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Original Appalachian Artworks, Inc. v. Granada Electronics, Inc.: The Cabbage Patch Doll Goes Gray?

Recent judicial and administrative decisions have forced both the judicial and executive branches to confront the problems posed by "gray-market" goods.¹ In *Original Appalachian Artworks, Inc. v. Granada Electronics, Inc.*, the Supreme Court in 1987 denied certiorari review of a gray-market goods case involving the trademark

1. See Cohen, *Grey Market Imports and the International Location of Manufacturing*, 11 N.C.J. INT'L L. & COM. REG. 172 (1986); *In Re Certain Alkaline Batteries*, 6 I.T.R.D. (BNA) 1849, reprinted in 225 U.S.P.Q. (BNA) 823 (1984), disapproved by President Reagan, 50 Fed. Reg. 1655, reprinted in 225 U.S.P.Q. (BNA) 862 (disapproved pursuant to 19 U.S.C. § 1337(g) (1982)), appeal dismissed sub nom. Duracell, Inc. v. United States Int'l Trade Comm'n, 778 F.2d 1578 (Fed. Cir. 1985) (The International Trade Commission excluded the importation of Duracell batteries manufactured in Belgium to avoid confusion by consumers with U.S. made Duracells. However, President Reagan disapproved the exclusion order saying that the ITC decision was at odds with the current Customs and Administration policy and would prejudice the pending study of the Cabinet Council on Commerce and Trade. The Judiciary has no jurisdiction to review the veto of the President). See also 2 J. MCCARTHY, TRADEMARKS AND UNFAIR COMPETITION § 30:35 (2d ed. Supp. 1984); *Original Appalachian Artworks, Inc. v. Granada Electronics, Inc.*, 816 F.2d 68 (2d Cir. 1987), cert. denied, 108 S. Ct. 143 (1987); *NEC Electronics v. Cal. Circuit Abco*, 810 F.2d 1506 (9th Cir. 1987); *Vivitar Corp. v. United States*, 761 F.2d 1552 (Fed. Cir. 1985), cert. denied, 474 U.S. 1055 (1986); *Olympus Corp. v. United States*, 792 F.2d 315, 319 (2d Cir. 1986) petition for cert. filed 55 U.S.L.W. 3372 (No. 86-757, Nov. 6, 1986); *Coalition to Preserve the Integrity of American Trademarks (COPIAT) v. United States*, 790 F.2d 903 (D.C. Cir. 1986), jurisdiction aff'd sub nom. K Mart Corp. v. Cartier, Inc., 56 U.S.L.W. 1419 (recalendared for argument on the merits, No. 86-625, March 7, 1988)).

The United States Supreme Court finally decided a case concerning "gray-market" goods in March, 1988. However, the emphasis of the case turned on a jurisdictional issue, only secondarily addressing the issue of "gray-market" goods. *K Mart Corp. v. Cartier, Inc.*, 56 U.S.L.W. 4219 (affirming jurisdiction) (recalendared for argument on the merits, No. 86-625, March 7, 1988). Other courts and commentators have given the term various spellings, such as "grey market," "grey-market," and "gray market," indicating the considerable confusion in this area.

owner of the Cabbage Patch Kids doll and a gray marketeer of Spanish made Cabbage Patch Kids dolls.²

In *Original Appalachian Artworks, Inc. v. Granada Electronics, Inc.*, a plaintiff trademark owner prevailed and the court issued a permanent injunction against a U.S. distributor, enjoining it from importing foreign-made Cabbage Patch Kids dolls into the United States.³ The U.S. distributor had obtained its supply of Cabbage Patch Kids dolls from a Spanish licensee of Original Appalachian Artworks Incorporated (OAA) in contravention of a restrictive covenant in a licensing agreement not to export the dolls to the United States.⁴ While the court's decision was based in part on the enforcement of this restrictive covenant, additional legal problems continue to plague the area of gray-market goods in general.

This writer will first explore the continuing legal development of gray-market goods emphasizing the interrelationship between section 526 of the Tariff Act and the Customs Service regulations. This writer's focus will be on the decision of *Original Appalachian, Inc. v. Granada Electronics, Inc.*, and how it might provide a solution to the problems associated with gray-market goods.

I. LEGAL BACKGROUND

A. Gray-Market Goods

"Gray-market" goods are items "produced and legitimately sold in competition with goods of the owner of U.S. trademark rights in the identical mark."⁵ Foreign-manufactured products bearing a United States registered trademark that enter the United States for sale in competition with the products of the trademark owner without that trademark owner's consent are defined as "gray-market goods."⁶ When the U.S. trademark holder is also the importer of the goods, the gray-market goods are known as "parallel importations."⁷ Parallel imports and gray-market goods must be distinguished from

2. 816 F.2d 68 (2d Cir. 1987), *cert. denied*, 108 S. Ct. 143 (1987).

3. *Id.*

4. *Granada*, 640 F. Supp. at 931.

5. *Vivitar Corp. v. United States*, 761 F.2d 1552, 1555 (Fed. Cir. 1985).

6. See, e.g., *Alkaline Batteries*, 6 I.T.R.D. (BNA) at 1849; *Vivitar Corp. v. United States*, 761 F.2d 1552, *cert. denied*, 474 U.S. 1055 (1986); *Granada*, 816 F.2d at 68; *K Mart Corp. v. Cartier, Inc.*, 56 U.S.L.W. 4219 (affirming jurisdiction) (recaledared for argument on the merits, No. 86-625, March 7, 1988).

7. See 2 MCCARTHY, *supra* note 1, § 30:35; *Vivitar*, 761 F.2d at 1555.

counterfeit goods, which are not genuine and usually unlawful.⁸ Counterfeit goods, unlike gray-market goods, do not carry the original trademark and are "manufactured" by entities who are unauthorized to do so.⁹

In this age of expanding international trade, companies naturally desire to expand their markets. Since an American manufacturer wants to maintain an exclusive right to sell its product within the United States, it will restrict a foreign manufacturer's sales of its trademarked goods to certain territories.¹⁰ One way in which a manufacturer can facilitate entry into a foreign market is by thus transferring rights to manufacture, sell and distribute the product to a foreign entity in a licensing agreement.¹¹ Gray-market activity often occurs after a transnational corporation has taken similar steps to have its goods produced and sold in a foreign market.¹² Due to the contractual relationship between the U.S. mark holder-licensor and the foreign entity-licensee, the subsequent use of the trademark or copyright will not amount to actionable infringement.¹³ The mark owner, however, still wants to restrict the trademarked goods from entering its territory.

"Gray-market" goods are or tend to be attractive to consumers because they have prices lower than the original products.¹⁴ However, gray-market goods pose problems for trademark owners because they generally do not carry the same warranties, safety warnings, instructions or quality controls that mark owners provide for their own goods.¹⁵ These problems may be manifested by consumer confusion and loss of goodwill in the trademark.¹⁶

To limit these potential difficulties of consumer confusion and lost goodwill, trademark owners and trade associations have sought legal

8. McDermott, *The Gray Market in the United States: Law, Policy, and Myth*, 2 CONN. J. INT'L LAW 1 (1986).

9. *Id.*

10. Issues of vertical trade restrictions and antitrust will be triggered in the minds of many readers. See *infra* text accompanying notes 180-82.

11. This transfer of rights may be done by contract. Most often a licensor-licensee relationship is established.

12. It must be assumed that this hypothetical transnational corporation owns the trademark to its product, and is the exclusive United States manufacturer and supplier to the United States market.

13. *Vivitar Corp. v. United States*, 761 F.2d 1552, 1555 (Fed. Cir. 1985).

14. Fitzpatrick & Brunnet, *Barring Importation of Gray Goods Under § 42 of the Lanham Act, and § 526 of the Tariff Act*, in GRAY MARKETS AND PARALLEL IMPORTATION: PROTECTIONISM VS. FREE TRADE, PATENTS, COPYRIGHTS, TRADEMARKS, AND LITERARY PROPERTY: COURSE HANDBOOK SERIES NUMBER 217 9 (1986) [hereinafter Fitzpatrick].

15. *Id.*

16. *Id.* at 11.

solutions to prevent "gray goods" from entering their markets.¹⁷ To date, however, the courts have not agreed on a uniform treatment of "gray-market goods."¹⁸ The approach used by Original Appalachian proved successful and appears to be one way of expanding a trademark owner's ability to control importation of gray-market goods.

B. Section 526 of the Tariff Act of 1922¹⁹

Section 526 is an amendment to the 1922 Tariff Act enacted in response to the Second Circuit appellate holding in *A. Bourjois v. Katzel*.²⁰ The purpose of section 526 of the Tariff Act is to protect the interests of the American trademark owner and its right to control the use of its registered trademark.²¹

Section 526 makes it "unlawful to import into the United States any merchandise of foreign manufacture if such merchandise . . .

17. See *infra* text accompanying notes 23-30.

18. See *infra* text accompanying notes 23-73.

19. Tariff Act of 1922 § 526, 19 U.S.C. § 1526 (1922) (reenacted without change as part of the Tariff Act of 1930 and codified in 19 U.S.C. § 1526 (1982)).

20. In *Bourjois v. Katzel*, the United States Supreme Court allowed a perfume manufacturer to halt the importation of face powder in competition with the U.S. mark holder. A French company, E. Wertheimer & Cie. (formerly A. Bourjois & Cie.), sold its United States' business related to face powder, known under its trademark JAVA, to A. Bourjois & Co., a New York corporation. In 1913, Wertheimer sold all of its rights in the United States to its trademarks, trade dress (a distinguished type of packaging), and trade names. Bourjois (NY) purchased the JAVA face powder in bulk from Wertheimer, which it then packaged for retail sale in the same style of box which Wertheimer had used in the United States and was continuing to use in France. Sometime prior to 1921, defendant Katzel, owner of a retail pharmacy in New York City, bought a quantity of Wertheimer's retail-packaged JAVA face powder in France and began selling the product in her New York store as well as to other retailers.

The Supreme Court reversed the Second Circuit's finding of non-infringement, and found that consumers would be confused, believing that Bourjois "sponsored" the sale of the face powder Katzel bought from France. Finding that consumer confusion as to the source of the face powder was enough to constitute trademark infringement, the Court enjoined Katzel from further sales of the JAVA powder. The Court's opinion stated that the local independent corporation (Bourjois (NY)) had developed goodwill separate from that of the foreign manufacturer and that purchasers would identify Bourjois as the source standing behind the quality of the goods sold under the JAVA trademark. Since Bourjois (NY) did not stand behind the goods sold by Katzel, the Court held that there was a likelihood of confusion and damage to Bourjois' (NY) goodwill. This resulted in a judicial ban on parallel importation. 260 U.S. 689 (1923).

Section 526 of the Lanham Act, 19 U.S.C. § 1526 (1982), was enacted a few months before the Supreme Court reversed the appellate court's decision in *A. Bourjois v. Katzel*. For a general discussion of *A. Bourjois v. Katzel*, consult *Vivitar Corp. v. United States*, 761 F.2d 1552, 1561 (Fed. Cir. 1985).

21. *Sturges v. Clark D. Pease, Inc.*, 48 F.2d 1035, 1037 (2d Cir 1931); see *Vivitar Corp. v. United States*, 761 F.2d 1552, 1565 (Fed. Cir. 1985), cert. denied 474 U.S. 1055 (1986); see also 71 CONG. REC. 3871 (1929) (remarks of Sen. George) cited in *K Mart Corp. v. Cartier, Inc.*, 56 U.S.L.W. 4219, 4222 (recalendared for argument on the merits No. 86-625, March 7, 1988); 62 CONG. REC. 11603 (1922) (remarks of Sen. Sutherland), cited in *K Mart*, 56 U.S.L.W. at 4222.

bears a trademark owned by a citizen of, or by a corporation or association created or organized within, the United States, and registered in the Patent and Trademark Office . . . unless written consent of the owner of such trademark is produced at the time of making entry."²² Since gray goods bear the trademark of a genuine good, the literal language of section 526 seems to suggest that all gray goods should be excluded from entry into the United States by the Customs Service.²³

The Customs Service, however, has not adopted this interpretation of section 526 and has refused to bar imports in instances in which the same or affiliated companies own the U.S. and the foreign trademark, or in cases in which the U.S. trademark owner has authorized the foreign manufacturer to use the trademark.²⁴ Once an American company has listed a foreign firm as an authorized manufacturer and distributor of its product, the Customs Service refuses to exclude the importation of these goods, even upon demand by the U.S. trademark holder.²⁵ United States Customs regulations do not bar importation of goods once they have been recorded with the Service.²⁶

Currently, a trademark owner may not make immediate resort to the exclusion remedies provided under section 526(c) of the Tariff

22. 19 U.S.C. § 1526 (1982).

23. See, *Coalition to Preserve the Integrity (COPIAT) v. United States*, 790 F.2d 844, 908-18 (Customs Service's regulations, allowing the admittance of grey goods, contrary to Congressional intent behind § 526 which was that the U.S. Customs Service was obliged to halt the importation of parallel imports), *jurisdiction aff'd sub nom.* *K Mart Corp. v. Cartier, Inc.*, 56 U.S.L.W. 4219 (recalendared for argument on the merits, No. 86-625, March 7, 1988).

24. S. Lipner, *Gray Market Goulash: The Problem of at-the-Border Restrictions on Importation of Genuine Trademarked Goods*, 77 TRADEMARK REP. 102, 103 (1987), reprinted in 20 CORNELL INT'L L. REV. 103, 104 (1987).

25. *Vivitar*, 761 F.2d at 1561.

26. 19 C.F.R. §§ 133.2(d), 133.12(d). The United States Customs Service requires that a United States company disclose foreign affiliated companies as part of the information required upon recordation of its mark. *Vivitar*, 761 F.2d at 1561 (citing 19 C.F.R. §§ 133.2(d), 133.12(d)). Since 1951, the Customs Service has issued several letters describing a consistent policy toward foreign-manufactured goods bearing trademarks owned by Americans under § 526. The policy of the Customs Service is that if the United States trademark owner and the owner of the foreign rights to the same mark are one and the same person, articles produced and sold abroad by the foreign owner may be imported by anyone, the trademark owner has itself either introduced or authorized the introduction of the articles into commerce and thereafter may not unreasonably restrict the use of the product. *Coalition to Preserve the Integrity of American Trademarks (COPIAT) v. United States*, 598 F. Supp. 844, 850 (D.D.C. 1984) (referring to Customs Service Letters dated March 27, 1951, July 2, 1962, March 19, 1963, June 27, 1962, and December 11, 1968), *rev'd* 790 F.2d 844, *jurisdiction aff'd sub nom.* *K Mart Corp. v. Cartier, Inc.*, 56 U.S.L.W. 4219 (recalendared for argument on the merits, No. 86-625, March 7, 1988).

Act.²⁷ Recent decisions hold that the mark owner does not have a right to require that the Customs Service prevent importation of all "gray-market" goods.²⁸ Presently, the mark owner must seek protection against persons engaging in parallel importation by first pursuing a private claim in court. The private claim may be based on breach of contract, trademark infringement or copyright infringement.²⁹ The mark owner is successful in the suit against the private party is then entitled to have the parallel imports excluded by the Customs Service.³⁰

In most cases concerning intellectual property, a plaintiff will seek an injunction to prevent the sale and distribution of another's goods. It is generally accepted that a preliminary injunction may be granted only upon a showing of "(a) irreparable harm and (b) either (1) a likelihood of success on the merits or (2) sufficiently serious questions going to the merits to make them a fair ground for litigation along with a balance of hardships tipping decidedly toward the party requesting the preliminary relief."³¹

The judiciary, and executive branch, through the United States Customs Service, have failed to agree as to a consistent interpretation of section 526. This inability to accommodate competing policies has resulted in numerous inconsistent cases.

C. Recent Case Law Developemnt Involving Gray-Market Goods

In *Osawa & Co. v. B & H Photo*,³² plaintiff Osawa & Co. was a Delaware corporation and registered owner of the U.S. trademark rights for MAMIYA marks.³³ This trademark applied to high quality

27. 19 U.S.C. § 1526(c) (1982) (injunction and damages). "Any person dealing in any such merchandise may be enjoined from dealing therein within the United States or may be required to export or destroy such merchandise or to remove or obliterate such trademark and shall be liable for the same damages and profits provided for wrongful use of a trademark, under the provisions of 15 U.S.C. §§ 81-109 (1982)." *Id.*

28. Original Appalachian Artworks v. Granada Electronics, 816 F.2d 68, 71 (2d Cir. 1987) (citing Olympus Corp. v. United States, 792 F.2d 315, 320 (2d Cir. 1986), *petition for cert. filed*, 55 U.S.L.W. 3372 (No. 86-757, Nov. 6, 1986)); *in accord*, Vivitar Corp. v. United States, 761 F.2d 1552, 1569-70 (Fed. Cir. 1985), *cert. denied*, 474 U.S. 1055 (1986). *But see*, *COPLAT*, 790 F.2d at 916-17.

29. 19 U.S.C. § 1526 (1982) (allowing owner of United States trademark to bring suit to enjoin importers, of products bearing the plaintiff's registered United States trademark).

30. *Vivitar*, 761 F.2d at 1570; *see Olympus*, 792 F.2d at 320.

31. *See, e.g., Granada*, 1986-1 Trade Cas. (CCH) ¶ 66,986 at 62,052 (S.D.N.Y. 1986); *Bell & Howell: Mamiya Co. v. Masel Supply Co.*, 719 F.2d 42, 45 (2d Cir. 1983); *Atari, Inc. v. North American Philips Consumer Electronics, Corp.*, 672 F.2d 607, 613 (7th Cir.), *cert. denied*, 459 U.S. 880 (1982).

32. *Osawa & Co. v. B & H Photo*, 589 F. Supp. 1163 (S.D.N.Y. 1984).

33. *Id.* at 1165.

photographic equipment manufactured in Japan by Mamiya Camera Company.³⁴ Plaintiff brought suit against the discount camera dealers who were importing gray-market goods bearing a Mamiya mark, based on theories that section 526 was violated and that its trademark was infringed.³⁵ The court stated that to obtain a preliminary injunction a party must make a showing of (a) irreparable harm and (b) either (1) a likelihood of success on the merits, or (2) sufficiently serious questions going to the merits to make them a fair ground for litigation.³⁶ A balance of hardships will tip decidedly toward the party requesting the preliminary relief.³⁷ In *Osawa*, the court found that the test was met and concluded that *Osawa* had made out a case entitling it to preliminary relief under section 526, as well as for trademark infringement.

Plaintiff *Osawa* showed that the gray-market imports resulted in consumer confusion, and therefore damage in the "consumers' eyes to the reputation of the mark."³⁸ This consumer confusion caused adverse effects on plaintiff's business reputation.³⁹ The "gray marketers" attempted a "free ride" on the plaintiff's marketing strategies and advertising, which resulted in the defendant's monetary gains at the expense of harm to the plaintiff's goodwill.⁴⁰ The defendants had not advertised as to the quality of Mamiya products, but merely advertised lower prices.⁴¹ Because they only sought a price advantage, the defendants had no incentive to support the goodwill of the products they sold.⁴² As a practical matter, the plaintiff was forced to honor warranties on the gray-market goods because failure to do so would have further hurt its reputation.⁴³ Customers would not know the cameras they purchased were from the gray-market because the defendants did not advertise them as "gray-market" Mamiya Cameras.⁴⁴ Thus, not only were defendants operating free of the significant costs of warranty repairs, but sales of cameras

34. *Id.* at 1166.

35. *Id.*

36. *Id.* at 1165; *Bell & Howell: Mamiya Co. v. Masel Supply Co.*, 719 F.2d 42, 45 (2d Cir. 1983); *Jackson Dairy, Inc. v. H.P. Hood & Sons, Inc.*, 596 F.2d 70, 72 (2d Cir. 1979) (*per curiam*).

37. *Osawa*, 589 F. Supp. at 1165.

38. *Id.* at 1168.

39. *Id.*

40. *Id.* at 1167.

41. *Id.*

42. *Id.*

43. *Id.*

44. *Id.*

without warranties would increase plaintiff's costs.⁴⁵ Furthermore, the court found that the wide price disparity between the legitimate cameras and gray goods cameras damaged the goodwill of the Mamiya trademark; consumers would question why the same products could be bought so cheaply at different places.⁴⁶ This would ultimately result in assumptions by the buyers that the plaintiff was "price gouging," thus creating further hostility toward the mark.⁴⁷ Ultimately, the defendants were enjoined from dealing in gray-market Mamiya products.⁴⁸

The *Osawa* decision has been subject to much criticism within the federal circuits. In *Olympus Corp. v. United States*,⁴⁹ the Second Circuit disagreed with the *Osawa* court's interpretation of section 526.⁵⁰ The *Olympus* court found section 526 and the Customs Service regulations inconsistent, upholding the Customs Service regulations and affirming the district court's dismissal of Olympus' section 526 claim.⁵¹ However, the *Olympus* court recognized the United States trademark owners rights to pursue private remedies under section 526(c) to have gray-market goods excluded.⁵²

In *NEC Electronics v. Cal Circuit Abco*,⁵³ a U.S. subsidiary of a Japanese parent company (NEC) brought suit against an importer who had purchased NEC's computer chips on the foreign market and sold them in the United States.⁵⁴ The District Court granted a preliminary injunction based on trademark infringement under the Lanham Trade-Mark Act.⁵⁵

The Ninth Circuit Court of Appeals reversed.⁵⁶ Despite the finding of consumer confusion as the source of the computer chips, the court reasoned that the parent and subsidiary companies were commonly controlled, and that the subsidiary was therefore not losing any benefits for which it had bargained.⁵⁷ The parent company was not attempting to evade any terms of its trademark agreement with its

45. *Id.* at 1168.

46. *Id.* at 1169.

47. *Id.*

48. *Id.*

49. 792 F.2d 315, 319 (2d Cir. 1986).

50. *Id.*

51. *Id.* at 321.

52. *Id.* at 320.

53. 810 F.2d 1506 (9th Cir. 1987).

54. *Id.*

55. *Id.* at 1511.

56. *Id.*

57. *Id.* at 1509.

subsidiary.⁵⁸ The subsidiary should have legitimately expected that the parent would sell computer chips to other companies for sale in the United States, thereby circumventing the subsidiary's business.⁵⁹ The *NEC* court stated that its decision was "reinforced by the fact that the Customs Service has for decades made an exception to section 526 in cases where the American trademark owner and the foreign producer are under common control." The court concluded that the U.S. subsidiary had no right to have the gray-market computer chips excluded.⁶⁰

The case of *Coalition to Preserve the Integrity of American Trademarks (COPIAT) v. United States* provides the most recent guidance for cases involving gray-market goods.⁶¹ COPIAT is an association of U.S. trademark owners.⁶² The association brought suit against the Commissioner of Customs, the Secretary of the Treasury, and the United States, asking for a declaration that the Customs regulations allowing the entrance of "gray goods" were inconsistent with section 526 and therefore invalid.⁶³ The D.C. Circuit Court of Appeals found that the Customs Service's interpretation of section 526 did not display the necessary "thoroughness, validity, and consistency" to merit judicial acceptance and found them invalid.⁶⁴ The lower appellate court in *COPIAT* discussed the legislative history of section 526 of the Tariff Act and determined that Congressional intent was to have the Customs Service enforce the statute by excluding importations of gray-market goods.⁶⁵

Two issues were presented for review to the Supreme Court, but the Court based its holding on the jurisdictional question, remanding for re-argument the question whether the challenged Customs regulation was a reasonable agency interpretation of section 526 of the Tariff Act.⁶⁶ In a five to three decision, the Court affirmed the

58. *Id.*

59. *Id.* at 1510.

60. *Id.* at 1510 n.4.

61. 790 F.2d 903 (D.C. Cir. 1986), *jurisdiction aff'd sub. nom.* K Mart Corp. v. Cartier, Inc., 56 U.S.L.W. 4219 (recalendared for argument on the merits, No. 86-625, March 7, 1988).

62. Coalition to Preserve the Integrity of American Trademarks (COPIAT) v. United States, 598 F. Supp. 844, 846 (D. D.C. 1984), *rev'd* 790 F.2d 903 (D.C. Cir. 1986), *jurisdiction aff'd sub nom.* K Mart Corp. v. Cartier, Inc., 56 U.S.L.W. 4219 (recalendared for argument on the merits, No. 86-625, March 7, 1988).

63. *COPIAT*, 790 F.2d at 904.

64. *Id.* at 916.

65. *Id.*

66. K Mart Corp. v. Cartier, Inc., 56 U.S.L.W. 4219, 4220 (recalendared for argument on the merits, No. 86-625, March 7, 1988).

appellate court's holding that the federal district court had jurisdiction to hear a challenge to the Secretary of the Treasury's regulation permitting the importation of certain gray-market goods.⁶⁷

In dicta, Justice Brennan did appear to recognize that section 526 provides a mechanism by which a private party, at its option, may enlist the aid of the Customs Service in excluding foreign-made goods bearing its trademark.⁶⁸ The Court went on to say that, "the trademark owner has sole authority to decide that all products bearing its trademark will enter or that none will, and to decide what entity may import them, under what conditions, and for what purpose."⁶⁹

In *Vivitar Corp. v. United States*, the United States Court of Appeals for the Federal Circuit held that the Customs Service did not violate section 526 of the Tariff Act when it failed to exclude all types of "gray-market" importations.⁷⁰

In *Vivitar*, the court held that the United States Customs Service, at its discretion, may authorize the admission of gray-market goods.⁷¹ Under current law, the mark owner does not have a right to require the Customs Service to prevent importation of all "gray-market" goods.⁷² A mark owner must first pursue a private claim against the

67. *Id.* Petitioners, 47th Street Photo, Inc., and K Mart Corporation intervened as defendants and filed a motion to dismiss on the ground that the Court of International Trade had exclusive jurisdiction over the case. 28 U.S.C. § 1581(i)(3) grants the Court of International Trade exclusive jurisdiction over suits against the Government arising out of federal laws that provide for "embargoes or other quantitative restrictions on the importation of merchandise for reasons other than the protection of the public health or safety. . ." The Court defined "embargo" as used in § 1581(i)(3) as a governmentally imposed quantitative restriction—of zero—on the importation of merchandise. The majority, in affirming the rejection of Petitioners' motion, held that § 526's importation prohibition is not such an "embargo." Rather than reflecting a governmental restriction on the quantity of a particular product that will enter, it merely provides a mechanism by which a trademark owner might, at its own option, enlist the Customs Service's aid in barring foreign-made goods bearing its trademark in order to enforce its own private trademark right. *Id.* at 4222.

68. *Id.* at 4222. The court gave the following example:

Suppose . . . that a domestic producer grants a foreign distributor exclusive distribution rights abroad, and that a provision of the contract, captioned "Importation prohibited," bars the foreign distributor from competing for domestic sales. If the foreign distributor nevertheless brazenly imports into the United States, the domestic manufacturer may invoke any of a number of contract remedies—including monetary or injunctive relief in court-enforcing its private right.

Id.

69. *Id.*

70. 761 F.2d at 1552.

71. *Id.*

72. *Granada*, 816 F.2d at 71 (citing *Olympus Corp. v. United States*, 792 F.2d 315, 320 (2d Cir. 1986), *petition for cert. filed*, 55 U.S.L.W. 3372 (Nov. 6, 1986) (No. 86-757)); *accord Vivitar*, 761 F.2d 1552. *But see*, *Coalition to Preserve the Integrity of American Trademarks (COPIAT) v. United States*, 790 F.2d 903 (D.C. Cir. 1986) (customs regulations allowing importation of gray goods inconsistent with statute governing entry of trademarked goods), *jurisdiction aff'd sub nom. K Mart Corp. v. Cartier, Inc.*, 56 U.S.L.W. 4219 (recalendared for argument on the merits, No. 86-625, March 7, 1988).

parallel importer to obtain assistance from the Customs Service.⁷³ Until the Supreme Court holds otherwise, the theories asserted in *Vivitar Corp. v. United States*⁷⁴ remain a guide for the trademark holder attempting to exclude the importation of gray-market goods.

II. THE CASE OF *Original Appalachian Artworks, Inc. v. Granada Electronics, Inc.*

A. The Facts

The Plaintiff/Appellee Original Appalachian Artworks, Inc. (OAA) is incorporated in the state of Georgia.⁷⁵ OAA owns American and foreign copyrights and trademarks in Cabbage Patch Kids dolls.⁷⁶ The Defendant/Appellant Granada Electronics, Inc. (Granada) is a New York corporation.⁷⁷ Granada is a U.S. importer and distributor of Cabbage Patch Kids dolls manufactured in Spain by an OAA licensee.⁷⁸

Cabbage Patch Kids dolls were introduced into the United States market in May 1977.⁷⁹ Since that time, Original Appalachian Artworks, Inc. has been a party to numerous lawsuits.⁸⁰ A majority of

73. *Vivitar*, 761 F.2d at 1570.

74. *Id.*

75. *Granada*, 640 F. Supp. at 929.

76. *Granada*, 1986-1 Trade Cas. (CCH) ¶ 66,986 at 62,051 (S.D.N.Y. 1986).

77. *Granada*, 640 F. Supp. at 929.

78. *Id.*

79. *Original Appalachian Artworks, Inc. v. Blue Box Factory*, 577 F. Supp. 625, 626 (S.D.N.Y. 1983).

80. *Original Appalachian Artworks, Inc. v. J.F. Reichert, Inc.*, 658 F.Supp. 458 (E.D. Pa. 1987) (OAA granted injunction against importer of Cabbage Patch Kids dolls plus statutory damages of \$250 for each copyright infringement as well as attorney's fees for the copyright infringement part of the suit. Importer not liable for damages or attorney's fees for violations of trademark law.); *Original Appalachian Artworks, Inc. v. McCall Pattern Co.*, 825 F.2d 355 (11th Cir. 1987) (OAA claims for copyright and unfair competition denied by the District Court; McCall moved for reasonable attorney's fees pursuant to 17 U.S.C. § 505. Parties, upon court's approval entered into a consent order for \$100,000.); *Original Appalachian Artworks, Inc. v. Topps Chewing Gum*, 642 F. Supp. 1031 (N.D. Ga. 1986) (Merchandise of "Garbage Pail Kids" bubble gum stickers and products injured owner of the "Cabbage Patch Kids" mark.); *Original Appalachian Artworks, Inc. v. Yuil Int'l Trading Corp.*, 105 F.R.D. 113 (S.D.N.Y. 1985) (Denial of a motion to set aside default judgement against Yuil in case filed by OAA, claiming copyright infringement, unfair competition, common law trademark infringement, and dilution.); *Original Appalachian Artworks, Inc. v. Blue Box Factory (USA) Ltd.*, 877 F. Supp. 625 (S.D.N.Y. 1983) (Court denied injunctive relief against producer of another line of dolls due to failure to show likelihood of success on the merits); *Original Appalachian Artworks, Inc. v. Cradle Creations Inc.*, 223 U.S.P.Q. (BNA) 80 (N.D. Ga. 1983) (Preliminary injunction issued for contribution infringement against defendant book publisher who published pattern book containing instructions for making copies of dolls that were substantially similar to OAA's copyrighted dolls); *Original Appalachian Artworks, Inc. v. Toy Loft*, 684 F.2d 821 (11th Cir. 1982) (judgment for OAA in copyright and trade dress infringement suit concerning "The Little People" dolls).

the litigation has been the area of intellectual property, including trademark and copyright infringement, trade secret violation, unfair competition, and consumer confusion.⁸¹

The original Cabbage Patch Kids doll was a hand-sewn, soft-sculptured doll created by Xavier Roberts, President of OAA.⁸² Not originally named "Cabbage Patch Kids," the original dolls were known as the "Little People" and were sold at a retail price in excess of U.S. \$100.⁸³ Roberts incorporated OAA in the fall of 1978, and on June 1, 1979 obtained a copyright certificate for the dolls.⁸⁴ In December, 1979 Roberts assigned his rights in the copyright to OAA.⁸⁵

The continuing commercial success of the Cabbage Patch Kids dolls has been attributed to the marketing techniques initially employed by Xavier Roberts.⁸⁶ The dolls are "adopted" by consumers at what OAA calls "adoption centers."⁸⁷ In fact, "adoption centers" are primarily specialty stores and finer department stores.⁸⁸ OAA has approximately 450 outlets around the United States.⁸⁹ The customer is provided with a "birth certificate" and "official adoption papers."⁹⁰ Each doll is individually named, accompanied by a matching name tag.⁹¹ Printed on the derriere of each doll is the name of its creator, "Xavier."⁹² The consumer is also sent a birthday card on the first anniversary of the date of purchase.⁹³ The process of distribution for the "birthday card" begins when the "adopting parent" mails his or her adoption papers to OAA and the relevant information is entered in OAA's computer. These unique marketing concepts, along with intense advertising campaigns, have turned the Cabbage Patch Kids into a phenomenon on the order of the "Hula Hoop," the "Pet Rock," and other comparable triumphs of the American toy industry.⁹⁴

81. See *supra* note 80.

82. *Granada*, 816 F.2d at 70.

83. *Granada*, 640 F. Supp. at 929.

84. *Original Appalachian Artworks, Inc. v. Toy Loft*, 684 F.2d 821, 823 (11th Cir. 1982).

85. *Original Appalachian Artworks, Inc. v. Blue Box Factory (USA) Ltd.*, 877 F. Supp. 625, 626 (S.D.N.Y. 1983).

86. *Toy Loft*, 684 F.2d at 823.

87. *Granada*, 640 F. Supp. at 929.

88. *Id.*

89. *Id.*

90. *Toy Loft*, 684 F.2d at 823.

91. *Id.*

92. *Id.*

93. *Id.*

94. *Original Appalachian Artworks, Inc. v. Blue Box Factory*, 577 F. Supp. 625, 626

In August, 1982, OAA granted Coleco Industries an exclusive license to manufacture, sell and distribute its dolls which were newly dubbed as the "Cabbage Patch Kids."⁹⁵ The dolls marketed by Coleco are a smaller version of OAA's "Little People" dolls.⁹⁶ In addition, the Coleco dolls have vinyl heads, are mass produced, and not hand-sewn.⁹⁷ The Coleco-produced dolls come in boxes which prominently feature the CABBAGE PATCH KIDS trademark and distinctive Cabbage Patch packaging. (The "Little People" dolls were unpackaged.)⁹⁸ The Coleco dolls retail for U.S. \$35 to U.S. \$45. Furthermore, they are accompanied by an English version of a birth certificate and adoption papers which display the Cabbage Patch Kids copyright.⁹⁹ Once the "adopting parent" returns the adoption papers to Coleco, he or she receives a birth certificate, as well as a card on the first birthday of the doll.¹⁰⁰

Coleco was initially granted exclusive worldwide distribution rights for the Cabbage Patch Kids dolls, but subsequently relinquished its worldwide rights, which allowed OAA to enter into agreements with foreign manufacturers and distributors.¹⁰¹ To this date, Coleco Industries remains the exclusive distributor of Cabbage Patch Kids dolls within the United States.¹⁰²

In 1984, OAA granted a restricted license to Jesmar S.A., a Spanish corporation, to manufacture and distribute the Coleco version of the Cabbage Patch Kids doll.¹⁰³ This license allowed the manufacture and distribution of the doll by Jesmar in Spain, the Canary Islands,

(S.D.N.Y. 1987). In 1981 OAA sold 71,127 dolls and in 1982 39,895 dolls. In 1983, Coleco, OAA's exclusive United States manufacturer, sold 2,840,000 dolls. *Original Appalachian Artworks, Inc. v. McCall Pattern*, 649 F. Supp. 832, 835 (11th Cir. 1987). Despite the well publicized shortage of supply, the high sales of the Cabbage Patch Kids dolls became "the most successful doll introduction in history." *Blue Box Factory*, 577 F. Supp. at 626.

95. *Blue Box Factory*, 577 F. Supp. at 626. The licensing agreement was entered into through Schlaifer Nance and Company, Inc., (SNC) whereby SNC was engaged to act as OAA's exclusive agent to license the CABBAGE PATCH dolls' rights to others. *Granada*, 640 F. Supp. at 930.

96. *Granada Electronics*, 640 F. Supp. at 930.

97. *Id.*

98. *Id.*

99. *Id.*

100. *Id.*

101. *Id.*

102. Coleco's Cabbage Patch Kids dolls that are sold in the United States are manufactured in Hong Kong, Korea, Taiwan, and the People's Republic of China. McDermott, *supra* note 8, at 6 n.21. More than 52 companies have obtained licenses to produce "Cabbage-Patch" products. *Original Appalachian Artworks, Inc. v. Blue Box Factory*, 577 F. Supp. 625, 626 (11th Cir. 1987) (referring to *What a Doll!: The Cabbage Patch Craze*, Newsweek, December 12, 1983, at 78; *The Strange Cabbage Patch Craze*, Time, December 12, 1983, at 64).

103. *Granada*, 640 F. Supp. at 930.

Andorra and Ceuta Melilla.¹⁰⁴ Jesmar contractually agreed not to make, sell or authorize any sale of the licensed products outside its licensed territory.¹⁰⁵ Furthermore, all of Jesmar's sales of the Cabbage Patch Kids dolls were required to contain an express agreement that the purchaser would not use or resell the licensed products outside these licensed territories.¹⁰⁶ OAA collected a royalty from Jesmar for each doll that was sold.¹⁰⁷

The Jesmar dolls came packaged in boxes bearing the "legend" of the dolls¹⁰⁸ and most of the other wording on the boxes in Spanish.¹⁰⁹ Moreover, the CABBAGE PATCH KIDS trademark was displayed on the box.¹¹⁰ The copyright notice on the rear panel of the box contained the address of OAA: Original Appalachian Artworks, Inc., Cleveland, Georgia, U.S.A.¹¹¹

The Jesmar dolls were sold with birth certificates and "adoption papers" completely in the Spanish language.¹¹² Purchasers were directed to send the "adoption papers" to an address in Spain.¹¹³

In December 1984 OAA and Coleco became aware that the vinyl-headed Cabbage Patch Kids dolls manufactured by Jesmar and other foreign licensees were being sold within the United States.¹¹⁴ OAA and Coleco began receiving letters and phone calls (12 to 15 per day) from people complaining about dolls with foreign language birth certificates and adoption papers.¹¹⁵ Approximately 40% of these calls received by Coleco concerned the Jesmar Spanish dolls.¹¹⁶ These

104. *Id.*

105. *Id.*

106. *Id.*

107. *Id.* at 930 n.1. If OAA receives a larger royalty from the foreign manufacturer (licensee) than from Coleco (the exclusive United States distributor of the dolls), OAA may even benefit financially from the alleged grey market activity. Even if the foreign licensee sells dolls at a lower royalty per doll than Coleco, and the sale of every licensee doll results in that loss of a sale on "one of the more lucrative Coleco dolls," it is still not clear that OAA has suffered irreparable economic harm. *Granada*, 1986-1 Trade Cas. (CCH) at ¶ 62,053.

108. The Legend of the Cabbage Patch Kids is that, "many years ago a young boy named Xavier happened upon an enchanted cabbage patch where he found very special little people who called themselves Cabbage Patch Kids. To help fulfill the Cabbage Patch Kids' dream of having families with whom to share their love, Xavier set about building a special place known as Babyland General, where the Cabbage Patch Kids remain until each is chosen for adoption." *Granada*, 640 F. Supp. at 930, n.1.

109. *Id.* at 930.

110. *Id.*

111. *Id.*

112. *Id.* at 931.

113. *Id.*

114. *Id.*

115. *Id.*

116. *Id.*

Jesmar dolls were being imported into the United States by Granada Electronics, Inc.¹¹⁷ Granada Electronics, Inc. received Jesmar's Cabbage Patch Dolls and resold them through jobbers¹¹⁸ and retail chains in the United States.¹¹⁹

OAA sent both a letter and a telex to each of its foreign licensees reminding them that, as licensees, they were contractually obligated to keep doll sales within their designated territory.¹²⁰ OAA filed at least 24 lawsuits in the United States against distributors and importers of the foreign-made Cabbage Patch Kids dolls,¹²¹ including the instant action against Granada in the United States District Court for the Southern District of New York.¹²²

B. Procedural Background

1. OAA's Theories

OAA originally alleged two causes of action against Granada. The first claim was for alleged infringement of OAA's U.S.-registered trademark CABBAGE PATCH KIDS under the Trademark Act of 1946 (Lanham Act).¹²³ The second cause of action was for infringement of OAA's U.S.-registered copyright of the design of the dolls under the Copyright Act of 1976.¹²⁴

2. Granada's Counterclaim Theory

Granada counterclaimed, charging OAA with violations of federal antitrust laws and the New York State Donnelly Act.¹²⁵ Granada argued that OAA's territorial licensing scheme constituted a vertical restraint of trade in that it eliminated intra-brand competition and artificially raised the price of Cabbage Patch Kids dolls in each territory.¹²⁶

117. *Id.*

118. A jobber is one who buys and sells goods for others; one who buys and sells articles in bulk and resells them to dealers; a merchant buying and selling in job lots. In general, a jobber is a wholesaler; one who buys and sells small lots; a middleman. BLACK'S LAW DICTIONARY 749 (5th ed. 1979).

119. *Id.*

120. *Granada*, 640 F. Supp. at 932.

121. *Id.*

122. *Original Appalachian Artworks, Inc. v. Granada Electronics, Inc.*, 640 F. Supp. 928 (S.D.N.Y. 1986).

123. *Granada*, 640 F. Supp. at 929.

124. *Id.*

125. N.Y. GEN. BUS. LAW § 340 (McKinney 1968 & Supp. 1986).

126. *Granada*, 1986-1 Trade Cas. (CCH) ¶ 66,986, at 62,053.

3. The Trial Court's Action

The District Court initially denied OAA's motion for a preliminary injunction pending a consolidated evidentiary hearing on the motion and an expedited trial on the merits.¹²⁷ The copyright claim was later voluntarily dismissed with prejudice.¹²⁸ A motion to dismiss Granada's federal and state antitrust counterclaims was granted.¹²⁹

Thus, what remained was "the always troublesome issue of whether the owner of a registered United States trademark can prevent the sale [in the United States] of imported 'gray goods' bearing the trademark which are manufactured abroad under license from the owner."¹³⁰

After hearing evidence on the merits, the District Court issued a permanent injunction against Granada.¹³¹ Granada was permanently enjoined from further importation of the Jesmar dolls and other Cabbage Patch dolls made abroad under similar territorially-restricted licenses.¹³² The court held that OAA's right to protection against unauthorized sales of imported dolls in the United States was not extinguished by the listing of the foreign manufacturer (Jesmar) on the owner's (OAA) application for recordation of the United States trademark CABBAGE PATCH KIDS with the Customs Service.¹³³ Furthermore, the court held that the owner of a trademark could prevent the sale of "gray goods" bearing an original United States trademark which were manufactured abroad under a territorially-restricted license.¹³⁴

127. FED. R. CIV. PROC. 65(a)(2) (consolidation of hearing with trial on merits). Before or after the commencement of the hearing of an application for a preliminary injunction, the court may order the trial of the action of the merits to be advanced and consolidated with the hearing of the application. Even when this consolidation is not ordered, any evidence received upon an application for a preliminary injunction which would be admissible at trial on the merits becomes part of the trial record and need not be repeated upon the trial. This subdivision [(a)(2)] shall be so construed and applied as to save the parties any rights they may have to trial by jury. *Id.*

128. *Granada*, 640 F. Supp. at 929.

129. *Granada*, 1986-1 Trade Cas. (CCH) ¶ 66,986, at 62,055 (S.D.N.Y. 1986).

130. *Granada*, 640 F. Supp. at 929.

131. *Id.* at 928.

132. *Id.* at 933.

133. *Id.*

134. *Id.* at 928.

C. The Appellate Opinion

1. Majority

On appeal, the Second Circuit affirmed that OAA had a right to relief under the Lanham Act from potential consumer confusion as to whether it sponsored the importation of these genuine but "inferior" dolls.¹³⁵ The court held that the likelihood of consumer confusion as to the source of origin constituted a violation under the Lanham Act.¹³⁶ Section 32 of the Lanham Trademark Act of 1946¹³⁷ prohibits the unauthorized sale of goods bearing a registered trademark where there is a likelihood of confusion, mistake, or deception of purchasers.¹³⁸

The CABBAGE PATCH KIDS trademark registration in the instant case had been received by OAA from the United States Patent Office on October 2, 1984.¹³⁹ The Trademark Registration was thereafter recorded with the United States Customs Service, and Jesmar was listed on the application for Customs recordation.¹⁴⁰ Since Jesmar was recorded on the trademark registration, the Customs Service permitted the importation of the gray-market Cabbage Patch Kids dolls.¹⁴¹ As noted previously, Customs Service regulations do not provide for halting importation of gray-market goods made abroad under license, such as Jesmar's Spanish Cabbage Patch Kids dolls.¹⁴²

135. *Original Appalachian Artworks, Inc. v. Granada Electronics, Inc.*, 816 F.2d at 76 (Cardamone, J., concurring).

136. *Id.* at 73.

137. 15 U.S.C. § 1114(1)(a) (1982).

138. *Granada*, 816 F.2d at 71 (citing *Syntex Laboratories, Inc. v. Norwich Pharmacal Co.*, 437 F.2d 566, 568 (2d Cir. 1971)).

139. *Granada*, 640 F. Supp. at 931.

140. *Id.* The regulations of the U.S. Customs Service, 19 C.F.R. §§ 133.2(c), 133.21-24 (1985) direct a party to state in its application, "the name and principal business address of each foreign person or business entity authorized or licensed to use the trademark and a statement as to the use authorized."

141. The Customs Service Regulation, 19 C.F.R. § 133.21(c)(2), allows third parties to import trademarked goods without the permission of the American markholder where the markholder is either a parent or subsidiary of, or is held in common ownership with, a foreign manufacturer. *Olympus Corp. v. United States*, 792 F.2d 315, 317 (2d Cir. 1986) (citing 19 C.F.R. § 133.21(c)(2) (1985)) *petition for cert. filed* 55 U.S.L.W. 3372 (No. 86-757, Nov. 6, 1986).

142. *Granada*, 640 F. Supp. at 931. *See also*, *Coalition to Preserve the Integrity of American Trademarks (COPIAT) v. United States*, 598 F. Supp. at 844, 849-50 (D.D.C. 1984), *rev'd*, 790 F.2d 903 (D.C. Cir. 1986), *jurisdiction aff'd sub. nom.* *K Mart Corp. v. Cartier, Inc.*, 56 U.S.L.W. 4219 (recalendared for argument on the merits, No. 86-625, March 7, 1988); *Olympus Corp.*, F.2d at 319; *Osawa & Co. v. B & H Photo*, 589 F. Supp. 1163, 1177 (S.D.N.Y. 1984).

Section 32 of the Lanham Trademark Act of 1946 prohibits the unauthorized sale of goods bearing a registered trademark when there is a likelihood of confusion, mistake, or deception of purchasers.¹⁴³ The owner's registration of the trademark CABBAGE PATCH KIDS with the Customs Service was prima facie evidence of validity of such registration and of the owner's exclusive right to use the trademark.¹⁴⁴ Applying the standard of confusion, mistake or deception, the appellate court adopted the trial court finding that the Jesmar (Spanish) dolls were "materially different" from the Coleco dolls because of the different languages used in the birth certificates.¹⁴⁵ The similarities in the packaging and prominent display of the CABBAGE PATCH KIDS trademark on the boxes were found to cause public confusion as to origin of the dolls.¹⁴⁶ The numerous phone calls and letters from doll owners was evidence that the public was confused, or mistook the Jesmar dolls for the Coleco dolls.¹⁴⁷ OAA's and Coleco's domestic goodwill was damaged by consumer confusion caused by the importation of the Jesmar dolls.¹⁴⁸ Purchasers of the Jesmar dolls were unable to properly process the Spanish language adoption papers in the United States.¹⁴⁹ Purchasers naturally expected that dolls sold in the United States bearing the trademark CABBAGE PATCH KIDS would include birth certificates and adoption papers in the English language which then could be mailed to an addressee in the United States, who would process the adoption papers and return them to the "parent."¹⁵⁰ Therefore, consumers were misled, disappointed and frequently held OAA and/or Coleco responsible.¹⁵¹ While the court held that OAA was under no legal or moral obligation to process the Spanish adoption papers and supply birth certificates to the purchasers of the Jesmar dolls, as trademark owner OAA was injured due to resulting damaged goodwill.¹⁵²

143. *Granada*, 816 F.2d at 71 (citing *Syntex Laboratories, Inc. v. Norwich Pharmacal Co.*, 437 F.2d 566, 568 (2d Cir. 1971)); S.Rep. No. 1333, 79th Cong., 2d Sess. 1, *reprinted in* 1946 U.S. CODE CONG. SERV.).

144. *Granada*, 816 F.2d at 71.

145. *Id.* at 73.

146. *Id.*

147. *Granada*, 640 F. Supp at 931.

148. *Granada*, 816 F.2d at 73.

149. *Id.* The United States "fulfillment houses," that processed the Cabbage Patch Kids dolls' adoption papers were unwilling to process Jesmar's adoption papers or mail adoption certificates and birthday cards to Jesmar doll owners. *Id.*

150. *Granada*, 640 F. Supp. at 931.

151. *Id.*

152. *Id.* at 933.

The court thus affirmed the trial court decision that OAA was entitled to a permanent injunction against the distributor of the foreign-made dolls, permanently preventing Granada from further importation of the Jesmar dolls and other Cabbage Patch dolls made abroad under territorially-restricted licenses.¹⁵³

2. Concurrence

Circuit Judge Cardamone's concurrence is enlightening for its discussion of Lanham Act violations, as it clarifies the rationales set forth in the majority opinion and discusses the functions and principles behind the application of trademark law.¹⁵⁴ Judge Cardamone states that the essential element of an action under section 32 of the Lanham Act is a showing of the likelihood of consumer confusion as to the source of the product's origin.¹⁵⁵ In determining whether the importation of "genuine" Cabbage Patch dolls creates a likelihood of confusion as to its "source," it was necessary for Judge Cardamone to examine the three major functions and principles of trademark law: (1) the "Trade Identity Theory," (2) the "Guarantee"

153. *Granada*, 816 F.2d at 73 (citing Lanham Trade-Mark Act, § 32, 15 U.S.C. § 114 (1982); distinguishing *Bell & Howell: Mamiya Co. v. Masel Supply Co.*, 719 F.2d 42, 45-46 (2d Cir. 1983)); cf. *Premier Dental Products Co. v. Darby Dental Supply Co.*, 794 F.2d 850, 859 (3d Cir. 1986) (finding irreparable damage to goodwill even though gray good was identical to goods sold by trademark owner), *cert. denied*, 107 S. Ct. 436 (1986).

154. Judge Cardamone commented as follows:

The majority states that the imported dolls were not intended to be sold in the United States and were "[materially] different" from those of the mark's owner because the adoption papers and birth certificates were in Spanish. [The majority holds] that it is this difference that creates confusion over the source of the product and constitutes the Lanham Act violation.

Granada, 816 F.2d at 74 (Cardamone, J. concurring).

These statements are confusing. The court is merely attempting to say that, even though the dolls are "materially different," the consumers are still confused as to the source of the dolls. Purchasers of the Jesmar Cabbage Patch Kids dolls will believe that they were authorized for sale in the United States by Coleco and attempt to have the adoption papers processed through Coleco's "fulfillment houses." When the fulfillment houses refused to process any adoption papers from foreign manufactured dolls, OAA's domestic goodwill was being damaged. A reasonable consumer would not understand why the originator of the Cabbage Patch Kids doll was not willing to process the "adoption papers" from a product they introduced into the market. J. Cardamone agrees that there is confusion over the source of the product, and that Granada should be permanently enjoined because of their infringing OAA's trademark. However, he reaches the conclusion in a different manner than the majority's "materially different" standard. *Id.*

155. *Id.* at 74 (Cardamone, J., concurring) (citing *Church of Scientology Int'l v. The Elmira Mission of the Church of Scientology*, 794 F.2d 38, 43 (2d Cir. 1986); *Miss Universe, Inc. v. Patricelli*, 753 F.2d 235, 237 (2d Cir. 1985); *Berlitz Schools of Languages, Inc. v. Everest House*, 619 F.2d 211, 215 (2d Cir. 1980); *McGregor-Doniger, Inc. v. Drizzle, Inc.*, 599 F.2d 1126, 1130 (2d Cir. 1979); *Mushroom Makers, Inc. v. R.G. Barry Corp.*, 580 F.2d 44, 47 (2d Cir. 1978), *cert. denied*, 439 U.S. 1116 (1979) (per curiam)).

function of trademark law, and (3) the doctrine of trademark "Exhaustion."¹⁵⁶

The function of the "Trade Identity Theory" is to identify the ultimate source of the goods, i.e., the owner of the mark.¹⁵⁷ Logically, there can be no confusion as to the source of the goods under the Trade Identity Theory when the domestic owner of the mark licenses use of its mark by a foreign manufacturer.¹⁵⁸ Thus, Judge Cardamone found no rationale for granting a Lanham Act injunction because Jesmar's Cabbage Patch Kids dolls carried a genuine trademark that accurately portrayed OAA as the originator of the product.¹⁵⁹

The second theory that Judge Cardamone considered is the "Guarantee" function of trademark law. Trademark law serves to guarantee the quality of the trademarked product.¹⁶⁰ Confusion as to source of origin or sponsorship is therefore sufficient to constitute a violation of the Lanham Act.¹⁶¹ The Lanham Act imposes an affirmative duty on the licensor to maintain quality control over its product.¹⁶² OAA fulfilled this affirmative duty to maintain quality control by imposing contractual sales restrictions in its licensing agreements.¹⁶³ Thus, insofar as Granada's importation of inferior dolls confused the public as to OAA's sponsorship, OAA had a right to bring suit against Granada.¹⁶⁴ However, Judge Cardamone also noted that the importation of genuine, but inferior, goods of a foreign licensee might be the fault of the trademark owner "in not exercising adequate supervision of the mark."¹⁶⁵ The failure of a mark owner to provide adequate supervision "should not be justification for protecting the mark owner, from importation of gray-market goods, under the trademark laws for the situation it has created."¹⁶⁶ However, it was

156. *Id.*

157. *Id.* (citing 3A R. CALLMANN, UNFAIR COMPETITION, TRADEMARKS AND MONOPOLIES § 21.17, at 76; 2 S. LADAS, PATENTS, TRADEMARKS AND RELATED RIGHTS § 732, at 1341 (1975); Takamatsu, *Parallel Importation of Trademarked Goods: A Comparative Analysis*, 57 WASH. L. REV. 433, 453 (1982).

158. *Id.* (citing 3A R. CALLMANN, *supra* note 157, at 76; 2 S. LADAS, *supra* note 157, at 1341; Takamatsu, *supra* note 157, at 457).

159. *Granada*, 816 F.2d at 75.

160. *Id.* at 76.

161. *Id.* at 75. Confusion as to "sponsorship" means the same as confusion as to "source of origin." *Id.* (citing *Societe Comptoir De L'Industrie Cotonniere v. Alexander's Dep't Stores*, 299 F.2d 33, 35 (2d Cir. 1962)).

162. *Granada*, 816 F.2d at 75.

163. *Id.*

164. *Id.*

165. *Id.*

166. *Id.* (referring to Vandenburg, *The Problem of Importation of Genuinely Marked*

found that the restrictive license was an effort by OAA to supervise its mark and prevent the importation of the Cabbage Patch dolls by third party distributors.¹⁶⁷ Without further means of controlling the distribution of its product, such as imposing an "equitable servitude" on the dolls, Judge Cardamone found OAA entitled to protection against importation of gray-market goods under the guarantee function of trademark law.¹⁶⁸

The third theory, the doctrine of "Exhaustion," operates to protect the gray marketer. This theory provides that a distributor has the right to resell a branded item in an unchanged state.¹⁶⁹ The rationale is that trademark rights are "exhausted" once unaltered trademarked goods have been placed into the market.¹⁷⁰ However, this doctrine does not apply to genuine goods which have been altered.¹⁷¹ In *Granada Electronics*, literature and packaging of the Cabbage Patch dolls was adapted to attract Spanish-speaking consumers.¹⁷² Because the goods were thereby altered, Judge Cardamone would have found the "Exhaustion" doctrine inapplicable.¹⁷³

Judge Cardamone found that the importation of Jesmar's Spanish dolls created the likelihood of consumer confusion as to whether OAA sponsored the importation of these genuine but "inferior" dolls.¹⁷⁴ This confusion, in light of the "Guarantee" function of trademark law, created a violation of the Lanham Act, entitling OAA to relief.¹⁷⁵ Granada's importation of Jesmar's Cabbage Patch Kids dolls was an interference with the OAA's right to control the quality of its own product.¹⁷⁶

Therefore, Judge Cardamone concluded that Granada's importation of Jesmar dolls created a likelihood of consumer confusion as to the source of origin and this constituted a Lanham Act violation.¹⁷⁷

Goods is Not a Trademark Problem, 49 TRADEMARK REP. 707, 716 (1959). See also *Parfums Stern, Inc. v. United States Customs Service*, 575 F. Supp. 416, 419 (S.D. Fla. 1983) (Criticizing mark owner for seeking federal trademark protection "to insulate itself from what it placed in motion itself through its own foreign manufacturing and distribution sources.").

167. Under its license Jesmar agreed not to sell outside of its territory, and to sell only to purchasers who also agreed not to sell outside that territory. *Granada*, 816 F.2d at 75.

168. *Id.* at 75-76.

169. *Id.* at 76.

170. *Id.*

171. *Id.*

172. *Id.* at 76.

173. *Id.*

174. *Id.*

175. *Id.*

176. *Id.*

177. *Id.*

Thus, Judge Cardamone affirmed the injunction to prevent further importation of Spanish Cabbage Patch Kids dolls by Granada.¹⁷⁸

In addition, the court found Granada's antitrust allegations insufficient.¹⁷⁹ Granada argued that OAA's territorial licensing scheme constituted a vertical restraint of trade by eliminating intra-brand competition and artificially raising the price of Cabbage Patch Kids dolls.¹⁸⁰ Granada's evidence of a wide price disparity along with a shortage of the Cabbage Patch dolls in the United States was insufficient to show that the territorial restrictions caused antitrust injury to the importer-distributor of foreign-made dolls.¹⁸¹ In fact, allegedly inflated prices were what made it economically feasible and profitable for Granada to purchase dolls in Europe and import them into the United States.¹⁸²

Furthermore, the court rejected Granada's claim that OAA's infringement suit was itself an antitrust violation because there was no evidence that the suit was brought in bad faith, or to harass Granada.¹⁸³

A petition for writ of certiorari in *Original Appalachian Artworks, Inc. v. Granada Electronics, Inc.* to the Supreme Court of the United States was denied on October 5, 1987.¹⁸⁴

III. LEGAL RAMIFICATIONS

Original Appalachian Artworks, Inc. v. Granada Electronics, Inc., is an important case for its potential impact on two areas involving gray-market goods. The case follows the rule set forth in *Vivitar Corp. v. United States*, that a plaintiff trademark owner must first pursue a judicial declaration of its rights before seeking the aid of the Customs Service to exclude gray-market goods. Moreover, while the irreparable harm required to support an injunction may be unique to the Cabbage Patch Kids dolls situation, the decision adds to the developing body of case law in this area.

In requesting a preliminary injunction, OAA was confronted with the irrefutable fact that it collected a royalty from Jesmar S.A. for

178. *Id.*

179. *Id.* at 74.

180. *Granada*, 1986-1 Trade Cas. (CCH) ¶ 66,986, at 62,053.

181. *Granada*, 816 F.2d at 74; cf. *W. Goebel Porzellanfabrik v. Action Industries, Inc.*, 589 F. Supp. 763, 766 (S.D.N.Y. 1984) (antitrust counterclaim to gray good copyright infringement suit dismissed because importer would have benefited from high domestic prices).

182. *Granada*, 1986-1 Trade Case (CCH) ¶ 66,986, at 66,054.

183. *Id.*

184. 108 S. Ct. 143 (1987).

each foreign doll that allegedly infringed OAA's American copyright.¹⁸⁵ Therefore, the argument was advanced that OAA may not have suffered monetary harm from the distributor's alleged infringement, or irreparable harm of any kind.¹⁸⁶ Again, the showing of irreparable harm is a predicate when injunctive relief is sought.¹⁸⁷ However, the court found in *Original Appalachian Artworks, Inc. v. Granada Electronics, Inc.* that the "likelihood" of confusion over the source of the Cabbage Patch Kids dolls was sufficient evidence of damage to OAA's goodwill to support a permanent injunction.¹⁸⁸ Another basis for injunctive relief may be the inadequacy of legal remedies.¹⁸⁹ OAA did not have to wait until actual confusion occurred because, under trademark law, the showing of a likelihood of consumer confusion as to source of origin was compelling.¹⁹⁰ Requiring that a trademark owner wait until actual confusion and damage to goodwill occur would result in an irreparable situation. An injunction is imposed to prevent any further harm from occurring. Once a consumer has viewed a certain mark as untrustworthy, the consumer will mistrust the product which bears the corresponding trademark. The mark owner, in turn, has lost a customer who will no longer purchase and recommend its products in the future.

The standard for "irreparable harm" in the instant case is consistent with the interpretations in other gray-market goods cases. The standard requiring irreparable harm used in *Original Appalachian, Inc. v. Granada Electronics, Inc.* was adopted in the case of *NEC Electronics v. Cal Circuit Abco*, although the court failed to find irreparable harm sufficient to support an injunction.¹⁹¹ The *NEC*

185. *Granada*, 1986-1 Trade Cas. (CCH) ¶ 62,053.

186. *Id.* If OAA receives a larger royalty from the foreign manufacturer (licensee), than from Coleco (the exclusive United States distributor of the dolls), OAA may even benefit financially from the alleged grey market activity. Even if the foreign licensee sells dolls at a lower royalty per doll than Coleco, and the sale of every licensee doll results in that loss of a sale on "one of the more lucrative Coleco dolls," it is still not clear whether OAA has suffered irreparable economic harm.

187. See *supra* note 31 and accompanying text.

188. 816 F.2d at 71.

189. *Beacon Theaters, Inc. v. Westover*, 358 U.S. 500 (1959).

190. See *supra* notes 136-38 and accompanying text. The essential element of an action under § 32 of the Lanham Act, 15 U.S.C. § 1114 (1982), is a showing of the likelihood of consumer confusion as to source of origin. *Granada*, 816 F.2d at 74 (referring to *Church of Scientology Int'l v. The Elmira Mission of the Church of Scientology*, 794 F.2d 38, 43 (2d Cir. 1986); *Miss Universe, Inc. v. Patricelli*, 753 F.2d 235, 237 (2d Cir. 1985); *Berlitz Schools of Languages, Inc. v. Everest House*, 619 F.2d 211, 215 (2d Cir. 1980); *McGregor-Doniger, Inc. v. Drizzle, Inc.*, 599 F.2d 44, 47 (2d Cir. 1979); *Mushroom Makers, Inc. v. R.G. Barry Corp.*, 580 F.2d 44, 47 (2d Cir. 1978), *cert denied*, 439 U.S. 1116 (1979) (per curiam)).

191. 810 F.2d at 1510.

court held that the parent company's sale of computer chips to a U.S. distributor was not an attempt to evade any terms of the trademark assignment and that a mere finding of consumer confusion as to source was not enough to support an injunction in the parent-subsidiary context.¹⁹² The U.S. subsidiary had no expectation that the parent company itself would not import computer chips into the United States in competition with the plaintiff-subsidiary.¹⁹³ Arguably, *NEC* is distinguishable from *Original Appalachian Artworks, Inc. v. Granada Electronics, Inc.* because no parent-subsidiary relationship exists in the later case.

In *Original Appalachian Artworks, Inc. v. Granada Electronics, Inc.*, the court enjoined Granada from importing the dolls, holding that the trademark owner could prevent the sale of "gray-market" Cabbage Patch Kids dolls in the United States which were manufactured abroad under the territorially-restricted license between OAA and Jesmar S.A.¹⁹⁴ The court appeared to suggest that the rationale for excluding gray-market goods might be contractually-based.¹⁹⁵ Because no contract existed between OAA and Granada, there could be no breach of contract claim. The court did not address whether Jesmar S.A. could be held liable for failing to police its distribution of Cabbage Patch Kids dolls and for allowing the dolls to be imported by Granada into a territory unauthorized by the OAA-Jesmar licensing agreement. To the extent that the restrictive licensing agreements are not in violation of antitrust laws, they should be enforceable against parties to a contract as well as against any third party beneficiaries.

The Supreme Court's opinion in *COPIAT v. United States* appears to lend support to the requirement that the trademark owner preliminarily must seek, "at its option," a judicial determination of its rights under contract or trademark law, then enlist the aid of the Customs Service to stop the importation of gray-market products.¹⁹⁶ While not a holding in *COPIAT*, the Supreme Court does appear to be leaning toward the current rule that a trademark owner does not have an absolute right to the exclusion of gray-market goods by the Customs Service.¹⁹⁷ Rather, the mark owner must first pursue a

192. *Id.*

193. *Id.*

194. *Granada*, 816 F.2d at 70.

195. *Id.*

196. *See K Mart Corp. v. Cartier, Inc.*, 56 U.S.L.W. at 1422.

197. *Id.*

private claim against the gray-marketeer.¹⁹⁸ However, the Court has yet to rule on whether section 526 of the Trademark Act imposes an affirmative duty on the Customs Service to exclude all gray-market goods. Similarly, the propriety of a mark owner resorting to section 526, without first obtaining a judicial determination, has yet to be decided. Logically, the burden of policing all licensing agreements between transnational corporations, to determine if imported products are unauthorized "gray-market" goods, cannot be imposed on the Customs Service. The mark owner-licensor has the responsibility to monitor and control its own agreements, and to resolve any improprieties that occur under these agreements. Lastly, the constitutionality of inconsistent Customs regulations also is an open question.

As noted earlier, the Customs Service has not enforced section 526, which appears to require the exclusion of all "gray goods" from the U.S. market. The Customs Service continues to adhere to its regulations and refuses to exclude gray-market imports when the U.S. trademark holder has listed the manufacturer of the foreign products in its application to register its trademark.¹⁹⁹ However, the trend in the recent cases has been to follow the theory set forth in *Vivitar*. This theory, followed in *Original Appalachian Artworks, Inc. v. Granada Electronics, Inc.*, requires that the trademark owner first bring a private suit to establish its legal rights prior to seeking assistance of the Customs Service in excluding unauthorized gray-market goods.²⁰⁰ Until the Supreme Court holds otherwise, *Original Appalachian Artworks, Inc. v. Granada Electronics, Inc.* should continue to represent the "model" for trademark owners seeking to exclude gray-market goods regarded as unlawful under section 526 of the Tariff Act.²⁰¹ After *Original Appalachian Artworks, Inc. v. Granada Electronics, Inc.*, importers and distributors of gray-market goods manufactured under a U.S. trademark are on notice that they risk suit from the mark owner when they distribute those goods in unauthorized territories. In a private suit brought by a trademark

198. *Id.*

199. See *Vivitar Corp. v. United States*, 761 F.2d 1552 (Fed. Cir. 1985), *cert. denied*, 474 U.S. 1055 (1986) (upholding customs regulations but not controlling with respect to the scope of protection of § 526(c), allowing a United States trademark owner to seek a private remedy against the gray marketeer).

200. *Id.* See also *K Mart Corp. v. Cartier, Inc.*, 56 U.S.L.W. 1419, 1422 (recalandered for argument on the merits, No. 86-625, March 7, 1988).

201. *Original Appalachian Artworks, Inc. v. Granada Electronics, Inc.*, 816 F.2d 68 (2d Cir. 1987); *cert. denied* 108 S. Ct. 143 (1987).

owner against a gray marketeer under section 32 of the Lanham Act, the mark owner must prove (1) ownership of a genuine registered trademark, (2) unauthorized use of the mark in the relationship between the foreign entity and the trademark owner, and (3) damage to the trademark's goodwill from the mere likelihood of potential consumer confusion.²⁰²

CONCLUSION

Gray-market importers contend that the lower prices of their products benefit the consumer.²⁰³ However, the higher prices of "legitimate goods" are justified by cost factors such as advertising, quality control, and warranty service.²⁰⁴ These costs enhance the quality of the mark, thereby improving the transnational corporation's reputation and, in turn, its economic position.

Due to the practices of the gray marketeer, potential consumer confusion is borne by the trademark owner, whose burden is increased and reputation harmed.²⁰⁵ Often the consumer is unaware when a purchase is a gray-market product. The consumer expects that the product's qualities and warranties will be guaranteed by the U.S. trademark owner.²⁰⁶ The consumer is harmed if the mark owner fails to honor warranties to repair or replace damaged gray-market goods. The goodwill of the trademark is also harmed due to public mistrust of the mark.²⁰⁷ The consumer who is unable to have a low-priced "gray-market good" repaired will not want to run the risk of purchasing another unwarranted product. Thus, there may be a decision by the consumer to no longer purchase any products bearing that trademark.

The sales price of a product is determined by the cost factors outlined above. The gray marketeer, however, incurs no such costs

202. See A. Seidel, *Common Law Trademark Infringement, Trademark Dilution, and Lanham Act § 43(a): Can Gray Market Products Bearing Unregistered Trademarks Be Excluded From Importation?*, in GRAY MARKETS AND PARALLEL IMPORTATION: PROTECTIONISM VS. FREE TRADE 51 (1986). Concerning the similarities to the standards involved in a common law trademark infringement suit. The Court in the instant case seems to be following the standards set forth as to common law trademark infringement suits. In order to prevail on a claim of common law trademark infringement a plaintiff must establish the same elements required to prevail on a claim of statutory trademark infringement: (1) ownership of the mark, (2) unauthorized use, and (3) a likelihood of confusion.

203. J. FITZPATRICK, *supra* note 14, at 9

204. *Osawa & Co. v. B & H. Photo*, 589 F. Supp. at 1167-68.

205. *Id.* at 1167.

206. *Id.* at 1169.

207. *Id.*

in maintaining the high quality that a certain trademark represents.²⁰⁸

The resulting burdens on the consumer and mark holders far outweigh the benefits that the gray marketeer receives. Competition in the market for any particular product is not precluded by a ban on gray-market goods. One may still legitimately compete against a mark holder; one is only required to do so without the use of a genuine trademarked good. The gray-marketeer should not be allowed a free-ride at the expense of the trademark owner.²⁰⁹

The Supreme Court's decision in *COPIAT v. United States* begins to resolve the many problems that prevail in the area of gray-market goods. The dicta in *COPIAT*, regarding the requirement that the plaintiff seek a judicial determination as a prerequisite to customs enforcement, suggests that the holding in *Original Appalachian, Inc. v. Granada, Inc.* is accurate. Trademark owners must police the use of their marks by first pursuing private claims in court prior to seeking the assistance of the Customs Service in having competing gray-market goods excluded.²¹⁰

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208. *Id.* at 1167.

209. *Id.* at 1167-68.

210. See Coalition to Preserve the Integrity of American Trademarks (*COPIAT*) v. United States, 790 F.2d 903 (D.C. Cir. 1986), *jurisdiction aff'd sub nom.* K Mart Corp. v. Cartier, Inc., 56 U.S.L.W. 1419, 1422 (recalendared for argument on the merits, No. 86-625, March 7, 1988); Vivitar Corp. v. United States, 761 F.2d 1552, 1570 (Fed. Cir. 1985), *cert. denied*, 474 U.S. 1055 (1986).

