and have strong brand images. The strong brand image is formed by manufacturer marketing, which infuses

163. *Id.*

164. *See* Lands' End, *Home Page* (visited Dec. 16, 1999) <<http://www.landsend.com>>.

165. *See id.*

166. *See id.*

167. *See id.*

168. *See* Useem, *supra* note 4, at 132.

169. *See* Lands' End, *supra* note 164.

emotion into the products.¹⁷⁰ Manufacturers and store retailers pay close attention to issues such as flooring, lighting, photography, music, and color in order to capture the personality of the brand.¹⁷¹ The same is true in on-line retailing, where manufacturers structure websites to elicit desired feelings from consumers.¹⁷² In essence, manufacturers use branding to elicit the social and psychological dimensions of shopping.¹⁷³ If these dimensions are removed from the products, it may decrease gray market demand.

Psychology also plays a major role in consumer decisions.¹⁷⁴ If products are labeled “gray market,” consumers may be reluctant to purchase them because they lose their prestige.¹⁷⁵ If manufacturers exploit consumer psychology by using different packaging and labeling on goods destined for foreign consumption, they may be able to deter gray market consumption by targeting its weakest link: consumers.

Furthermore, the popularity of some products is based, in part, on the services associated therewith. By providing customer support and services only to products purchased through legitimate distribution channels, product manufacturers may thwart unwanted gray market distribution. For example, purchasing high-tech electronics through the gray market may not be worthwhile because consumers lose the service and support manufacturers provide to consumers of the legitimate products. This service and support could include access to a members-only website providing valuable information about the product, free technical support, and consumer-friendly warranties.

170. See *supra* Part II.B.

171. See Harriet Marsh, *Point-of-Purchase: POP Stars of the Retail World*, MARKETING, Jan. 7, 1999, at 19, available in 1999 WL 8315008 (discussing how soft flooring slows customers down and encourages them to browse and lighting turns dead space into a selling area).

172. Cf. *id.* (discussing the significance retail design in the traditional storefront context).

173. See Marsh, *supra* note 171.

174. See *id.*

175. See Shah, *supra* note 13, at 35. But see Ghosh, *supra* note 127, at 428 (endorsing the practice of properly labeling gray market products as “gray market” and arguing that such a practice would benefit consumers).

VI. CONCLUSION

Courts have decreased the methods through which manufacturers can protect their products from entering the gray market economy. Claims filed under trademark law, for example, are increasingly difficult to win. The "material difference" standard in trademark law loses its significance as globalization increases because manufacturers need to maintain consistent brand images throughout the world. Moreover, in many cases, patent law is inapplicable because products sold on the gray market do not lend themselves to patent protection. Copyright law has also lost its utility as a shield against the gray marketeering of products since the Supreme Court, in *L'Anza*, held that the First Sale Doctrine supersedes a manufacturer's right of distribution once the first sale is made.

The ITC remedy might be useful to product manufacturers hoping to stop the flow of gray market products into the United States. But again, few gray market suits under section 1337 are successful. Protection through private channels, such as raising prices on products slated for foreign distribution or filing tort or contract law claims, is largely impractical for gray market products traveling through e-commerce. In fact, it may be nearly impossible for manufacturers to fully protect themselves from the gray market economy because there will always be slight fluctuations making arbitrage profitable. The most productive way for manufacturers to protect themselves may be to use liquidated damages clauses, or implement more novel approaches such as exploiting consumer psychology by using different packaging on goods destined for different countries, or more drastically, by cannibalizing the business to regain control of all channels of distribution.

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