THE LEGALITY OF THE PARALLEL IMPORT OF TRADE-MARKED GOODS: A COMPARATIVE ANALYSIS

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ABSTRACT

This thesis analyses the legality of parallel import of trade-marked goods from a comparative standpoint as the author will examine the legal, judicial and administrative responses to it in three jurisdictions: United States, Canada and the European Union.
This issue lies at the core of the inherent tension between the promotion of free trade and the traditional territorial allocation of intellectual property rights. Parallel import refers to the unauthorized sale of genuine branded products in a given jurisdiction through market channels without the consent of the trade-mark owner in that jurisdiction. The exhaustion of rights doctrine is one of the most fundamental limitations on intellectual property rights as it provides, in general terms, that once an intellectual property right holder sells an article embodying those rights he no longer has any authority to control the future sale or movement of this article because his right have been exhausted with respect to that article. This inextricable link between parallel imports and the exhaustion of rights will thus be the focus of our analysis throughout this thesis.

RÉSUMÉ

Cette thèse est une analyse comparative des réponses juridiques, judiciaries et administratives fournies aux Etats-Unis, au Canada et dans l'Union Européenne à la question de la légalité de l'importation parallèle de produits protégés par une marque de commerce. Ce thème est au coeur de la tension inhérente existant entre la promotion du libre commerce et l'allocation traditionnellement territoriale des droits de propriété intellectuelle. L'importation parallèle d'un produit protégé par une marque implique la vente non autorisée dans une juridiction par le titulaire de la marque de produits authentiques dans la même juridiction. La théorie de l'épuisement des droits est une limitation fondamentale des droits de propriété intellectuelle puisqu'elle dispose, en termes généraux, qu'une fois que le titulaire d'un droit de propriété intellectuelle vend un article protégé par un de ces dits droits, il n'est plus habilité à en contrôler la vente ou la circulation future, son droit étant épuisé vis à vis de cet article. Ce lien inextricable existant entre les notions d'importation parallèle et d'épuisement des droits sera donc au coeur de notre analyse tout au long de cette thèse.

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Introduction

In an era of constant trade liberalization and globalization, the relationship between intellectual property protection[1] and international trade has been one of the most controversial issues in recent global negotiations.[2] Since a great percentage of the goods and services in world trade today are protected by some form of intellectual property right, the potential for the inhibition of trade based on the territorial allocation of intellectual property rights is substantial. At the core of this inherent tension between the promotion of free trade and the traditional territorial allocation of intellectual property rights lie the issues of parallel import[3] and the exhaustion of intellectual property rights through exploitation.[4]

Parallel importation involves the sale of genuine products subject to intellectual property rights which have been imported into a country without the authorization of the holder of the intellectual property rights for that product in that country. The exhaustion of rights doctrine is one of the most fundamental limitations on intellectual property rights as it provides, in general terms, that once an intellectual property right holder sells an article embodying those rights he no longer has any authority to control the future sale or movement of this article because his right have been exhausted with respect to that article.[5] There is thus an inextricable link between parallel imports and the exhaustion of

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[1] This thesis adopts the term "intellectual property" to designate both industrial and intellectual property.
[2] See J.H. Reichman, "Intellectual Property in the International Trade and the GATT" in M. Goudreau et al., *Exporter notre technologie : protection et transferts internationaux des innovations /Exporting our Technology: International Protection and Transfers of Industrial Innovations* (Montreal: Wilson & Lafleur 1995).
[3] F-K. Beier some decades ago remarked that "the parallel import problem is a typical symptom accompanying a largely liberalized and internationally involved economy." See F-K. Beier, "Territoriality of Trademark Law and International Trade" (1970) 1 IIC 48 at 49 [hereinafter Beier].
[4] Technically, there are two forms of exhaustion. The first is the expiration of a fixed term of protection for the right itself. The second, more complex issue involves exhaustion through exploitation, the effect of a holder authorized "first sale".
[5] *See* D.E. Donnelly "Parallel Trade and International Harmonization of the Exhaustion of Rights Doctrine", (1997) 13 Santa Clara Computer & High Tech. L.J. 445[hereinafter Donnelly].

rights: whether goods can be parallel imported depends on whether the intellectual property rights they embody have been exhausted by previous sales.

The aim of this thesis is to examine the legality of parallel import[6] of trade-marked goods,[7] as most of the literature and case law dealing with parallel importation concerns trade-marked goods, from a comparative perspective. As a trade-related aspect of intellectual property, one might suspect that international initiatives to harmonize intellectual property rights would have harmonized the law of the exhaustion of rights. The contrary is, in fact, the case. Countries vary considerably in their legal treatment of parallel imports, as determined by their choice of exhaustion doctrine.[8] (Chapter 1)

Analysis of the current law of exhaustion of rights reveals deep divisions in the law of the major exporters of intellectual property such as the United States, Canada and the European Union. (Chapters 2 to 4) The need for legal changes revealed by the laws of these nations is then analyzed in more detail. Lastly, brief conclusions regarding the appropriate type of harmonization to be made in certain aspects of these jurisdictions' laws relating parallel importation will be considered. (Chapter 5)

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[6] The terms "grey goods" and "grey market" are used in the United States, while the term "parallel imports" was adopted in the European Community.

[7] This thesis focuses on the problem of trade-mark exhaustion only, thus leaving exhaustion of copyright and other kinds of intellectual and industrial property aside. While the trade-mark aspect in most cases will not suffice when the distribution rights to a product is to be established, the inclusion of other aspects of intellectual property would have forced the discussion to be too superficial.

[8] See Keith E. Maskus and Yongmin Chen, "Vertical Price Control and Parallel Imports: Theory and Evidence." (2000, Oct. 1). World Bank Research, Washington D.C. [On-line]. Abstract from: World Bank Working Paper Number: 2461. Web site: http://www.worldbank.org/

Chapter 1: The exhaustion of trade-mark rights

It is first necessary to come to grips with the economic phenomenon of parallel importation[9] in order to see what kinds of legal patterns have been formulated to address this issue. Parallel importation arises when an entrepreneur purchases legitimately trade-marked goods in a lower-priced market, without the authorization of the trade-mark owner in a higher-priced market, and then resells the goods in the higher-priced market.[10] The price differential may stem from fluctuations in currency exchange rates, advertisement costs, manufacturers' multi-tiered pricing schemes, tax differences, differing consumer preferences, differences in product quality and characteristics, warranties, and services.[11] The grey marketer reaps the benefit of higher profits by selling the products in a geographic area in which the proprietor of the trade-mark has authorized the sale of the product to certain individuals but not to the parallel importer. Each case of parallel importation has elements that can differentiate it from the rest. However it is possible to distinguish three main types of parallel importation[12]: "unintended goods",[13] "licensed goods",[14] and "distress goods".[15] The distinction is important because, depending on the jurisdiction, certain forms of parallel importation may or may not be considered as an infringement of intellectual property rights.

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[9] See the explanation of the concept in W.A. Rothnie *Parallel Imports* (London: Sweet & Maxwell, 1993) at 1 ff. See as well M.J. Tawfik, "Parallel Importation and Intellectual Property Law" in G.R. Stewart, MJ. Tawfik & M. Irish, eds., *International Trade & Intellectual Property* (Boulder, Colorado, Westview Press, 1994) at footnote 2.
[10] For an explanation of the concept, see Rothnie *supra* note 9 at 1ff.
[11] See Seth E. Lipner, *The Legal and Economic Aspects of Gray Market Goods* (Westport: Greenwood, Quorum Books, 1990), at 6 ff [hereinafter Lipner].
[12] *Ibid.* at 6-7.
[13] "Unintended goods" are those goods authorized for sale in one country, but then redirected to another country, often in direct competition with authorized distributors in that country. Unintended goods may be further divided into goods manufactured domestically, and those manufactured abroad by an entity under "common control" or a foreign license.
[14] "Licensed goods" are those goods manufactured pursuant to a trade-mark license but sold through unauthorized channels.
[15] "Distress goods" are those goods dumped by an otherwise authorized dealer, who typically has an excess supply or outdated goods. Distress goods, typically dumped into the domestic grey market, may also be dumped into the foreign market and eventually become unintended goods.

Parallel imports are certainly one of the most iridescent and enigmatic phenomena of international trade. On the one hand, they strictly follow the laws of the market; on the other hand, the laws of the market are not the only laws that apply to this kind of activity.[16] Parallel importation is a difficult and controversial issue. Grey goods are often said to benefit the consumer at the expense of the trade-mark holder. Arguments about the economical desirability for and against the desirability of grey marketing are raised in two broad fields: economic arguments and intellectual property arguments. We shall focus our attention on the legality of the phenomenon.

In order to stop the parallel importation, trade-mark owners, manufacturers or licensees will try to enforce their exclusive rights arguing that the rights protected by the trade-mark are endangered by the activities of the parallel importer.[17] Whether or not this succeeds depends on the doctrine adopted by the jurisdiction which deals with the problem, as no consensus on the issue of exhaustion of trade-mark rights has been reached in the international forum.

1. The substance of trade-marks and parallel imports.

The debate about the legitimacy of parallel imports incorporates a more general question regarding the purpose of trade-mark protection laws.[18] The discussion about the rationale for trade-mark is not new. The earliest historical function of the trade-mark was to help

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[16] Christopher Heath, "Parallel imports and international trade" (1997) 28 IIC at 623.

[17] A good definition of what is a trade-mark can be found in the article 2 of the *Council Directive* 89/104/EEC, art. 2, 1989 O.J. (L 40):

> A trade-mark may consist of any sign capable of being represented graphically, particularly words, including personal names, designs, letters, numerals, the shape of goods or of their packaging, provided that such signs are capable of distinguishing the goods or services of one undertaking from those of other undertakings.

Similarly, the *Canadian Trade-Marks Act,* R.C.S., 1985, c. T-13, provides in s. 2(a) that a trade-mark means:

> a mark that is used by a person for the purpose of distinguishing or so as to distinguish wares or services manufactured, leased, hired or performed by him from those manufactured, sold, leased, hired or performed by others, [...]

[18] See J. Picard, "The Legality of International Gray Marketing: A Comparison of the Position in the United States, Canada and the European Union" (1996) 26 Can. Bus. L.J. 422, at 424 [hereinafter Picard].

consumers in identifying the source or origin of the goods put on the market.[19] As trading expanded and goods were transported to distant markets, the trade-mark took on the additional function of being a symbol of quality for consumers who were far removed from the producers of the trade-marked goods. Accordingly businesses started to rely on their trade-marks to establish their reputation, distinguish competitor's products, and more recently to advertise and market goods.

Nowadays there is a consensus in the doctrine about three principal functions of a trade-mark: an indication of origin, a guarantee of quality and a marketing and advertising device. However, there is not complete agreement as to the main purpose behind trade-mark purpose. One school of thought considers the rationale of trade-mark protection to be the protection of the consumer against confusion or deception about the source of the branded goods. Thus the "likelihood of confusion" is a basic concept in trade-mark law. In order to claim infringement, the plaintiff has to show that the defendant's use of the trade-mark is likely to cause confusion among consumers. From the approach taken in different jurisdictions, it appears that in order to find infringement confusion must exist as to the origin of the product or as to the connection between the product and the owner of the trade-mark.[20]

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[19] F. Schechter, "The Rational Basis of Trademark Protection", (1927) 40 Harv. L. Rev., 813. See also S. Zhang, *De l'OMPI au GATT, La Protection Internationale des Droits de la Propriété Industrielle* (Paris : Litec, 1994) at 34.

[20] Section 6(2) of the Canadian *Trade-Marks Act,* R.S.C., 1985 c. T-13 states :

> The use of a trade-mark causes confusion with another trade-mark if the use of both trade-marks in the same area would be likely to lead to the inference that the wares or services associated with those trade-marks are manufactured, sold, leased, hired or performed by the same person, [...]

Section 43 of the *Lanham Act* 15 U.S.C. sates:

> (a) is likely to cause confusion, or to cause mistake, or to deceive as to the affiliation, connection, or association of such person with another person, or as to the origin, sponsorship, or approval of his or her goods, services, or commercial activities by another person, [...]

The European Court of Justice analyzed the subject matter of trade-marks in the case *Centrafarm* v. *Winthrop* (No 16/74) [1974] ECR 1183, [hereinafter *Winthrop*], to be:

> [t]he guarantee that the owner has the exclusive right to use that mark, for the purpose of putting products protected by the trade-mark into circulation for the first time, and is therefore intended to protect him against competitors wishing to take advantage of the status and reputation of the trade-mark by selling products illegally bearing that trade-mark.

The second school of thought, on the other hand, considers that trade-mark protection laws are intended mainly to protect the trade-mark owner's goodwill from unfair competition, as the main function of the trade-mark is seen to be to guarantee quality or to protect the investment made to promote the trade-mark. Accordingly, the entry of parallel imports should be barred in all circumstances because of the damage to the goodwill suffered by the trade-mark owner or licensee through "free riding".[21] The consequence of this argument is that trade-mark should be used as a legal barrier among markets. As we will see, not only the European Union[22] but other countries[23] as well have reacted against this position.

The result of extensive doctrinal discussion on the main function of trade-marks has been to accept the primary function of trade-mark to be a source of identifier for goods and services and the only function the law should be concerned about.[24]

2. The doctrine of exhaustion.

According to the doctrine of exhaustion, once a trade-mark owner directly or indirectly puts goods into the market in a particular country, the rights of that owner in relation to

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[21] "Free riding" can be defined as the practice of selling products identical to those of the authorized distributor, trade-mark owner or licensee without incurring the licensing or promotional expenses incurred by them. See R.J. Staaf, "The Law and Economics of the International Gray Market: Quality Assurance, Free-Riding and Passing Off" (1988) 4 I.P.J. 191 at 206.

[22] Article 36 of the Treaty of Rome allows member states to restrict the free movement of goods in certain circumstances. This article provides that:

> The provisions of Articles 30-34 shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of [...] the protection of industrial and commercial property. Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between member states.

For an early application of this principle see *Parke Davis v. Centrafarm,* (No 24/67) [1968] E.C.R. 299 [hereinafter *Parke Davis*].

[23] The idea that one of the trade-mark registration's goals is the prevention of free riding has been challenged by the recent *Coca-Cola* judgment of the Canadian Federal Court of Appeal. *Coca-Cola Bottling Ltd. v. Musaadiq Pardhan & al.* (1999), 85 C.P.R. (3d) 489 (F.C.A.) [hereinafter *Coca-Cola*].

[24] W.R. Cornish, *Intellectual Property: Patents, Copyrights, Trade Marks and Allied Rights,* 3d ed., (London: Sweet and Maxwell, 1996) at 529-530. The following arguments are based in the work of this author. See as well Beier *supra* note 3 at 60-65 where he defines the purposes and functions of the trade-mark.

genuine goods are said to be exhausted, and the trade-mark owner no longer has the ability to control the subsequent marketing of genuine goods in that country. This doctrine is very complex and its scope can reach three levels: domestic, regional and international exhaustion of right. Depending on how far the doctrine extends over this range, parallel importation will either be allowed or banned.

The territorial or national exhaustion doctrine holds that a trade-mark has a separate legal existence under the laws of each country in which it is used, and that its proper function is not merely to specify the origin of the goods, but to symbolize the domestic goodwill of the domestic trade-mark owner so that the public may rely with confidence on the domestic reputation of the mark. Thus, according to this doctrine, trade-mark rights can be severed territorially like patents or copyrights, and the rights of the owner in one jurisdiction have no relevance to the rights of the owner in another jurisdiction.[25]

The regional exhaustion doctrine is applied by the European Union (EU) which denies parallel imports from outside the EU territories, but does not restrict parallel trading within those territories. This system has emerged from the jurisprudence of the European Court of Justice, which in the early 1970s ruled that national exhaustion would be inconsistent with the Treaty of Rome which aims at uniting national markets into a single market. Other regional trade agreements largely remain silent on the exhaustion issue. The North American Free Trade Agreement (NAFTA),[26] for example, has no explicit provision on the exhaustion of intellectual property rights. The substantive provisions of NAFTA's Chapter 17 on intellectual property rights can be interpreted to the effect as giving member countries freedom on the question of rights exhaustion.

When the exhaustion doctrine is applied world-wide, it is referred to as the universality doctrine or the international exhaustion doctrine. This doctrine holds that the only

[25] See Cornish *supra* note 24.
[26] *North American Free Trade Agreement*, signed December 17, 1992, (1992) 31 I.L.M. 997 [hereinafter NAFTA].

purpose of a trade-mark is to identify the source of the product and the rights associated with the trade-mark cannot be cut into territorial pieces. Under this principle, grey market activities are entirely legal, as the good is a genuine trade-marked item wherever it might travel.[27]

3. Absence of international consensus on the issue of exhaustion of trade-mark rights

Underlying the legal issues associated with parallel importation is the conflict between free trade and protectionism. This conflict has existed throughout the world for a long time, and likely will continue to exist, to a greater or lesser degree, despite international efforts to the contrary. Unless bound by an international agreement, countries are free to adopt their preferred exhaustion regime for each form of intellectual property right. So far, no international convention or multilateral agreement on intellectual property rights has mandated a particular regime. The older intellectual property agreements, such as the Paris Convention and the Berne Convention, do not touch upon this issue at all. The most recent global intellectual property agreement, the Agreement on Trade Related Intellectual Property Rights (TRIPs Agreement), carefully circumvents this issue as its article 6 states that:

> For the purposes of dispute settlement under this Agreement, subject to the provisions of Articles 3 and 4 above nothing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights.[28]

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[27] S.K. Verma, "Exhaustion of Intellectual Property Rights and Free Trade- Article 6 of the TRIPS Agreement" (1998) 5 IIC 534, at 539.

[28] Articles 3 and 4 of TRIPs require national treatment and most-favored-nation treatment of intellectual property owners. Hence, exhaustion regimes that discriminate between foreign and national right holders, or between foreign right holders can be challenged in WTO dispute settlement proceedings. *Agreement on Trade-related Aspects of Intellectual Property Rights* [hereinafter TRIPs Agreement], Annex 1C of the Marrakesh Agreement Establishing the World Trade Organization, concluded on April 15, 1994, effective on January 1, 1995; Legal Instruments - Results of the Uruguay Round vol. 31, (1994) 33 I.L.M. 81.

Article 6 of the TRIPs Agreement is widely interpreted as an "agreement to disagree", giving the World Trade Organization members the freedom to opt for national, regional or international rights exhaustion doctrines. It reflects the negotiating history of the TRIPs Agreement, in which the exhaustion issue was raised, but where member countries could not form consensus on a multilateral statute. This should come as little surprise as the debate on parallel trade and the issue of exhaustion incorporates aspects of competition policy and passionate debates concerning the relationship between advanced-industrialized countries and less-advanced developing countries. As Cottier observed:

> [w]orld trade law is only in its beginnings in dealing with this careful balance. While parallel imports amounts to perhaps the most central trade-related issues of intellectual property rights, it has not been extensively dealt with in negotiations. Within the TRIPs Agreement it was mainly agreed to disagree, and leave the matter for further work.[29]

Accordingly many countries, particularly those with traditions of strong intellectual property rights protection, have faced the issue with respect to the effects of domestic intellectual property rights on their internal market and regarding imports from outside that market.[30]

The phenomenon of parallel importation is more complex than this simple description which is only an overview of how the problem fits into the general framework of international trade and the international protection of intellectual property. The aim of this thesis is to analyze the legality of parallel importation in certain jurisdictions. The extent to which intellectual property rules can be used to stop parallel importation is the subject matter of the subsequent chapters.

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[29] Thomas Cottier, "The WTO System and Exhaustion of Rights" (Draft manuscript presented at the Conference on the Exhaustion of Intellectual Property Rights and Parallel Importation in World Trade, Geneva, Switzerland) (November 6-7, 1998) at 1.

[30] See Donnelly *supra* note 5 at 449-85, discussing the domestic positions on international exhaustion in the United States, the European Union and Japan.

Chapter 2: The legal regime in the United States

In the United States the legal position towards parallel imports has developed in an attempt to accommodate the multiple purposes and functions of the trade-mark,[31] through the provisions of two main sources: section 42 of the *Lanham Act* [32] (1) and section 526 of the *Tariff Act of 1930* [33] (2).

The American case law has proved to be ambiguous and unstable, changing successively the exhaustion doctrines applied. As we will see, in last century, the doctrine of universality prevailed,[34] while at the turn of the century the doctrine of territoriality took hold.[35] The doctrine of territoriality then evolved as the courts found arguments to allow or ban parallel importation on the existence of local goodwill, product differentiation and "common control."[36] Also, a significant exception was developed in case of genuine products containing material differences from those legitimately sold in the United States under the mark in order to fulfill one of the fundamental policies of trade-mark law, the prevention of consumer source confusion.[37]

1. Protection afforded under the Tariff Act.

The Tariff Act evolved from the 1886 *Apollinaris Co. v. Scherer* case[38] which allowed the importation of grey market goods, concluding that the trade-mark denoted the source and authenticity of goods. This decision shaped grey market rights until 1922, when the

[31] The objectives of U.S. trade-mark law are to:
(1) prevent consumer confusion over the origin of particular goods or services and
(2) protect businesses from unfair competition.
[32] 15 U.S.C. 1142 (1988).
[33] 19 U.S.C. 1526 (1988).
[34] *Apollinaris Co., Ltd., v. Scherer*, 27 F. 18 (S.D.N.Y. 1886) [hereinafter *Apollinaris*].
[35] *A. Bourjois & Co., Inc. v. Katzel,* 260 U.S. 689 (1923) [hereinafter *Katzel*].
[36] *K-mart Corp. v. Cartier, Inc.*, 486 U.S. 281 (1988) [hereinafter *K-mart*].
[37] See 15 U.S.C.1127 (1988) (stating policies of *Lanham Act*).
[38] *Apollinaris, supra*, note 34.

Second Circuit Court of Appeal in *A. Bourjois & Co. v. Katzel*[39] ruled to not prohibit parallel importation of goods bearing a trade-mark which a domestic company had purchased from a foreign manufacturer. In response to this decision, Congress enacted section 526 of the *Tariff Act* barring imports of foreign goods which had US registered trade-marks without consent of the American owner of the trade-mark. In 1988, the United States Supreme Court, in *K-Mart Corp. v. Cartier, Inc,*[40] specifically examined the three ways grey markets in which can arise and how section 526 of the *Tariff Act* applies to each of these three situations.

The first important decision on parallel imports was the ruling of the Circuit Court of the Southern District of New York in *Apollinaris Co., Ltd., v. Scherer* of March 16, 1886,[41] which focused on the "first sale doctrine". The British company Apollinaris, the plaintiff, had acquired the exclusive right to sell Hungarian "Hunyadi Janos" mineral water in the United Kingdom and the United States from the owner of the trade-mark. At the same time, the owner was marketing the water in Europe. The defendant purchased the water from a German dealer and imported it into the United States, even though the bottles contained a legend prohibiting the importation into the US and Great Britain. The plaintiff sued the defendant for trade-mark infringement and unfair competition. The Court rejected the claim. As the water sold by the defendant was genuine, there was no likelihood of confusion about the origin and therefore no infringement. The Court stated:

> There is no exclusive right to the use of a name or symbol [...] except to denote the authenticity of the article with which it has become identified by association. The name has no office except to vouch for the genuineness of the thing which it distinguishes from all counterfeits [...].[42]

According to the decision, the only function of the trade-mark was to denote origin, and the parallel importation did not run afoul of this principle. Moreover, the decision was founded in the doctrine of universality which prevailed at that time. That is, it can be argued that the source-identifying function applied across all jurisdictions.

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[39] *Katzel, supra*, note 35.
[40] *K-mart, supra,* note 36.
[41] *Apollinaris, supra*, note 34.
[42] *Ibid.*, at 20.

This decision was overruled at the turn of the century by the US Supreme Court's decision in *Bourjois & Co. v. Katzel.*[43] By providing that trade-marks are legally enforceable only in the country granting the trade-mark and its accompanying rights, the court established the territoriality of trade-marks. In that case, the plaintiff, the U.S. corporation Bourjois, had purchased all the U.S. business, goodwill and rights to the U.S. trademark in JAVA face powder from the French manufacturer. Bourjois was completely independent of the French company. The plaintiff, continued to import the French company's face powder. He was selling the face powder in boxes that bore the mark POUDRE JAVA and disclosing the plaintiff's relationship to the French company. The defendant, Katzel, imported the French face powder and marketed it in the original French boxes, which bore the mark POUDRE DE RIZ JAVA. The plaintiff sued the defendant for trade-mark infringement.

The District Court granted a preliminary injunction against the parallel importer. The Second Circuit Court of Appeal declined to enjoin the encroachment on the trade-mark holder's newly purchased market. The Appeal Court could find no trade-mark violation so long as the competitor's French labels accurately identified the product's manufacturer. It adhered to the then prevailing "universality" theory of trade-mark law, a view that it had espoused for several years.[44] Under that view, trade-marks do not confer on the owner a property interest or a monopoly power over intra-brand competition. Rather, they merely protect the public from fraud or deception by indicating the origin of the goods they mark.

The Supreme Court held, on the contrary, that the defendant had infringed the plaintiff's trade-mark rights even though the defendant sold only the genuine French face powder, thus establishing the principle of the territoriality of trade-marks. The doctrinal

[43] *Katzel, supra*, note 35.
[44] See for example *Fred Gretsch Mfg. Co. v. Schoening*, 238 F. 780, 782 (1916).

implication of territoriality is that trade-mark rights guaranteed under United States law would not be exhausted by first sales outside of the United States.[45]

In announcing the new principle of territoriality, the Supreme Court addressed the purposes and limitations of trade-mark law. Specifically, the Court sought to answer the following questions: whether a trade-mark is to be primarily protected for the purposes of protecting the local trade-mark owners' investment in their business or whether a trade-mark is exclusively limited to guarding the public against confusion concerning the source and quality of the trade-marked goods. Viewing the trade-mark as exclusively for the benefit of consumers without regard for the goodwill of businesses, which the trade-marks are relied on to produce, is a limiting position that the Supreme Court did not embrace.[46] Rather, the Supreme Court took a more expansive view of the functions of the trade-mark,[47] with Justice Holmes recognizing its multiple functions:

> Ownership of the goods does not carry the right to sell them with a specific mark. It does not necessarily carry the right to sell them at all in a given place [. . .]. It is said that the trade-mark here is that of the French house and truly indicates the origin of the goods. But that is not accurate. It is the trade-mark of the plaintiff only in the United States and indicates in law, and, it is found, by public understanding, that the goods come from the plaintiff although not made by it. It was sold and could only be sold with the goodwill of the business that the plaintiff bought.[48]

Holmes made clear in his opinion that trade-marks serve a function beyond that of mere source identifier; rather they represent broader concepts of business goodwill. Here, a foreign firm sold the rights to register and use its trade-mark in the United States to an independent United States company only later to import and distribute its goods in the United States. Allowing parallel imports in this scenario would work an injustice because

[45] See Donnelly, *supra* note 5, at 455 (explaining that this is not an accurate reflection of state of trade-mark law in the United States because the principle has been limited by subsequent decisions construing *Katzel* narrowly).
[46] See Lipner *supra* note 11, at 17 (noting that by 1920 the Court seemed willing to protect a trade-mark owner's interest in goodwill).
[47] *Ibid.*, at 18.
[48] *Katzel, supra*, note 35, at 692.

the United States company had invested in developing the goodwill associated with the trade-mark.

However, it is equally clear that Justice Holmes did not intend his opinion to be a blanket proscription on the importation and sale of grey market goods as indicated by his emphasis on the purchase of the company's goodwill. Moreover, the restriction against parallel imports enunciated by the Court in *Katzel* can be limited to the factual situation in which the trade-mark owner has purchased the goodwill of the business and is deserving of the protection which the trade-mark may afford to protect that business. Indeed by the 1980's, most of the courts of appeals in the US had adopted the view that banning grey market goods in all cases would be incompatible with fundamental principles of trade-mark law as well as with the interests of promoting competition and with those of consumers.[49]

Although Justice Holmes' opinion for the unanimous Court in the *Katzel* case unambiguously rejected the universality doctrine, Congress also acted to reverse the Second Circuit's adoption of that principle and passed section 526 (a) of the *Tariff Act* of 1922, a provision that subsequently was reenacted as part of the *Tariff Act* of 1930. This provision states:

> [I]t shall be unlawful to import in the United States any merchandise of foreign manufacture if such merchandise, or the label, sign, print, package, wrapper, or receptacle, bears a trade-mark owned by a citizen of, or by a corporation or association created or organized within the United States, and registered in the Patent and Trade-mark Office by a person domiciled in the United States [. . .], unless written consent of the owner of such trade-mark is produced at the time of making entry .[50]

[49] See S.E. Lipner, "Trade-marked Goods and Their Gray Market Equivalents: Should Product Differences Result in the Barring of Unauthorized Goods from the U.S. Markets ?", (1990) 18 Hofstra L. Rev. 1029, at 1034.

[50] 19 U.S.C. 1526(a).

Unlike trade-mark infringement remedies under the *Lanham Act*, there is no requirement under the *Tariff Act* to show a likelihood of confusion in order for section 526(a) to be violated. Goods imported into the United States in violation of section 526(a) are "subject to seizure and forfeiture."[51] U.S. trade-mark owners may therefore also use customs laws to exclude grey market goods.

The purpose of the amendment was to protect United States trade-mark owners. However, the United States Customs Service, which was responsible for the application of the *Tariff Act*, took a restrictive approach in its interpretation of section 526, probably because of concern about possible monopolistic behavior. Exceptions to the import ban were created and eventually were incorporated in the Customs Service regulations. Essentially, the objective of those exceptions was to exclude the application of section 526 of the *Tariff Act* where the foreign and United States trade-mark owners were related parties (as for instance subsidiaries or licensees).[52] Since the exceptions include the situations in which many parallel importation situations arise, the Customs regulations were the subject of intense lobbying efforts and attacks in the courts by American trade-mark owners.

The controversial Customs Service interpretation ultimately led to the U.S. Supreme Court decision in *K-Mart Corp. v. Cartier,*[53] which considered whether these regulations constituted a proper construction of section 526 (a). In this 1988 case, the United States Supreme Court examined the legality of the importation of genuine goods under section 526 of the *Tariff Act*. Justice Kennedy, writing for the majority of the Court, specifically

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[51] 19 U.S.C. 1526(b).

[52] 19 C.F.R. (1987) 133-21(c). This section provides:

> The restrictions set forth [...] do not apply to imported articles when: (1) both the foreign and the U.S. trade-mark or trade name are owned by the same person or between entity; (2) the foreign and domestic trade-mark or trade name owners are parent and subsidiary companies or are otherwise subject to common ownership or control; (3) the articles of foreign manufacture bear a recorded trade-mark or trade name applied under authorization of the U.S. owner.

[53] *K-mart, supra*, note 36, at 285.

took a close look at the three ways in which grey markets can arise and how section 526 of the *Tariff Act* applies to each of these three.

In the first scenario, a domestic firm buys, from an independent foreign firm, the rights to register and use a foreign trade-mark as a US trade-mark and sell the foreign-manufactured product in the USA. Therefore, if the foreign manufacturer imports trade-marked goods for distribution in the USA, even though the trade-mark has been sold to a domestic firm, the domestic firm would be in competition with goods with identical trade-marks. Competition also occurs if the foreign manufacturer markets goods outside the USA and a third party legally buys them abroad to import them into the USA. If parallel importation were allowed, it would create a grey market which jeopardizes the trade-mark holder's investment.[54] The Supreme Court held that, under this situation, Customs may bar importation of grey market goods because it was analogous to the *Bourjois v. Katzel* case.[55]

The second scenario is also known as the "common control" exception because the foreign and domestic trade-mark holders are the same or related in such a way that the domestic trade-mark holder really has control over the foreign entity.[56] The Customs Service has defined "common control" as the existence of any relationship that allows one company to share effective control over the policy and operation of another.[57] The companies do not need to share common ownership. For instance, a foreign firm wishing to distribute its wares in the US will incorporate a domestic subsidiary and then register its trade-mark in the subsidiary's name. Alternatively an American company may create a manufacturing subsidiary abroad. If the products sold abroad by the manufacturing parent

[54] *Ibid.*, at 292-93.
[55] *Ibid.* at 292. See also Donnelly, *supra* note 5, at 455.
[56] *K-mart, supra*, note 36, at 286-87.
In this situation, three sub-cases arise: (a) the U.S. company is a subsidiary of the foreign firm;(b) the U.S. firm is the parent of its overseas manufacturing subsidiary; and (c) the U.S. firm opens a foreign plant, which is not separately incorporated and the assets of which are owned by the domestic firm.
[57] 19 CFR 133. 2(d)(2).

or the subsidiaries are imported into the US, a grey market appears. The US Supreme Court upheld the regulations in this case.[58] This reasoning is based on the assumption that an integrated firm can use self-help methods to prevent grey goods from entering the domestic market by ensuring that its distributors minimize sales to grey marketers.

The third scenario can be referred to as the "independent foreign entity" scenario.[59] A domestic holder of a US trade-mark authorizes an independent foreign manufacturer to use the trade-mark.[60] The trade-mark holder usually sells the exclusive right to use the trade-mark to the foreign manufacturer in a specific foreign location, conditioning the right to use the trade-mark on the foreign manufacturer's promise not to import the trade-mark product into the USA. If the foreign manufacturer or third party imports the products into the USA, the foreign-manufactured goods compete on the grey market with the US trade-mark holder's domestic goods. The Supreme Court decided that under those circumstances, the goods made in a foreign country by an independent manufacturer will be banned. Under the *Customs Regulations*, these goods could not be stopped from entering the United States, but the Supreme Court struck down the regulations as inconsistent with the plain language of section 526.

The importation of so-called grey-market goods may also be challenged under another legal basis: the *Lanham Trade-mark Act*.[61]

2. Protection afforded under the Lanham Act

Trade-mark owners who remained unable to prevent the importation of grey market goods using section 526 of the *Tariff Act* after the *K-Mart* decision then turned to trade-

[58] The Court split on case 2, with the Chief Justice and Justices Blackmun, O'Connor, and Scalia dissenting. *K-mart, supra*, note 36, at 309-10. For a good illustration of a common control exception case, see *Weil Ceramics and Glass, Inc. v. Dash*, 878 F.2d 659 (3d Cir. 1989).
[59] See Donnelly, *supra*, note 5, at 456.
[60] *K-mart, supra*, note 36, at 294.
[61] 15 U.S.C. 1051-1127.

mark law. The *Lanham Act*, specifically sections 32, 42, and 43(a), gives the owner of a registered trade-mark a cause of action against unauthorized use of the likeness of a trade-mark in a manner which can cause customer confusion. Courts have used sections 32, 42, and 43(a) to preclude the importation of products that would otherwise be permitted under the common control exception by considering materially different trade-marked goods not to be genuine.[62] We will lastly examine how the Customs Service's new regulations implemented the decision of the District Court for the District of Colombia, affirmed by the Court of Appeals, *in Lever Brothers Co. v. United States* that had adopted a definition of "physically and materially different" goods.

In the late 1930's and early 1940's, Congress considered a wholesale revision and codification of United States trade-mark laws, resulting in the *Lanham Trade-mark Act* of 1946. Under this Act, if the trade-mark owner can prove that the authorized goods bear a material difference from those intended for domestic production, he can either enjoin their importation at the border (section 42) or seek civil damages for trade-mark infringement (section 32 and section 43(a)).

A codification of the common law tort of infringement, section 32 provides the owner of a federally registered trade-mark with a cause of action against anyone who uses a "[...] reproduction, counterfeit, copy, or colorable imitation of a registered mark [...] likely to cause confusion, or to cause mistake, or to deceive [. . .]".[63] Similarly, section 43 (a) of the Act allows the owner of a registered or unregistered trade-mark to bring infringement actions against defendants using "false designation of origin [...] likely to cause confusion, or to cause mistake, or to deceive [...]."[64] According to those two sections,

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[62] *Lever Bros. Co. v. United States of America (Lever II)*, 981 F.2d 1330 (D.C. Cir. 1993) [hereinafter *Lever*] (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) [hereinafter *Appalachian*] (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).
[63] 15 U.S.C. 1132 (1988).
[64] 15 U.S.C. 1143(a) (1988).

trade-mark infringement under the *Lanham Act* requires a likelihood of confusion between the genuine goods and the allegedly infringing goods, even for grey goods.[65]

In contrast, section 42 of the *Lanham Act*,[66] does not create a cause of action against the actual infringement of trade-marks, but instead excludes imports.[67] This section provides that U.S. trade-mark rights will not be exhausted by sales of products in foreign jurisdictions bearing those marks that differ in ways material to consumers from those sold in the United States.

The *Lanham Act* contains several other provisions that protect manufacturers' trade-marked products from the grey market economy. One pertinent provision is section 1114(1)(a), which prohibits the use of any trade-mark likely to confuse consumers.[68] In addition, section 1124 prohibits admitting products into the United States if the products copy or simulate U.S.-manufactured products[69] and section 1125(a)(1) prohibits the use of trade-marks that falsely designate a product's origin.[70]

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[65] Although the precise formulation of the test for determining whether confusion is likely varies from jurisdiction to jurisdiction, courts most frequently consider the following factors :
1) the fame of the trade-mark sought to be protected,
2) the similarity of the products bearing the trade-mark,
3) the similarity of the parties' purchasers and channels of trade,
4) the degree of care that purchasers are likely to exercise when purchasing the parties' products; and
5) evidence that consumers are confused (eg. Consumers purchasing one party's good attempt to return them to the other party).
See: *Helen Curtis Indus. v. Church & Dwight Co*, 560 F 2d. 1325, at 1330 (7th Circ. 1977).
[66] 15 U.S.C. 1142 (1988).
[67] This section provides, in relevant part:

> No article of imported merchandise which shall copy or simulate the name of [...] any domestic manufacture, or manufacturer, or trader, or of any manufacturer or trader located in any foreign country which, by treaty, convention, or law affords similar privileges to citizens of the United States, or which shall copy or simulate a trade-mark registered in accordance with the provisions of this Act or shall bear a name or mark calculated to induce the public to believe that the article is manufactured in the United States, or that it is manufactured in any foreign country or locality other than the country or locality in which it is in fact manufactured, shall be admitted to entry at any customhouse of the United States.

[68] 15 U.S.C. 1114(1)(a) (1988).
[69] 15 U.S.C. 1124 (1988).
[70] 15 U.S.C. 1125(a)(1) (1988).

As one of the key functions of trade-mark is to provide assurances of quality, consumers who purchase a particular product expect to receive the same special characteristics every time. The import of products designed for consumers abroad but later imported on the domestic market may however endanger those expectations. Those products very often have different characteristics in terms of presentation or composition than the ones sold under the same trade-mark domestically. Because those differences may surprise consumers and harm the brand's reputation, American courts have developed the material difference standard as a mean of placing reasonable limits on the territoriality of trade-mark law.

Key to the evolution of the material different goods standard has been an understanding of the impact of those goods on consumers. While misrepresentation is implicit, those goods may as well cause physical and economical injuries to consumers.[71] However, because the courts have found it difficult to apply a uniform rule, there has been no consistency as to the manner in which they have applied the material difference standard. As a consequence, material differences in the product have been determined on a case by case basis, sometimes turning on extremely factual distinctions. We will thus study several cases and highlight some of the shortfalls in their reasoning.

A pragmatic definition of the notion has been adopted both in *Original Appalachian Artworks, Inc. v. Granada Electronics, Inc.*[72] and in *Societe Des Produits Nestle, S.A. v. Casa Helvetia, Inc.* In the former case, in 1987, the Second Circuit Court of Appeal interpreted material difference as that which causes consumer confusion or disappointment with the goods.[73] The Court ruled that Cabbage Patch Kids dolls bearing the owner's trade-mark, but manufactured abroad and intended for a foreign market, were not to be imported into the United States because the foreign dolls were accompanied by

[71] Economical injury could occur if, for example, the product is less suited to the consumers' intended purposes or is missing the warranty that the consumers normally expect. Physical injury could occur if the product contains different ingredients to which the consumer is allergic.
[72] *Appalachian, supra* note 62.
[73] *Ibid.* at 73.

"birth certificates" and "adoption papers" that were not in English, but in Spanish. Unlike purchasers of U.S. dolls, purchasers of imported dolls were unable to have the dolls "adopted" through U.S. fulfillment houses, which would also send a "birthday card" to purchasers of the U.S. dolls on the first anniversary of the "adoption". Taking a rather lenient approach, the Court considered that, although readily apparent to consumers, these differences were material enough to create confusion over the source of the product and result in a loss of the trade-mark owner's goodwill because the adoption process was critical in the decision to purchase the product.[74]

In *Societe Des Produits Nestle, S.A. v. Casa Helvetia, Inc.* [75] in 1992, the First Circuit Court of Appeals interpreted material difference to mean any difference which the consumer would consider relevant when purchasing a product.[76] The case was about the sale of chocolates bearing the trade-mark PERUGINA in Puerto Rico. The plaintiff, the Swiss owner of the mark, had authorized its subsidiary, Nestle Puerto Rico, to market Italian-made chocolates under the mark in Puerto Rico. The defendant, Nestle's former Puerto Rico distributor, imported chocolates manufactured by a Venezuelan company under license from Nestle. The Venezuelan products differed from the Italian products in presentation, variety, composition, and price.[77]

The First Circuit Court of Appeals held that the use of the same PERUGINA label on chocolates manifesting differences in quality control, composition, configuration, packaging and price is presumptively likely to cause confusion sufficient to support a

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[74] *Ibid.* at 73.
[75] *Societe des Produits Nestle, S.A. v. Casa Helvetia, Inc.*, 982 F.2d , at 633 (1st Cir. 1992) [hereinafter *Nestle*].
[76] *Ibid.*, at 641.
[77] The district court found the following differences between the competing products: there were different procedures of quality control; the Italian-made version of one variety of chocolates, the so-called BACI, contained five percent more milk fat than the Venezuelan chocolates, and other ingredients differed between the two products; the Italian chocolates came in a greater variety of shapes; the description of the packaging differed; and the price of the products differed substantially.

Lanham Trade-mark Act claim.[78] The Court noted moreover that the defendant was unable to show that consumers did not consider these differences relevant or that retailers explained the differences to consumers.[79]

The Court, in considering price difference as a material difference, unfortunately tends to reverse the usual justifications for allowing some measure of parallel importing. Indeed, one of the purposes of the first sale doctrine is to put pressure on the trade-mark owner and on the official distributor to lower prices. The Court's decision does the opposite. It is also doubtful that price differences lead to consumer confusion or deceit.

While the definition of the material difference standard in *Original Appalachian Artworks* and in *Nestle* goes rather far, it does seem to be defensible. This is hardly the case with regard to the ruling in *Martin's Herend Imports v. Diamond & Gem Trading USA, Co.*.[80] It has been said that the Fifth Circuit Court of Appeal's decision in this case grants U.S. trade-mark owners the greatest possible protection against grey market goods and thereby undermines the purpose behind the material differences standard itself, which is intended to place reasonable limits on the territoriality of trade-mark law.

In *Herend*, the Court adopted a broad interpretation of material difference, a definition that included mere differences in style between high-end products and their grey market counterparts. Herendi, the foreign manufacturer of luxury porcelain figures, registered its mark "Herend" in the United States and entered into an exclusive distributorship agreement with the United States company, Martin's Herend Imports (MHI).[81] The owners of Diamond & Gem Trading USA, Co. (Diamond & Gem), the Juhaszs, obtained

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[78] *Nestle, supra*, note 75, at 644.
[79] *Ibid.*, at 644.
[80] *Martin's Herend Imports, Inc. v. Diamond & Gem Trading USA*, Co., 112 F.3d 1296 (5th Cir.1997).
[81] *Ibid.*, at 1298.

genuine Herendi goods bearing the mark from several sources and sold the figurines in the United States.[82]

In finding a material difference, the Court first noted that the goods offered for sale by Diamond & Gem were not all offered for sale in the United States by MHI.[83] The Court proceeded to note the minor stylistic differences between the authorized and the grey goods.[84] For example, some of the figurines were of different shapes and were painted with different patterns and colors.[85] The Court concluded that these differences were material as a matter of law because "consumer choices for such artistic pieces are necessarily subjective or even fanciful, depending on each consumer's personal artistic tastes."[86]

This holding is highly open to criticism. By allowing the plaintiff to maintain the territorial integrity of its trade-mark, the Court failed to strike a proper balance between the interests of trade-mark holders and consumers based on the policies behind trade-mark law. As it was neither obvious how consumers could have been misled about the origin of the goods nor clear that they were of a lower quality, the approach taken by the Court is absolutely anti-competitive in that it amounts to a denial of product choice to American consumers.

On February 24 1999, the U.S. Customs Service responded by issuing a final rule amending the Code of Federal Regulations to restrict the importation in certain circumstances of grey market goods that are "physically and materially different" from goods authorized for sale by the U.S. trade-mark owner. [87] As expected, the Customs Service largely adopted the proposed rule that it had issued in March 1998. The new

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[82] *Ibid.*
[83] *Ibid.*, at 1302.
[84] *Ibid.*
[85] *Ibid.*
[86] *Ibid.*
[87] 64 C.F.R. 9058 , amending 19 C.F.R. 133.

regulation became effective on March 26, 1999. As the new regulation has its roots in the 1993 *Lever Brothers* case,[88] we will first discuss that case.

In *Lever Brothers*, the merchandise involved was deodorant soap and dishwashing liquid manufactured by Lever's related enterprise in the U.K.. Lever Brothers, the producer of the domestic goods win the U.S. as a wholly-owned U.S. subsidiary of Unilever United States, Inc., which was itself a wholly owned subsidiary of the Dutch Unilever N.V.. The imported goods were produced by Lever UK, a subsidiary of British Unilever PLC, which was affiliated with Unilever N.V. The marks were identical; however, there were material differences between the products produced by the U.S. subsidiary from those produced by the British subsidiary, because they were tailored to specific national tastes and conditions. The dishwashing detergent produced under the "Sunlight" mark in the U.K. was designed for water with a higher mineral content than that found in the U.S. and did not perform as well in the U.S. as the U.S. "Sunlight" product. The deodorant soap produced under the "Shield" mark in the U.K. also performed differently in the U.S. than the U.S. version. There were specific findings of fact that consumers were confused as to the qualities of the products and had complained to the U.S. producer.

Lever Brothers sought the assistance of the Customs Service to bar the importation pursuant to section 42 of the *Lanham Trade-mark Act*. The U.S. Customs Service denied seizure of the grey market imports, citing *Tariff Act* regulations[89] that permit entry of grey market goods whenever the U.S. and foreign trade-mark owners are the same or affiliated entities. [90]

Lever Brothers brought suit against the Customs Service, claiming that the UK products violated section 42 of the *Lanham Trade-mark Act* and thus were subject to seizure without regard to the affiliated company exception. The U.S. Court of Appeals for the

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[88] See *Lever*, *supra* note 62.
[89] 19 CFR 133.21(c).
[90] See *Lever*, *supra* note 62, at 1331.

District of Columbia Circuit found in favor of Lever Brothers and ordered the Customs Service to seize the grey market soap products.[91] The Court noted several prior cases in which courts found differences in the imported product to justify excluding merchandise from the U.S. market on the basis of the *Lanham Act*.[92] Based on these cases, the Court concluded that material physical differences in a grey-market product meant that the trade-mark applied to it "copies or simulates" the U.S. trade-mark. The Court ruled that because the UK products were manufactured using a different formula, they were "materially" and "physically" different from similarly trade-marked products intended for sale in the United States. These "material differences" were sufficient to render the goods "non-genuine" from the perspective of a U.S. consumer and thus in violation of the *Lanham Act*.

Significantly, the Court rejected the affiliated company exception as a bar to seizure, holding that the regulation does not apply to violations of the *Lanham Act*, even in cases involving grey market imports. In sum, the Customs Service cannot indiscriminately apply the affiliate exception upheld in *K-mart* to the extent that the plain meaning of section 42 of the *Lanham Act* conflicts with the agency interpretation of section 526 of the *Tariff Act*.

Shortly after the Lever Brothers decision, the Coalition to Preserve the Integrity of American Trade-marks (COPIAT) submitted a proposal to the Customs Service containing draft regulations to implement the *Lever Brothers* decision. COPIAT's proposed test was intended to encompass not only observable physical differences, but also differences in things like quality control, storage and handling, adherence to shelf-

[91] See *Lever*, *supra* note 62.

[92] See *Appalachian*, *supra* note 62: Spanish-language "adoption papers" in Cabbage-Patch Kids dolls and lack of system to send "birthday cards" to dolls violated § 32 (1)(a) of Lanham Act, 15 U.S.C. § 1114(1)(a), which prohibits use of a trade-mark where it "is likely to cause confusion, or to cause mistake, or to deceive".

life limitations, warranty protection and return policies. The Customs Service rejected COPIAT's proposals and issued its revised "Final Rule" on February 24, 1999.[93]

The final rule contains guidelines for determining whether grey market products produced by a company affiliated with the U.S. trade-mark owner are eligible for seizure, a description of the process for obtaining such "Lever-rule" protection and an exemption for grey market imports that bear a specified label notifying consumers that physical and material differences exist. Rather than adopting a definition of "physically and materially different" goods, the Final Rule provides categories of information that the Customs Service will use as non-exclusive "guidelines" for determining whether certain trade-marks are eligible for Lever-rule protection. These categories include:

(a) the specific composition of both the authorized and grey market product(s) (including chemical composition);

(b) formulation, product construction, structure, or composite product components, of both the authorized and grey market product;

(c) performance and/or operational characteristics of both the authorized and grey market product;

(d) differences resulting from legal or regulatory requirements, certification; and

(e) other distinguishing and explicitly defined factors that would likely result in consumer deception or confusion as proscribed under applicable law.[94]

The US Customs Service will publish in the Customs Bulletin a list of those products for which Lever-rule protection has been requested, together with summaries of physical and

[93] 64 C.F.R. 9058

[94] 19 C.F.R. 133.2(e)(1)-(5).

In order to obtain Lever-rule protection, owners of U.S. registered trade-marks currently recorded with the Customs Service may submit requests to Customs for Lever-rule protection. According to 19 C.F.R. 133.2(e) the application must include:

(a) a detailed description of any physical and material differences between the specific articles authorized for importation or sale in the United States and those not so authorized;

(b) "competent evidence" to support claims of physical and material differences; and

(c) a summary of physical and material differences for Publication.

material differences. Customs will then examine the request and issue a determination whether grey market protection is granted. If an application for Lever-rule protection is granted, subsequent imports of physically and materially different products will presumptively be detained under existing regulations.

However, such detention will not occur, despite the existence of "physical and material differences", if the product bears a "conspicuous and legible label" designed to remain on the product until the first point of sale to a retail consumer in the United States stating that: "This product is not a product authorized by the United States trade-mark owner for importation and is physically and materially different from the authorized product." This label must be "in close proximity to the trade-mark as it appears in its most prominent location on the article itself or the retail package or container."[95] According to the Customs Service, the foregoing label will eliminate the likelihood of consumer confusion that forms the basis of trade-mark infringement under the *Lever Brothers* case and will offer greater protection and product differentiation than what currently exists.

The Lever-rule in the U.S. Final Rule bears virtually no resemblance to the legal standard applied in the previous case law. Under the final Lever rule the threshold of materiality is high. The narrow list of physical differences deemed material significantly limits the type of trade-marked goods eligible for protection because it presumably excludes differences in quality control, labeling, packaging and product selection.

In addition, the labeling exemption adopted by the Customs Service can be inadequate to eliminate consumer confusion.[96] Significantly, the required labeling language does not inform the consumer as to how the grey market import differs from the genuine product. Moreover, even if the labeling language were sufficient to dispel consumer confusion,

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[95] 19 C.F.R. 13323(b).
[96] See Charles E. Buffon, Laurie C. Self, Ronald G. Dove, "U.S. Customs service issues final rule regarding 'Pysically and materially different' gray market import." www.cov.com/publications/LEVERAGE.PDF

there is no guarantee that products will reach the consumer with their labels intact. Although the label must be designed to remain on the product until the first point of sale to a retail consumer, there is nothing to prevent the distributor or retailer from removing the label after entry into the country. Accordingly, in many instances, the requirement of a label will not afford much protection to the lawful trade-mark owner or avoid consumer confusion. Further, there is no requirement that the grey marketer identify himself on the label. Thus, the only identifiable information associated with the grey market product is that of the trade-mark owner or his mark. Without information about the grey marketer on the label, the consumer is unable to hold the proper party accountable for the inferior or dissatisfying quality of the product.

While the approach adopted by the Customs Service appears to be on many points flawed and defective, it may in some instances offer significant protection to U.S. trade-mark owners where there are clear physical differences in the domestic and foreign products at issue, and where labeling may prove prohibitively expensive or otherwise undesirable to the grey market importer.

3. Conclusion

The conditions under which grey-market goods have been excluded by the American courts implement the territorial nature of trade-mark registration, and reflect a legal recognition of the role of domestic business in establishing and maintaining the reputation and goodwill of a domestic trade-mark.

Until the Supreme Court's decision in *A. Bourjois & Co. v. Katzel*, the prevailing rule in the United States was that the authorized sale of a validly trade-marked product, anywhere in the world, exhausted the trade-mark's exclusionary right. Thus the holder of the corresponding registered United States trade-mark was believed to have no right to bar the importation and sale of authentically marked foreign goods. However, in the

Katzel case the Court recognized the territorial boundaries of trade-marks, stressing that the reputation and goodwill of the holder of the corresponding United States mark warrants protection against unauthorized importation of goods bearing the same mark, although the mark was validly affixed in the foreign country.

Since the *Katzel* decision, the regional and federal circuit courts have drawn a variety of distinctions in applying grey market jurisprudence. This has been done primarily in consideration of whether the foreign source of the trade-marked goods and the United States trade-mark holder are related commercial entities and whether the imported goods bearing the foreign mark are the same as (or not materially different from) the goods that are sold under the United States trade-mark. In doing so, the courts are applying a standard of materiality suitable to considerations of consumer protection and support for the integrity of the trade-marks of domestic purveyors, all with due consideration to the territorial nature of registered trade-marks in the context of international trade. These decisions implement the reasoning that the consuming public, associating a trade-mark with goods having certain characteristics, would be likely to be confused or deceived by goods bearing the same mark but having materially different characteristics. This confusion or deception would also erode the goodwill achieved by the United States trade-mark holder's business.

As we have seen, the courts have applied a low threshold of materiality, requiring no more than showing that consumers would be likely to consider the differences between the foreign and domestic products to be significant when purchasing the product, for such differences would suffice to erode the goodwill of the domestic source. As explained in *Nestle*, "[a]ny higher threshold would endanger a manufacturer's investment in product goodwill and unduly subject consumers to potential confusion by severing the tie between a manufacturer's protected mark and its associated bundle of traits."[97]

[97] 982 F.2d at 641, 25 USPQ2d at 1263.

Following the *Lever Brothers* case, the U.S. Customs Service has adopted in 1999 a Final Rule containing guidelines for determining whether certain goods have to be considered materially different. It thus remains to be seen whether or not the courts will change their approach towards a more stringent definition of the material difference standard, given the existence of the Final Rule and the *Lever Brothers* case.

Chapter 3: The legal regime in Canada

In Canada, the issue of parallel importation of trade-marked goods is complicated by the coexistence of two types of actions concerning trade-mark violation: the action for passing off [98] (2) and the action for trade-mark infringement (1). The former has its source in common law, while the latter is based on the *Trade-mark Act* [99] and is only available to the registered owner of a trade-mark or the registered user.[100]

Whereas in the United States the statutory law follows closely the common law, in Canada the *Trade-Mark Act* has departed in significant ways from the common law. The passing off and the trade-mark infringement actions in Canada are not based on the same rationales. Whereas the common law action for passing off is based on deception of the public that is likely to injure the plaintiff, the statutory action is based on an invasion of the plaintiff's right to exclusive use of his registered trade-mark.

1. Action for trade-mark infringement

Although the *Trade-Mark Act* does not contain any specific provision regulating parallel importation, some authors claim that a trade-mark owner can obtain a total ban under sections 19 and 20 of the *Trade-Marks Act.*[101] Section 19 of the *Trade-Marks Act* gives to the owner of a valid registered trade-mark, the exclusive right to use the trade-mark throughout Canada in respect of the goods or services for which the trade-mark has been

[98] The action of passing off arose to prevent unfair trading and was developed by the common law. In Canada section 7 of the *Trade-marks Act* codifies the tort of passing off.
[99] R.S.C. 1985, c. T-13, ss. 19-20.
[100] The latter possibility is no longer feasible in Canada since the abolition of the Register User System and its substitution by a license to use system. See the *Intellectual Property Law Improvement Act*, S.C.1993, c.15, s.69.
[101] P.A. Dubois, "I.P. Rights v. Grey: Who Wins in Canada" (1992) 9 C.I.P.R. 244; J. Clark, "Intellectual Property and Transfer of Technology: Cross border Transactions.", *Meredith Memorial Lectures*, McGill University, April 1994, at p. 188.

registered.[102] Section 20 of the *Trade-Marks Act* provides that the right of the owner of a registered trade-mark shall be deemed to be infringed by a person not entitled to its use who sells, distributes or advertises wares or services in association with a confusing trade-mark or trade name.[103]

If at first glance it would appear that the *Trade-Marks Act* does provide a simple basis for combating parallel importation, the situation is more subtle and complex. First, attempts by trade-mark holders to rely on their exclusive right to use have proved to be inefficient when it was considered that their trade-marks were associated by the public with another source.[104] The *Heinz* decision[105] confirmed that the only solution to prevent grey marketing lies in the early establishment of a separate and independent Canadian operation to protect the distinctiveness of the trade-mark. The concept of distinctiveness in the Canadian case law, as in the American *Katzel* case,[106] has been used in association with the creation of an independent local goodwill enabling the trade-mark owner to ban parallel imports.

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[102] Section 19 states:

> Subject to sections 21, 32 and 66, the registration of a trade-mark in respect of any wares or services, unless shown to be invalid, gives to the owner the exclusive right to the use throughout Canada of such trade-mark in respect of such wares or services.

[103] Section 20 provides:

> The right of the owner of a registered trade-mark to its exclusive use shall be deemed to be infringed by a person not entitled to its use under this Act who sells, distributes or advertises wares or services in association with a confusing trade-mark or trade name, but no registration of a trade-mark prevents a person from making
> (a) any bona fide use of his personal name as a trade name, or
> (b) any bona fide use, other than as a trade-mark,
> (i) of the geographical name of his place of business, or
> (ii) of any accurate description of the character or quality of his wares or services, in such a manner as is not likely to have the effect of depreciating the value of the goodwill attaching to the trade- mark.

[104] *Wilkinson Sword (Canada) Ltd. v. Juda*, (1967) 51 C.P.R. 55; [1968] 2 Ex.C.R. 137 [hereinafter *Wilkinson*]; *Breck's Sporting Goods Co. Ltd. v. Magder*, (1975) 17 C.P.R. (2d) 201[hereinafter *Breck's*].

[105] *H.G. Heinz Company of Canada Ltd.* v. *Edan Foods Sales Inc* (1991) 35 C.P.R. (3d) 213 (F.C.T.D) [hereinafter *Heinz*].

[106] *Katzel, supra*, note 35. The Court found that the distributor had developed a distinct trade-mark which was connected with his products and not with those of the French manufacturer.

Second, in most of the judgments where a ban has been obtained, consumer confusion or misrepresentation was established.[107] The courts in the last ten years have however shifted their position in two important judgments. The *Mattel* judgment,[108] although not departing from the territorial doctrine, supported the proposition that an action for infringement may succeed even in the absence of conclusive evidence of public deception. The idea that one of the trade-mark registration's goals is the prevention of free riding has been challenged by the recent *Coca-Cola* judgment[109] of the Federal Court of Appeal. Recognizing the exhaustion doctrine, the Court has significantly curtailed the possibility of trade-mark infringement action against grey marketers since it decided that the resale of legitimate goods could not constitute trade-mark use susceptible to deceive consumers as to the provenance of the goods.

One of the first Canadian cases dealing with the association of the concept of distinctiveness and the creation of a local goodwill has been the *Wilkinson* judgment.[110] In this case, the Canadian distributor of Wilkinson Sword razor blades commenced action against an unauthorized distributor who had purchased genuine Wilkinson Sword razor blades in Great Britain and imported them into Canada. The trade-mark registration for Wilkinson Sword originally was owned by Wilkinson Sword Limited ("Wilkinson Sword U.K."), the British manufacturer, and they were distributed in Canada by Wilkinson Sword (Canada) Ltd. ("Wilkinson Sword Canada"), the Canadian subsidiary of the British firm. In order to meet the defense of license, prior to commencing suit against the grey goods importer, Wilkinson Sword U.K. transferred in 1965 the Canadian trade-mark registration for Wilkinson Sword to Wilkinson Sword Canada.

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[107] *Remington Rand Ltd. v. Transworld Metal Company Ltd,* (1960) Ex. C.R. 463; [hereinafter *Remington*]. The Court determined that there was a likelihood of confusion in connection with the warranties.
[108] *Mattel Canada Inc v. G.T.S Acquisitions and Nintendo of America Inc* (1989), 27 C.P.R. (3rd) 358 (F.C.T.D.) [hereinafter *Mattel*].
[109] See *Coca-Cola , supra* note 23.
[110] *Wilkinson, supra,* note 104.

The Court declined to lift the corporate veil and treated Wilkinson Sword U.K and Wilkinson Sword Canada as separate entities for the purposes of the case.[111] However, the Court concluded that the trade-mark registration, in the hands of Wilkinson Sword Canada, was invalid for lack of distinctiveness because the trade-mark in fact signified the goods of the British parent rather than the Canadian registrant.

The same conclusion was found to apply in *Breck's Sporting Goods Co. Ltd.* v. *Magder*.[112] The Canadian trade-mark owner of fishing equipment manufactured in France and bearing the trade-mark MEPPS was the exclusive distributor in Canada of that product. The parallel importer sold genuine French fishing equipment bearing the same trade-mark in Canada.

The Supreme Court of Canada, confirming the Federal Court of Appeal, found that, according to section 2 and 18(1) of the *Trade-marks Act,*[113] the trade-mark MEPPS was invalid in the hands of the exclusive Canadian distributor, because the trade-mark was understood by the public to be a manufacturer's mark of an anonymous French source, and not the trade-mark of the registrant Breck's.[114]

The *Wilkinson Sword* and *Breck's* cases cast a pall over the use of trade-mark registrations for controlling parallel importation, which has lasted to this day.[115] As one

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[111] The problem of lifting the corporate veil in grey goods cases was discussed in *Colgate-Palmolive Ltd. v. Markwell Finance Ltd.*, (1989) R.P.C. 497 at p. 523. There, Justice Slade was dubious whether the Court should treat parent and subsidiary as one entity unless the subsidiary was acting as the agent of the parent, but he found it unnecessary to express any final view on the point.

[112] *Breck's, supra*, note 104.

[113] The registration of a non-distinctive trade-mark is invalid. If the Canadian public associates the trade-mark with the foreign assignor, the mark is not distinctive of the Canadian assignee and the registration is invalid. See See Picard *supra* note 18 at 423.

[114] It is interesting to read the comparison made with the American case *Katzel* by G.S. Takach in "Passing-Off, Trade-mark Protection and Parallel Imports After Consumers Distributing v. Seiko" (1985) 63 Can. Bar Rev 645, at 654, [hereinafter Takach].The author points out that in the American case the Court found that the distributor had developed a distinct trade-mark, which was connected with his products and not with those of the French manufacturer.

[115] R. Hayhurst, "The Vulnerability of Trade-marks Associated in Canada With More Than One Source", (1977) 67 TMR 169.

can see, life was being made difficult by Canadian courts for exclusive contractual distributors, even when they owned a trade-mark registration. Normally, exclusive distributors have no trade-mark interest in the product they distribute. The financial and administrative commitment of these distributors is however substantial since they have the obligation to maintain a trained sales staff, produce promotional materials and others, expenses unknown to grey marketers. Exclusive distributors are vulnerable to parallel importers who benefit from their advertising and promotion expenses.

More recently, a decision by the Trial Division of the Federal Court of Canada in *H.G. Heinz Company of Canada Ltd.* v. *Edan Foods Sales Inc.*[116] confirmed that the only solution to prevent grey marketing of legitimate goods lies in the early establishment of a separate and independent Canadian operation to protect the distinctiveness of the trade-mark.

Heinz Canada was asking for an interlocutory injunction restraining Edan Foods from infringing its registered trade-marks for ketchup by importing in Canada ketchup produced by Heinz U.S., the plaintiff's parent company. The Heinz trade-marks had been used in Canada by the U.S. company from 1909 until 1940 when they were assigned to Heinz Canada, upon its incorporation. Since then, Heinz Canada advertised its own ketchup which is made in Canada in accordance with the taste preferences of the Canadian public. The packaging was specifically designed with the characteristics of the Canadian market in mind.

Dealing with a motion for an interlocutory injunction, Justice Cullen merely had to find that plaintiff had satisfied the "serious issue to be tried" test before considering irreparable harm and balance of inconvenience. The Court found that there was a serious issue to be tried, relying on sections 19, 20 and 6 of the *Trade-marks Act* and the

[116] *Heinz, supra*, note 105. For a comment on this decision see Joseph F. Caruso "Claiming Trade-mark Infringement as a Means to Stop Grey-Marketing: H.J. Heinz Co. of Canada Ltd. v. Edan Food Sales Inc." (1992) 5 Can – U.S. Bus. L. Rev. 183

Remington case.[117] Plaintiff had a registered trade-mark and a presumption of infringement exists if a person not authorized by the owner uses trade-mark likely to create confusion with a registered trade-mark, as defined by section 6 of the *Trade-marks Act*. The balance of inconvenience was held to favour the plaintiff because the defendant had no investment in the sale of imported ketchup in Canada and did not need to keep a large inventory. The plaintiff was found to have made a large investment to attain its position in the Canadian ketchup market.[118] Sales of ketchup were found to constitute a substantial portion of the plaintiff's sales, while the same was not found to be true of the defendant.

Summarizing the above, it appears that the only solution to prevent grey marketing of legitimate goods lies in the early establishment of a separate and independent Canadian operation exclusively dealing in the products within the territory and understood as such by the consumers, to protect the distinctiveness of the trade-mark. In such circumstances, the Canadian operation should preferably from the start or as early as possible become owner of the registered trade-mark.

In the 1960's, when grey marketing was not as popular as it is today, it was believed that ownership of a trade-mark by a Canadian operation would, in all cases, be sufficient to prevent grey marketing. This position has been evidenced in an early example of the use of registered trade-marks to control parallel importation, the *Remington Rand Ltd. v. Transworld Metal Company Ltd* case.[119] There, electric razors marked with the trade-mark REMINGTON were imported into Canada and sold in competition with electric razors distributed in Canada by the plaintiff, who was a subsidiary of the U.S. manufacturer of the goods. The wares were not originating from the plaintiff but from a

[117] *Remington, supra*, note 107.
[118] It seems that when a Canadian distributor is the registered trade-mark owner and has developed goodwill associated with the trade-mark in the Canadian marketplace, the courts tend to protect its interest.
[119] *Remington, supra*, note 107.

common manufacturing source in the United States. The Canadian trade-mark registrations were owned by the plaintiff, not its U.S. parent.

Notwithstanding the fact that both the plaintiff and the defendant sold in Canada goods made by the same manufacturer, namely the parent company of the plaintiff, the Court found that the defendant was guilty of trade-mark infringement. The Court here relied on the reasoning presented in the first passage of the English case *Dunlop Rubber Company v. A.A. Booth & Co. Ltd.*.[120] The ruling of the Court in *Remington* strongly embraced the doctrine of territoriality leading to a market segmentation Also, commenting on the balance of convenience, the Court found a likelihood of confusion in that a purchaser of razors imported by the defendant could be led to think that they had been put on the market and warranted by the plaintiff. As a result, it was held that the plaintiff was likely to suffer injury to its goodwill. This standard can be compared to the one adopted in the United States in the *Appalachian* [121] and in the *Nestle* [122] cases.

The *Mattel Canada Inc v. G.T.S Acquisitions and Nintendo of America Inc.*[123] case contrasts with the previous case law as it supports the position that an action for trade-mark infringement can succeed even in the absence of conclusive evidence of public deception. In this case the goods were made by Nintendo Co. Ltd. ("Nintendo Japan"), but the trade-mark was owned by Nintendo of America Inc. ("Nintendo U.S.A."), a wholly owned subsidiary of Nintendo Japan. Nintendo U.S.A. was the exclusive distributor of Nintendo products in North America. In 1986, Mattel Canada was appointed as the exclusive Canadian distributor of Nintendo products by Nintendo

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[120] *Dunlop Rubber Company v. A.A. Booth & Co. Ltd*, (1926), 43 R.R.C. 139 (Ch.D.). the Court stated that tires manufactured by Dunlop France and marketed under the Dunlop trade-mark could not be imported in England where Dunlop UK was manufacturing tires under the same trade-mark because the differences in the sources would amount to a trade-mark infringement in the absence of consent by the right holder.

[121] *Appalachian, supra* note 62. The Second Circuit Court of Appeal interpreted material difference as that which causes consumer confusion or deception with the goods.

[122] *Nestle, supra* note 75. The First Circuit Court of Appeal interpreted material difference to mean any differences which the consumer would consider relevant when purchasing a product.

[123] *Mattel, supra*, note 108.

U.S.A., and since then Mattel Canada engaged in a massive marketing and advertising campaign to promote the sales of Nintendo products in Canada, with impressive results. Nintendo products sold in Canada by Mattel Canada were made and packaged in Japan, with English and French printing.

Commencing early in 1989, Mattel Canada began to notice certain instances of parallel importation of Nintendo games from the United States, despite the fact that Nintendo U.S.A. was required to prohibit its distributors and dealers from selling games for export from the United States. The defendant was shown to have acquired Nintendo video games obtained from sources in the United States, and to have resold them in Canada. The two products were physically identical and were made by the same company, the only difference being that the U.S. product was available with the packaging and the instructional material in English only. The warranty offered against all defects did not apply to U.S. products and Mattel Canada had to explain to the public that it could not be held responsible for the U.S. video games. This affected its credibility and its capacity to meet its minimum sales contractually agreed to with its U.S. principal. Also, despite the fact that Mattel Canada's warranty did not apply to the U.S. games, the plaintiff received numerous "hot line" calls from Canadian purchasers of U.S. Nintendo games, apparently in the mistaken belief that Mattel Canada was responsible for them.

The Federal Court, Trial Division, was called upon to consider this situation in 1989.[124] The plaintiff filed an application for an interlocutory injunction restraining the defendant, GTS Acquisitions, from infringing the Nintendo trade-marks, that is from dealing with any Nintendo games which did not emanate from Mattel. As the case was founded on the basis of trade-mark infringement, Mattel Canada claimed that its exclusive rights under the trade-mark registration for Nintendo had been infringed, entitling it to an injunction

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[124] *Ibid.*

irrespective of any disclaimer. Nintendo U.S.A. was named as a party defendant.[125] The defendant argued that there could be no infringement of the Nintendo trade-marks when used in association with the genuine goods supplied by the actual owner of the mark.[126] As well, following the reasoning in *Breck's*,[127] the defendant claimed that the goodwill was associated directly with Nintendo.

Citing with approval the *Remington* case, the Court found that Mattel Canada was entitled to the exclusive use of the trade-mark Nintendo in Canada as evidenced by its status as exclusive registered user, and that these exclusive rights had been violated by the unauthorized sales of Nintendo products imported from the United States. Accordingly, the Court issued a broad injunction against the defendant. Had the action been brought by the owner of the Nintendo mark (Nintendo U.S.A.), there would have been no infringement, because it "would be somewhat ridiculous to assert infringement or passing off when the defendant is dealing with the owner's own wares."[128]

Thus, the Court in *Mattel* followed the territorial theory. This approach is based on the assumption that the exclusive rights under a trade-mark registration can be infringed regardless whether there is any confusion or deception as to the source. Accordingly, the Court saw no difficulty in permitting trade-mark rights to be carved up territorially and took the position that the wares sold by Mattel Canada were not the wares of the trade-mark owner. It did not matter that Nintendo Japan was the common source. It remains however a serious question as to whether a Canadian trade-mark registration can be infringed by the sale of genuine goods obtained from the trade-mark owner or a source

[125] Under section 50 (4) of the *Trade-marks Act*, subject to any agreement subsisting between the parties, a registered user of a trade-mark may call upon the owner to take proceedings for infringement, and, if the owner refuses or neglects to do so within two months after being so called upon, the registered user may institute proceedings for infringement in his own name as if he were the owner, making the owner a defendant.
[126] See J. C. Cohen & A. J. Finlayson, "Trade-mark Potpourri : Recent Developments in the Law of Passing-Off and Unfair Competition" (1992) 9 Can. Intell. Prop. Rev. 56, at 61 [hereinafter Cohen].
[127] See *Breck's supra* note 104.
[128] *Mattel, supra* note 108, at 362.

approved by the trade-mark owner. The reason why exclusive rights are granted to the owner of a valid registered trade-mark under section 19 of the *Trade-Mark Act* is to prevent confusion in the public. That is the main purpose of the statute as a whole. Also, sections 19 and 20 of the *Trade-Mark Act* must be read together, and in this light it is clear that likelihood of confusion, which is the basis for infringement under section 20, logically must also apply to section 19. Thus, a Canadian trade-mark registration should be regarded more as an evidentiary right than a novel property right that is both independent of and larger than the common law rights upon which it depends.

The territorial approach of *Mattel* leading to market segmentation[129] has been challenged recently by the *Coca-Cola Bottling Ltd. v. Musaadiq Pardhan et al.* [130] decision of the Federal Court of Appeal, which once again addressed the question of exhaustion of trade-mark rights. The Court had to consider whether the export from Canada of Coca-Cola products packaged and labeled for sale only in Canada constitutes trade-mark infringement and depreciates the value of the goodwill attached to this trade-mark. The plaintiffs, the Canadian owner of the Coca-Cola trade-mark and its Canadian licensee-manufacturer, brought an action against the defendants, who distributed, stored, shipped, transshipped and exported from Canada products manufactured by the Canadian licensee. The plaintiffs pleaded that the sale of goods outside Canada by the defendants constitutes a violation of the license agreement between the trade-mark owner and its Canadian licensee and was a violation of the trade-mark rights of those who own the mark in other jurisdictions. The plaintiff also pleaded that the products being transshipped by the defendants were packaged and labeled only for sale in Canada and that the defendant had failed to ensure that the products were labeled for the countries receiving them. These acts, according to the appellants, caused deception and confusion between the unauthorized use of the Coca-Cola trade-marks by the defendants and the legitimate use

[129] H.Knopf, "Trade-marks Laws and the free flow of goods in Canada", in G.F. Henderson, "*Trade-Marks Law of Canada*", Scarborough, Ont, Carswell, (1993), p. 33-376, at 366.- "To conclude this assessment, it is fairly apparent that the Canadian courts are going in the general direction of market segmentation, although there is considerable uncertainty in the state of jurisprudence in Canada."
[130] See *Coca-Cola supra*, note 23.

of the Coca-Cola trade-marks, thus infringing these companies' trade-mark rights and depreciating their goodwill.

The defendants argued that their activities did not amount to actionable use under the Act, invoking the doctrine of exhaustion of rights. The Court agreed. In Justice Strayer's words,

> [o]nce the appellants' goods, bearing the appellants' trade-mark, were sold by them in the course of trade, subsequent resale of those same goods bearing the same trade-mark could not constitute use or actionable use.[131]

The Court, whose previous jurisprudence has emphasized deception as a necessary element of infringement shifted its position. Although agreeing that "the essence of the law of trade-marks is to prevent deception as to the provenance of goods or services where the originator of those goods or services has adopted a distinguishing mark for them", the Court stated that "the re-sale of goods manufactured by a trade-mark owner, bearing the trade-mark of the manufacturer, cannot realistically be said to be a use by the vendor to deceive the purchaser as to the provenance of the goods". As such, it cannot be the basis for an infringement action based on section 19 of the Act which confers on the trade-mark owner the exclusive right to use the trade-mark to identify his goods.

The court was not swayed by the plaintiffs' arguments that subsection 4(3) of the *Trade-Marks Act*, which deems the export of goods bearing a trade-mark to constitute use of the trade-mark within Canada, supported the proposition that the defendants' activities constituted use of the Coca-Cola trade-mark in Canada. The court held that the purpose of subsection 4(3) was to enable Canadian producers who do not make local sales, but simply ship their goods abroad, to show use in Canada for the purposes of obtaining registration of their trade-mark in Canada (and presumably, assert rights against infringers in Canada). The Court was not prepared to interpret subsection 4(3) as having

[131] *Coca-Cola supra* note 23, at 495.

the effect of creating a use within the meaning of the Act for genuine goods of the trade-mark owner being shipped from Canada.

The Court of Appeal also rejected the plaintiffs' arguments that section 8 of the Act precluded the defendants from relying on the doctrine of exhaustion. This section provides that every person, who in the course of trade transfers goods in association with a trade-mark is, unless before the transfer it expressly states in writing, deemed to warrant to the person to whom the property is transferred that the trade-mark has been and may be lawfully used in connection with the wares. Coca-Cola attempted to argue that, if the owner of the trade-mark has given notice to a defendant that it restricts the use of the product, the rights of the owner to sue for infringement remain unimpaired. The Court found that for this provision to apply and the warranty to be enforceable, there must be privity of contract between a plaintiff and a defendant. No such relationship had presently been alleged.

For all those reasons, the Court was of the view that the appellants' allegations did not reveal a reasonable cause of action before it, and dismissed the appeal. In light of the decision in *Coca-Cola*, it would appear that grey marketing can give rise to no cause of action in trade-mark infringement, since the resale of legitimate goods does not constitute trade-mark use.

2. Action for passing off

Owning a trade-mark registration proves sometimes to be insufficient to stop parallel imports. However, traders need not have a trade-mark registration in order to protect the goodwill and reputation developed in their products, services and businesses. The tort of passing off remains the most comprehensive course of action for protecting goodwill, while additional statutory rights under section 7 of the *Trade-marks Act* provide for the protection of unregistered trade-marks.[132]

The evolution of commercial practices has seen the courts treat the tort in a modern context such that judicial recognition of the necessary degree of association required in the minds of the public has evolved. The "classic" scenario involved a misrepresentation as to the origin of goods or services for the purpose of diverting business. However, the tort has responded to the constant variety of commercial practices and conduct such that it broadly embraces misrepresentation for business purposes involving a reputation enjoyed by another where such misrepresentation results in confusion and deception.

Attempts have been made by authorized distributors and licensees to rely upon the law of passing-off to prevent grey marketing, when the facts showed that the public could be deceived into thinking it was getting goods provided by an authorized distributor with all the benefits attached to these goods when in fact it was not.

The landmark decision for passing-off actions in Canada was the *Consumers Distributing v. Seiko* case.[133] The plaintiff in that case was Seiko Time (Canada) Inc. ("Seiko Canada"), the exclusive Canadian distributor of Seiko watches manufactured by K. Hattori & Company Limited in Japan, the registered owner of the trade-mark. The product was marketed around the world through a distribution system consisting of authorized distributors and their authorized dealers. By contractual arrangements, Seiko Time Canada was an authorized distributor and was entitled to choose authorized dealers who would sell Seiko watches in Canada, provide the service and respect the manufacturer's warranty. The defendant, Consumers Distributing Co. Ltd., who was not an authorized dealer of Seiko watches, imported in 1978 into Canada and sold Seiko watches that it had obtained from an authorized distributor of Hattori in another country.

[132] Like s. 43(a) of the Lanham Act, s. 7(b) may be invoked in the absence of a trade-mark registration.
[133] *Consumers Distributing Co. Ltd. v. Seiko Time Canada Ltd.*, (1984), 1 C.P.R. (3d) 1[hereinafter *Seiko*] For a more detailed review of the case, see Daniel R. Bereskin, "Notes From Canada", (1981) 71 TMR 590.

The products sold by the two companies were physically identical. The watches were sold to the consumers in their original packaging, together with an instruction book and a warranty issued under the name of Hattori which stated that it was valid in any Hattori affiliated service centre. The only difference was that the guarantee booklet accompanying the watches sold by Consumers Distributing was intended for the United States and stated that the guarantee would be valid only if properly filled by an authorized dealer.

Seiko Canada started proceedings in January 1979 and was accorded an interlocutory injunction enjoining the defendant from advertising or selling Seiko watches in Canada and from holding itself out as an authorized Seiko dealer of the plaintiff by advertising and selling Seiko watches as internationally guaranteed. The defendant was as well ordered to post permanent notices in its premises to the effect that it was not an authorized distributor, that the Seiko watches on sale on the premises had not been purchased from Seiko Canada, and that they were not internationally guaranteed by Seiko Canada. The trial started in April 1980. Seiko Canada[134] based its claim on the common law doctrine of passing off. It argued that Consumers was selling only the Seiko watch, while the product sold by Seiko Canada consisted of the watch together with point-of-sale and after-sale service.

The trial judge, Justice Holland, accepted Seiko's argument that the product was composed not only of the watch but also of the point of sale service and instruction booklet, the warranty properly filled out by an authorized dealer and the after-sale service. The watches sold by Consumers Distributing were announced and sold as Seiko products. The defendant was misleading the public since it offered only one of the four elements of the "product". He also found that the common law action of passing-off applied to the present case for a number of reasons. There was a misrepresentation to the public, made by a trader in the course of trade, to prospective customers, which was

[134] Hattori did not join in the suit.

calculated to injure the business or goodwill of another trade and which caused actual damages to the business or goodwill of the trader by whom the action was brought. [135] The judge granted, *inter alia*, an injunction permanently enjoining the defendant from advertising and selling Seiko watches in Canada and awarded $5,000 for damages suffered by the plaintiff.

Consumers Distributing appealed against the ban from advertising or selling Seiko watches.[136] The appeal was dismissed for the reasons given by the trial judge and particularly because of the fact that the product marketed by the plaintiff was not simply a watch alone.

The Supreme Court[137] dissolved the injunction and approached the doctrine of passing off by taking into account the importance of competition in a market economy.[138] In the words of Justice Estey:

> The common law principles relating to commerce and trade generally proceed on the basis of a recognition of perceived benefits to the community from free and fair competition [...] [A]ny expansion of the common law principles to curtail the freedom to compete in the open market should be cautiously approached.[139]

In the light of this statement, to use the passing-off action to prohibit parallel imports would be seriously anti-competitive.

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[135] In the *Erven Warnink B.V. v. J. Townend & Sons (Hull) Ltd.*, (1979) 2 All E.R. 927 which is cited in the present case, it is said that in order to create a valid cause of action for passing-off, five characteristics must be present:

- a misrepresentation,
- made by a trader in the course of trade,
- to prospective customers of his or ultimate consumers,
- which is calculated to injure the business or goodwill of another trader,
- and which causes actual damage to a business or goodwill of the trader by whom the action is brought or will probably do so.

[136] Consumers did not appeal against the first part of the permanent injunction which restrained Consumers from holding itself out as an authorized dealer of Seiko Canada by advertising and selling Seiko watches as being internationally warranted.

[137]See *Seiko, supra* note 133.

[138] It seems that the Court was not attempting to curtail free competition in the marketplace. See Cohen *supra* note 126 at 57-58

[139] See *Seiko, supra* note 133, at 11-12.

Justice Estey, writing for the Court, found that for several reasons the conduct of the defendant did not amount to "passing-off" as the concept is known in Canada. First of all, elements such as the point of sale service and the after sale service which were offered by Seiko Time Canada for its authorized dealers only cannot be included in the definition of the "product". The defendant was selling precisely the same watch, coming from the same source, as the plaintiff. Second, restraining grey marketing of "legitimate" products could be perceived to be a restriction to the right of free competition in the marketplace. Indeed, the public would be deprived of the right to purchase Seiko watches on the alternative basis (the watch being unsupported by the manufacturer's warranty). This could have as a consequence that a monopoly would be established similar to that established by a validly issued patent except that the monopoly would be for an unlimited period of time. Lastly, there is a requirement in passing-off cases that there must be a misrepresentation or deceit of some kind to the public in terms of the quality, physical characteristics or service attached to the parallel products.[140] There is no deception or misrepresentation if the public is warned by the grey marketer of the distinctions between the service it provides and the service provided by the authorized dealer. In Seiko, there was no such misrepresentation or deceit once the defendant was ordered by the first injunction to warrant the public by way of notices posted at point-of-purchase locations that Consumers Distributing was not an authorized dealer and that the watches it sold were not internationally guaranteed by Seiko Time Canada.

After the *Seiko* decision, the tendency has been to use the doctrine of passing-off to restrain parallel imports only in the cases where the characteristics of the products would require it, such as, in the case of a very sophisticated product where regular service is necessary.[141] In such cases the additional service offered by the authorized distributor is

[140] See Picard , *supra* note 18, at 433. It is interesting how the author frames this case within the exhaustion of rights theory.
[141] See Takach , *supra* note 114, at 650.

deemed to form part of the product itself. A good example of this trend is the *Sharp v. Continental* case where safety standards were involved. [142]

The *Sharp* case involved an application for an interlocutory injunction and, like *Seiko*, was argued on the basis of passing off. The defendant had imported Sharp fax machines from the United States which bore Underwriters Laboratories stickers but not the approval stickers of Canadian testing or regulatory agencies, particularly those of the Electrical Safety Branch (ESB) of the British Columbia Ministry of Municipal Affairs, whose approval of electrical devices sold in British Columbia is mandatory. The machines were made by Sharp Kabushiki Kaisha ("Sharp Japan"). The plaintiff, Sharp Electronics of Canada Ltd. ("Sharp Canada"), the exclusive Canadian distributor of Sharp fax machines and registered user of the trade-mark Sharp, contended that the sale of Sharp grey goods by the defendant was likely to cause confusion by leading the public to believe that the Sharp fax machines sold by the defendant were approved by the same Canadian agencies as had approved the plaintiff's machines. The defendant contended that the machines it sold were identical in all material respects to those sold by the plaintiff. The defendant had not notified the public that it was not an authorized dealer appointed by Sharp Japan or that the products sold by the defendant were not warranted by Sharp Japan or by the plaintiff.

The defendant was enjoined from selling any Sharp fax machines without an appropriate notice of the kind required in *Seiko*. In addition, the Court enjoined the defendant from selling any Sharp fax machines in British Columbia not duly approved by ESB. The basis for the second injunction was that the public in British Columbia was likely to be confused into thinking that the grey goods fax machines sold by the defendant had been ESB approved, because they would assume that any fax machines sold under the trade-mark Sharp had been ESB approved. Thus, the defendant was not absolutely enjoined

[142] *Sharp Electronics of Canada Ltd. v. Continental Electronic Info. Inc.*, (1989) 23 C.P.R. (3d) 330.

from dealing with Sharp fax machines: the injunctions could be avoided by using a proper notice, and having the grey goods machines ESB approved.

The next case, *Smith & Nephew Inc. v. Glen Oak Inc*[143] was a classic example of grey marketing. The plaintiff, Smith & Nephew, was a Canadian licensee for various NIVEA trade-marks and imported the goods bearing its licensed trade-marks from the United States, where they were manufactured by Beiersdorf AG (BDF). The defendant, Glen Oak, imported and distributed face cream and soap bearing the NIVEA trade-mark from either a Mexican affiliate or subsidiary of Beiersdorf AG. Those products contained an ingredient which was not in the product sold by the Canadian licensee. Differences thus existed in source and composition of both parties' NIVEA products.

The Court of Appeal acknowledged that under section 50 of *Trade-marks Act*[144] a licensee may institute proceedings for infringement in the licensee's own name as if the licensee were the owner, making the owner a defendant. However the Court also stated that the licensee's rights could be no greater than those of its licensor. Licensor rights clearly include the right to restrict sales of counterfeit or infringing goods. However, the Court stated that:

> [g]oods which originate in the stream of commerce with the owner of a trade mark are not counterfeit or infringing goods simply because they may have arrived in a particular geographical market where the trade mark owner does not wish them to be distributed. [145]

Thus, as a Canadian licensee of BDF, the appellant could not complain of the sale of other goods which are also manufactured by or under license from BDF and bear the same trade-marks.[146] In short, the Court found there was no deception as to the origin of the goods, which were exactly what they purported to be, NIVEA creams and soaps, whose quality and character is controlled by BDF. If the respondent was distressed that

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[143] *Smith & Nephew Inc. v. Glen Oak Inc* (1996), 68 C.P.R. (3d) 153. [hereinafter *Smith & Nephew*]
[144] As it now reads since June 9, 1993.
[145] See *Smith & Nephew supra,* note 143 at p 158.
[146] *Ibid.* at 160.

the goods imported by appellants were different in quality or character from those which it was importing and obtaining from BDF, or that they were in the Canadian marketplace at lower prices in direct competition with it, its complaint had surely to be with BDF itself. There was no evidence that the appellants had obtained the goods illegally and they had no obligation either in contract or under the provisions of the *Trade-marks Act* not to compete with the respondent in the Canadian market.

Having reached this unambiguous conclusion, the Court discussed Smith & Nephew's arguments that it could assert rights to a statutory action in passing-off under Section 7 of the *Trade-marks Act* and more particularly under paragraphs 7(b) and 7(e). Dismissing paragraph 7(e) for obvious constitutional reasons, [147] the Court noted that paragraph 7(b) was of little assistance to Smith & Nephew in the circumstances of its case. If there was no doubt that Glen Oak and Dylex were directing attention to the wares they sold in a way which could cause confusion with the wares sold by Smith & Nephew; the wares in question, in both cases, were not those of Glen Oak and Dylex or Smith & Nephew, but rather those of BDF, the owner of the trade-mark and the goodwill associated with it. Therefore, the statutory passing-off action like its common law counterpart could only be brought by BDF as the owner of such goodwill. The Court therefore allowed the appeal and dismissed Smith & Nephew's application for an interlocutory injunction.

The Court's decision is a confirmation that Canada is a country where free competition is the rule and monopoly the exception: when goods distributed are legitimate, whatever their source in a trade-mark owner's various affiliates, licensees or exclusive distributors[148] of products in Canada ought to raise the issue of grey market goods with the trade-mark owner abroad rather than applying for injunctions before the Federal Court of Canada.

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[147] The Supreme Court decision *McDonald v. Vapor Canada Ltd.*,[1977] 2 R.C.S., 134, declared section 7(e) *ultra vires*.

[148] The Federal Court of Appeal has not, however, explored the issues arising if the Canadian distributor/manufacturer is also the trade-mark owner.

3. Conclusion

The Canadian case law seems to have adopted recently a liberal approach towards parallel imports. Although legal responses in Canada to the issue of parallel imports seem to be somehow ambiguous and scattered, some conclusions can be drawn.

In case of an action for trade-mark infringement, the Canadian trade-mark owner must have become distinctive, that is the Canadian trade-mark owner must be able to prove that he used his trade-mark in association with an independent, local goodwill. As seen above some doubts have been cast by the *Cola-Cola* decision on the ability of trade-mark registration to prevent parallel imports. Recognizing the exhaustion doctrine, the Court has significantly curtailed the possibility of trade-mark infringement action against grey marketers since it decided that the resale of legitimate goods could not constitute trade-mark use susceptible to deceive consumers as to the provenance of the goods.

In case of an action for passing off, it would seem, by virtue of the *Smith & Nephew*, that only the trade-mark owner, the owner of the goodwill, could be successful in a passing-off action for grey marketing. The Federal Court of Appeal has left open the issues arising in cases where Canadian trade-mark rights are owned by the Canadian manufacturer and/or distributor. Accordingly, an action in passing-off might be available when the plaintiff is both the registered trade-mark owner and the Canadian manufacturer, particularly when the Canadian products are specifically designed for the Canadian market.

Chapter 4: The legal regime in the European Union

More than three decades ago the European Court of Justice gave its first judgment on parallel importation.[149] There are few topics in European intellectual property law that have aroused a similar interest in legal literature and given rise to such amount of case law.[150] The importance and complexity of the issue of parallel importation of trade-marked goods within the European Union[151] is due to its single market focus[152] and the principle of free movement of goods attached to it.

The balance that had to be set between the objectives of European law and the enforcement of intellectual property right holders resulted in a considerable amount of case law by the European Court of Justice. Following it the early decisions (1), the Court progressively developed the principle of exhaustion of trade-mark right (2) and set the acceptable boundaries of trade-marked product repackaging (3).

1. The objectives of the Treaty and their early applications by the European Court of Justice

Intellectual property presents a major problem for a European community of nation states seeking to create a single market without internal frontiers barring the free movement of goods and services. The principles of free movement of goods could come into conflict with the existence of discrete and sometimes different intellectual property regimes in different Member States. Each such national intellectual property right gives its owner

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[149] The first cases were decided under Article 81, 82 (formerly Articles 85, 86) of the EC Treaty: *Consten and Grundig v. Commission* (No 56/64; 58/ 64) [1966] E.C.R. 299; *Parke Davis supra* note 22.
[150] The European Court of Justice is independent and its decisions are binding on the Member States.
[151] The first of May 1999 the Amsterdam treaty went into force. It amends the EC-treaty, however, not in the intellectual and industrial property area. Through the Amsterdam treaty, the articles of the EC-treaty are renumbered.
[152] See Donnelly, *supra* note 5, at 468-69.

some form of exclusivity within its national territory. This is because intellectual property rights have been traditionally national and territorial in character. Indeed, it is important to recall that the origins of many intellectual property rights lie in protectionist attempts by early modern states to prevent competition from abroad while at the same time facilitating the borrowing of foreign technology.

Intellectual property rights are granted by states under national laws the effect of which outside the national territories concerned is necessarily extremely limited if not excluded altogether. To take into account this reality, Article 30 *(Article 28 in Treaty of Amsterdam)* of the Treaty, states that: "Quantitative restrictions on imports and all measures having equivalent effect shall without prejudice to the following provisions be prohibited between member states." Basically, quantitative restrictions are quotas or absolute bans on trade. The phrase "measures of equivalent effect" encompasses intellectual property rights, price controls, and indications of origin.

However, if the principle of free movement of goods were unqualified, in many cases it could lead to the destruction of national intellectual property rights. That is why exceptions under Article 36 allow member states to restrict the free movement of goods in certain circumstances. This article provides that:

> The provisions of Articles 30-34 shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of [...] the protection of industrial and commercial property. Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between member states.

Although in *Bristol-Myers Squibb v. Paranova*[153] Advocate General Jacobs said that the two parts of this Article can be read as a whole, it is convenient and, perhaps, less confusing to look at them separately. In accordance with the first sentence, a rights holder will only be able to stop or restrict inter-State trade where that is "justified" so as to

[153] *Bristol-Myers Squibb v. Paranova* (No. 71/94; 72/94; 73/94) [1996] ECR I-3457 [hereinafter *Bristol*].

protect his intellectual property right. The ECJ has made it clear that such justification only exists if the unrestrained inter-state trade would cause significant and substantial harm to what it calls the "specific subject matter" of the intellectual property right. The scope and effect of the first sentence of Article 30 has been put clearly and unequivocally by the ECJ in *Bristol*:

> The Court's case-law shows that Article 36 allows derogations from the fundamental principle of the free movement of goods within the common market *only* in so far as such derogations are justified in order to safeguard the rights which constitute the specific subject-matter of the industrial and commercial property in question.[154]

So, if the infringer's activities do not harm the specific subject matter of the intellectual property right, nothing stands in the way of the rigorous application of the principle of free movement of goods. In the latter case the owner of the right cannot enforce it against the importer/exporter. His rights are effectively removed. On the other hand, if the alleged infringer's activities damage the specific subject matter of the intellectual property right then his importation (or exportation) can be stopped by infringement proceedings.

However, according to the second sentence, the owner of those rights does not have an unfettered entitlement to prohibit or restrict importation. On the contrary, the second sentence of Article 30 makes it clear that even where an intellectual property owner has a prima facie entitlement to restrain importation, that entitlement is removed if the restraint constitutes "a means of arbitrary discrimination or a disguised restriction on trade between Member States". As the ECJ said in *Parke Davis*:

> As regards the provisions relating to the free movement of products, prohibitions and restrictions on imports may be justified under Article [30] on grounds of the protection of industrial property, but subject to the expressly stated reservation that these shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States. [155]

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[154] *Ibid.*, at paragraph 42 of the judgment. Emphasis is mine.
[155] See *Parke Davis, supra* note 22.

The core principles underlying Articles 30 and 36 as applied to intellectual property right cases can be put quite shortly. Free movement of goods is fundamental to the creation, operation and development of the Common Market. Derogations from it are only possible where justified under Community law. Even where a derogation appears to be justified in accordance with the preceding concepts, if it can be shown that the proprietor of the rights, deliberately or otherwise, placed his intellectual property rights in the way of free movement of goods for reasons which are not objectively justifiable or is using them to interfere with the free movement of goods in a way which is not objectively justifiable, the derogation will not be allowed to prevail and the principles of free movement of goods continue to apply.

The ECJ has developed a considerable body of case law spelling out the circumstances in which the enforcement of intellectual property rights will not be permitted to interfere with the free movement of goods. Early cases on the application of Articles 30 to 36 on the import and export of goods which were alleged to infringe intellectual property rights under national law were alluded to the free movement provisions rather than directly applied them. [156] The European Court of Justice, after having shifted its emphasis from Article 85 to Article 30,[157] gave in the early 1970's a series of landmark judgments on articles 30 to 36 in relation to intellectual property. These judgments established the principle of exhaustion of rights, in the context of the European Union laying foundations for a reconciliation of intellectual property rights with the free movement of goods.

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[156] See *Rewe-Zentral AG v. Bundesmonopolverwtungfur Branntwein* (No. 120/78) [1979] ECR 649 (commonly known as the Cassis de Dijon case). See also F-K. Beier, "Industrial Property and the Internal Market" (1990) 2 IIC 131, at 145 for criticism of the exclusion of such laws from Article 36.
[157] This shift took place in the early 1970's with the *Deutsche Grammophon v. Metro* case (No 78/70), [1971] 4 IIC 429. Here the provision of Article 36 was established as a separate rule against barriers to intra-community trade. The Court explained that Article 85 could be applied only if an agreement or concerted practice existed. If there was no such agreement or concerted practice a further test is required, namely, an application of the rules on the free movement of goods (Article 30).

According to this doctrine, the owner of intellectual property has the exclusive right to put his product on the EU market for the first time (or determine who else may do so), so as to allow him to obtain payment for the product. However, with that single payment the owner's right is exhausted. An early annunciation of this principle was made by the European Court of Justice in its *Terrapin v. Terranova* case:

> The proprietor of an industrial or commercial property right protected by the law of a Member State cannot rely on that law to prevent the importation of a product which has been lawfully been marketed in another Member State by the proprietor himself or with his consent. [158]

The Court established the principle of exhaustion of rights in relation to trade-marks in *Centrafarm v. Winthrop.* [159] This case concerned an attempt by the owner of a trade-mark to rely on his rights under national law to prevent the parallel import of pharmaceutical products in their original packaging. The Court held that if a trade-mark owner is allowed to use his trade-mark to prevent the importation and sale of goods that have been placed on the market with his consent in another Member State, this will amount to a quantitative restriction or a measure having equivalent effect within the meaning of Article 30. Accordingly, the exercise by a trade-mark owner of his trade-mark rights to prevent such parallel trade could not be justified under Article 36.[160] This latter article admits of derogations from the free movement of goods only where such derogations are justified for the purpose of safeguarding rights which constitute the specific subject-matter of the trade-mark. The specific subject-matter of the trade-mark is the guarantee that the owner has the exclusive right to use that mark for the purpose of putting products protected by the trade-mark into circulation for the first time, and is therefore intended to protect him against competitors wishing to take advantage of the status and reputation of the trade-mark by selling products illegally bearing that trade-mark.[161] Where a product had been put onto the market in a legal manner in the Member State from which it had been imported, by the trade-mark owner or with his consent, so that there could be no

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[158] *Terrapin v. Terranova* (No 119/75) [1976] E.C.R. 1039 at 1061, at paragraph 6 of the judgment.
[159] See *Winthrop supra* note 20.
[160] *Ibid.*, at paragraph 12 of the judgment.
[161] *Ibid.*, at paragraph 8 of the judgment.

question of abuse or infringement of the mark, there was no justification for permitting the trade-mark owner to prevent such trade.[162]

Although the concept of specific subject matter has retained a core consistency, is has been used flexibly to adapt to particular situations which came before the European Court. This is readily apparent in the repackaging cases, in which part of the specific subject matter has been considered to be the right to prevent use of the trade-mark liable to impair the guarantee of origin of the product [163] or the reputation of the trade-mark.[164]

2. Developments of the principle of community-wide exhaustion

The principle of Community exhaustion was subsequently enshrined in Article 7(1) of the *Trade-marks Directive*[165] 89/104/EEC of 21 December 1988, which provides as follows:

> The trade-mark shall not entitle the proprietor to prohibit its use in relation to goods which have been put on the market in the Community under that trade-mark by the proprietor or with his consent.

This article codifies in practice the case law relating to community-wide exhaustion of trade-mark rights based on the interpretation by the ECJ of Articles 30 and 36 of the EC Treaty. The European Court of Justice had then to answer two important interpretative questions relating to Article 7. The most controversial one was whether Article 7 allowed member states to maintain or to introduce the principle of international exhaustion of trade-mark rights. The other one led the European Court of Justice to clarify to concept of consent.

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[162] *Ibid.*, paragraphs 7, 8 and 10 of the judgment.
[163] *Hoffmann-La Roche v. Centrafarm* (No. 102/77) [1978] E.C.R. 1139 at 1164, at paragraph 7 of the judgment [hereinafter *Hoffmann*].
[164] *Parfums Christian Dior v. Evora BV* (No. 337/95) [1997] ECR I-6013, paragraph 43.
[165] *First Council Directive* 89/104/EEC of 21 December 1988 *to approximate the laws of the Member States relating to trade-marks*, OJ 1989 L 40, p. 1. The provision now embraces equally the additional states of the EEA (Iceland, Liechtenstein and Norway), by virtue of the Agreement on the European Economic Area.

The issue of international exhaustion arose for full consideration by the Court for the first time in the *Silhouette International Schmied GmbH & Co KG v. Hartlauer Handelsgellschaft* case.[166] The *Silhouette* case arose out of the following facts. Hartlauer, an Austrian retailer capitalizing on its reputation for low prices, wanted to sell the high-end spectacles that Silhouette produces. Silhouette, another Austrian based company, refused to permit Hartlauer to sell its spectacles fearing its reputation would be tarnished by having its goods sold in a discount store. Nevertheless, Hartlauer obtained twenty-one thousand pairs of outmoded spectacles that had been marketed in Bulgaria, outside the European Economic Area (EEA),[167] and put them up for sale in Austrian stores without Silhouette's consent. Silhouette brought an action against Hartlauer seeking to enjoin Hartlauer from selling the spectacles under Silhouette's trade-mark, and the case eventually made its way to the Austrian High Court. However, the Austrian Court did not answer Hartlauer's contentions. Instead, the Court concluded that the issue's resolution turned on EC law and applied to the ECJ for clarification.[168]

In a preliminary opinion, Advocate General Jacobs addressed the critical issue in *Silhouette*, namely, whether the inference to be drawn from the language "in the Community" found in Directive 89/104/EEC article 7(1) requires a non-exhaustion principle for goods first marketed outside the EEA.[169] The Advocate General concluded not only that the Directive did not require member states to impose a principle of

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[166] *Silhouette International Schmied GmbH & Co KG v. Hartlauer Handelsgellschaft* (No. 355/96) [1998] ECR I-4806; see also the Opinion of Advocate General Jacobs delivered on January 29, 1998. [hereinafter *Silhouette*]

[167] There are in reality two Europes, that of the European Community proper and the slightly larger European Economic Area (EEA) embodying all Member States of the Community plus those residual remaining states of the old European Free Trade Area (EFTA) organizations which have chosen not to join the enlarged Community. The EEA States are the following: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden and the United Kingdom.

[168] See *Silhouette supra* note 166, at I-4807-08.

[169] *Ibid.*, at I-4802.

international exhaustion[170] but that in fact article 7(1) of the directive precludes member states from adopting it. His opinion was based on a reading of the directive as a whole and relied heavily on the fact that the directive was intended to ensure that trade-marks "enjoy the same protection under the legal systems of all Member States."[171]

To no avail, Hartlauer maintained before the ECJ that Directive 89/104/EEC of 21 December 1988 left member states free to provide for exhaustion in their national law, not only in respect of products put on the market in the EEA but also of those put on the market in non-member communities. In essence, Hartlauer argued that Silhouette had exhausted its trade-mark rights by selling the goods in Bulgaria.

The ECJ proceeded to decide the case in the same manner as the Advocate General's opinion, as is usually the practice, and decided that the doctrine of international exhaustion of trade-mark rights is incompatible with Article 7(1). Thus, Hartlauer was blocked from selling the spectacles it had imported from Bulgaria because Silhouette's rights under the trade-mark were still viable. Although the *Silhouette* decision appears to offer a straightforward solution to the problem of unauthorized parallel trade between Member States and third countries, it leaves an important question unanswered. As Cornish anticipated, the decision offers no guidance on the important issue of consent (particularly the problematic concept of implied consent) or the relationship between the exhaustion of trade-mark rights and Community competition law.[172]

Even if after the *Silhouette* case the EU member states are not allowed to apply the doctrine of international exhaustion of trade-mark rights, the European Free Trade Agreement (EFTA) states belonging to the EEA however have that possibility in

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[170] *Ibid.*, at I-4810.
[171] W.R. Cornish, "Trade-marks: Portcullis for the EEA ?", (1998) 20 E.I.P.R. 172, at 175 (explaining that the Advocate General was driven to his conclusion "largely as a consequence of concluding that it cannot be left to Member States to apply their differing national rules on the subject").
[172] *Ibid.*.

accordance with the *Mag Instrument Inc v. California Trading* case.[173] This imbalance results from the fact that while the EU States[174] operate the principle of free movement of goods *put on the market* in the EEA, EEA States which are not EU States (namely Norway, Iceland and Liechtenstein) only operate the principle of free movement of goods *originating* in the EEA (ie. produced in the EEA). In contrast with the EU Member States, the EEA States have not transferred their autonomy in matters of foreign trade to any supranational organ, and, unlike the EC Treaty, the EEA Agreement does not establish a customs union. The EFTA Court concluded from this observation that it is for the EEA States to decide whether to introduce or to maintain the principle of international exhaustion. The Court pointed out that its interpretation of Article 7(1) of the Trade-mark Directive is in line with the Agreement on Trade Related Aspects of Intellectual Property Rights[175] (TRIPs Agreement) in which it is left open for the Member States to regulate the issue.[176]

The European Court of Justice has been obliged to clarify to concept of consent, as set in Article 7 (1) of the Trade-mark Directive, in two important judgments. The first one, the *Sebago* case, related to the condition of the consent by the trade-mark owner to the first marketing of his products within the EEA. In the second one, the *Davidoff* case, the Court had to determine if consent by the trade-mark owner to the importation of his goods can be implied from the conditions of their marketing outside the EEA.

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[173] *Mag Instrument Inc v. California Trading* (1998) 1 CMLR 331 [hereinafter *Mag*].
The case involved parallel imports of Maglite lights from the USA, where they were manufactured, to Norway.
[174] At the time of the EEA Agreement, the Member States of the E.C. were Belgium, Denmark, Germany, Greece, Spain, France, Ireland, Italy, Luxembourg, Netherlands, Portugal and the United Kingdom. Of the EFTA states who signed the EEA Agreement, Austria, Finland and Sweden joined the E.U. as from January 1, 1995.
[175] See TRIPs *supra* note 28.
[176] See *Mag, supra* note 173 at 339.

In the *Sebago Inc. and Ancienne Maison Dubois et Fils SA v. GB-Unic* case,[177] Sebago, a U.S. company, owned two Benelux trade-marks in the name of DOCKSIDES and three Benelux trade-marks in the name of SEBAGO registered in respect of shoes. GB-Unic purchased shoes made in El Salvador and sold them in the EEA. Sebago claimed that GB-Unic had infringed its trade-marks by marketing goods within the EEA without its consent.

Before the Belgian Court of Appeal, GB-Unic argued that the requirement of consent is satisfied if similar goods bearing the same trade-mark have been lawfully marketed in the EEA with the consent of the trade-mark proprietor. Sebago countered that consent must be obtained in relation to each defined parcel of goods.

The Belgian Court of Appeal referred to the ECJ to determine if the consent of the trade-mark proprietor to the marketing of one batch of a certain type of goods within the EEA bearing its trade-mark exhaust its right to object to the marketing of other batches of his identical (or similar) goods bearing the same trade-mark. The ECJ found that a trade-mark proprietor who places a particular batch of goods on the market puts only that batch into circulation. It does not thereby consent to entry in EEA commerce of all other batches of identical (or similar) goods remaining in its warehouse. Accordingly, consent to first marketing within the EEA must be in respect of the specific goods being resold.

The consent issue was examined in more detail in the context of the recent case *Zino Davidoff SA v. A&G Imports Limited*[178] before the UK Patents Court. The trade-mark owner of the two trade-marks COOL WATER and DAVIDOFF COOL WATER for toiletries and cosmetics tried to prevent importation of a batch of its products into the Community. A & G Imports acquired stocks of products which had originally been placed on the market in Singapore by Davidoff or with its consent. A & G imported those

[177] *Sebago Inc. and Ancienne Maison Dubois et Fils SA v. GB-Unic SA*, (No 173/98) [1999] 2 CMLR 1317.
[178] *Zino Davidoff SA v. A&G Imports Limited,* (1999) 3 All ER 711 (Ch. D), (1999) 2 CMLR 1056.

products into the Community (the United Kingdom, in this case) and began to sell them. Only the removal or obliteration of the batch code numbers distinguished those products from other goods bearing the Davidoff trade-mark.

In 1998 Davidoff brought proceedings against A & G before the High Court of Justice of England and Wales, Chancery Division (Patent Court), alleging, *inter alia*, that the importation and sale of those goods in the United Kingdom infringed its trade-mark rights. Although it was clear that the products were not marketed within the EU with the explicit consent of the right holder, it was not clear whether the trade-mark owner's consent while marketing his products in Singapore also extended (implicitly) to their free circulation and sale throughout the world. The distribution agreement for the goods in question had set out exclusive rights to Luxasia Singapore to import, promote, sell and distribute the products throughout Singapore, Malaysia, Indonesia, Philippines, Hong Kong, Cambodia, Sri Lanka and Myanmar. The Agreement contained the undertaking that the distributor undertakes not to sell any products outside the territory and shall oblige his sub-distributors, sub-agents and/or retailers to refrain from such sales.[179]

A & G relied on Articles 5(1) and 7(1) of the Directive, maintaining that, having regard to the circumstances in which the goods were placed on the market in Singapore, their importation and sale was, or should be deemed to have been, with Davidoff's consent.
A&G maintained that the distribution agreement did not require the distributor to incorporate self-perpetuating contractual terms on everyone further down the chain of distribution limiting where the goods may be sold. They argued that where, as in this case, goods are placed on the market in circumstances where the plaintiff could have placed, but did not place, an effective restraint on their further sale and movement, purchasers within the distribution chain were free to market the goods where they like, including within the EEA. Justice Laddie found in favor of the defendant, A&G Imports

[179] See Ansgar Ohly, "Trade Marks and Parallel Importation – Recent Developments in European Law", (1999) 5 IIC 513, at 529.

Limited. Davidoff denied that it had consented, or could be deemed to have consented, to the products concerned being imported into the EEA.

The English court referred to the ECJ for clarification on the scope and effect of Article 7(1). The six questions chiefly sought to determine the circumstances in which exhaustion occurs and more specifically, to clarify the concept of "consent".

Advocate General Stix-Hackl delivered his opinion on 5 April 2001.[180] After having reviewed the case-law on trade within the Community,[181] Advocate General concluded that the notion of consent within the meaning of Article 7(1) of the Trade-marks Directive relates to the possibility of the trade-mark proprietor's exercising control over the first instance in which his products are placed on the market or distributed within the EEA. The Advocate General, not answering the question as to the nature of the notion of consent (express or implicit, direct or indirect), stated that it was for the national court, having regard to all the circumstances of the individual case, to determine whether, when the products concerned were in fact first placed on the market, the trade-mark proprietor had waived his exclusive right to control distribution within the EEA.

The ECJ took a different analytic step,[182] considering necessary for it to provide a uniform interpretation of the concept of "consent" to the placing of goods on the market within the EEA. The Court found that consent must be expressed positively.[183] Accordingly, the factors taken into consideration in finding implied consent must

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[180] Opinion of Advocate General Stix-Hackl delivered on 5 April 2001 is available at the web site of the European Court of Justice: www.curia.eu.int
Joined Cases C-414/99, C-415/99 and C-416/99: *Zino Davidoff SA v. A & G Imports Ltd* (C-414/99), *Levi Strauss & Co., Levi Strauss (UK) Ltd v. Tesco Stores Ltd, Tesco plc* (C-415/99), *Levi Strauss & Co., Levi Strauss (UK) Ltd v. Costco Wholesale UK Ltd* (C-416/99).
[181] Opinion of Advocate General paragraph 67 to 75, citing *Deutsche Grammophon v. Metro* case (No 78/70), [1971] 4 IIC 429, paragraph 13, Opinion in *Centrafarm* v. *Sterling Drug* (No 15/74) [1974] ECR 1147 and *Winthrop supra* note 20.
[182] Judgment of the Court delivered on 20 November 2001. The judgment is available at the web site of the European Court of Justice: www.curia.eu.int
[183] Paragraphs 38 to 51 of the ECJ judgment.

unequivocally demonstrate that the trade-mark proprietor has renounced any intention to enforce his exclusive rights. The Court concluded that implied consent to the marketing of goods within the EEA put on the market outside that area cannot be inferred from the mere silence of the trade-mark proprietor, nor from the fact that contractual reservations were not imposed at the time of the transfer of ownership of the goods bearing the mark. Neither can implied consent be implied from the fact that the trade-mark proprietor did not communicate his opposition to marketing within the EEA.

Since the ECJ has said that brand owners' consent to a parallel import may be implied, the door is not actually completely shut on the grey goods market. However, with the nature of "implied consent" being so narrowly construed, the circumstances in which it can be successfully implied are hard to foresee.

This ruling clarifies the law in an area which has been open to question since 1999 when the referral to the ECJ was originally made. In ruling as it did the ECJ again moves away from the principle of "international exhaustion" of trade mark rights, confirming its previous case law on community wide exhaustion of trade-mark rights.

3. Repackaging and re-branding

The overriding importance attached to the principle of free movement of goods is perhaps best demonstrated in the so-called "repackaging" and "re-branding" cases. In the European Union, the many different national language and regulatory regimes may themselves present a significant barrier to marketing of parallel imports from one country in another. Parallel imports may require repackaging to meet local standards and expectations in the import market, re-labeling in the local language and even re-branding with a local trade-mark, if the original manufacturer happens to use a different mark itself in the source and import countries.[184]

Parallel importers have therefore sought to legitimize the practices of repackaging, re-labeling and re-branding and trade-mark owners have sought to restrain them. Consequently, a considerable body of case law has been established, setting out the conditions under which, on the one hand, a parallel importer may carry out such activities and, on the other hand, a brand owner may exercise its trade-mark rights to prevent them.

The early case-law of the ECJ recognized that there are circumstances in which a trade-mark owner may be justified by virtue of Article 30 in opposing the import from another Member State of products which had been put on the market by him or with his consent. That qualification to the principle of exhaustion of rights, later developed by the ECJ, is reflected in Article 7(2) of the Trade-marks Directive. The ECJ later developed an additional requirement, specifying that the use of a trade-mark right to object to the importation of repackaged goods contributes to artificial partitioning if and to the extent that repackaging is necessary for the goods to be marketed in the state of importation.

As previously mentioned, Article 28 of the Treaty of Rome prohibits quantitative restrictions on trade between member states and all measures having equivalent effect. All trading rules which are capable of hindering directly or indirectly, actually or potentially, intra-Community trade are regarded as measures of equivalent effect on imports within the meaning of Article 28, including provisions of trade-mark legislation which restrict parallel imports. However, Article 30 of the Treaty of Rome specifies that Article 28 does not preclude prohibitions or restrictions on trade between member states which are justified on grounds of (amongst other things) the protection of industrial or

[184] In the case of pharmaceutical products, the form of packaging used for those goods is, to a large degree, determined by public rules authorizing packaging only of a certain size and by medical prescription practices which have the same effect.

commercial property. That such prohibitions or restrictions must not constitute a means of arbitrary discrimination or a disguised restriction on trade between member states.

Article 30 being an exception to a fundamental principle of the common market, has therefore been interpreted strictly by the ECJ. The Court, as we will see, allowed restrictions of the free movement of goods on grounds of protection of intellectual property where justified for the purpose of safeguarding rights which constitute the "specific subject-matter" of the intellectual property.

In order to determine the precise scope of the specific subject-matter of a trade-mark, regard has been had to its essential function, which is to guarantee the origin of the trade-marked product. This guarantee includes the assurance that the product has not been subject to interference by a third party without the consent of the trade-mark owner such as to affect the original condition of the product. Accordingly, the right to prevent the trade-mark being affixed after repackaging forms part of the specific subject-matter of the trade-mark right, whether the mark is the same as the mark originally applied[185] or a different mark of the same proprietor.[186] On the other hand, the specific subject-matter of a trade-mark does not include the right to object to the addition of new external packaging which does not bear the registered trade-mark, as where the parallel importer replaced the outer packaging with its own packaging which included a transparent window through which the manufacturer's mark on the internal packaging was visible.[187]

Even where a parallel importer's activities fall within the scope of the specific subject-matter of a trade-mark, the use of the trade-mark right against them may be prohibited by the proviso in the second sentence of article 30 (36) of the Treaty of Rome. In the

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[185] See *Hoffmann supra* note 163.
[186] *Centrafarm v. American Home Products* (No 3/78) [1978] ECR 1823, [979] 10 IIC 231. [hereinafter *American Home Products*]
[187] *Pfizer v. Eurim-Pharm,* (No 1/81) [1981] ECR 2913.

Hoffmann-La Roche & Co. AG v. Centrafarm case,[188] the European Court of Justice, by defining the circumstances in which this prohibition takes place, established the basic rules for repackaging and re-labeling. In that case, a US corporation had subsidiaries in both UK and Germany producing Valium. Both subsidiaries used the same trade-mark, VALIUM-ROCHE. The trade-mark was held by a further subsidiary, Roche-Basel. In the 1970's, the parallel importer Centrafarm started putting Valium, purchased in the United Kingdom, in new packages fit for the German market and affixing the original trade-mark VALIUM-ROCHE to it, together with a notice that the product had been marketed by Centrafarm. The manufacturer, Hoffmann-La Roche, sued him for infringement of his trade-mark.

The Court reasoned that under the first sentence of Article 36 the proprietor of a trade-mark accordingly had the right to prevent an importer of the trade-marked product, following repackaging of the product, from affixing the trade-mark to the new packaging without the authorization of the proprietor.[189] The Court then qualified that proposition, stating that it was still however necessary to consider whether the exercise of that right may constitute a disguised restriction on trade between Member States within the meaning of the second sentence of Article 36. The Court ruled that such prevention of marketing constitutes a disguised restriction on trade between Member States within the meaning of the second sentence of Article 36 where:

- It is established that the use of the trade-mark right by the proprietor, having regard to the marketing system which he has adopted, will contribute to the artificial partitioning of the markets between Member States;
- It is shown that the repackaging cannot adversely affect the original condition of the product;
- The proprietor of the mark receives prior notice of the marketing of the repackaged product; and

[188] See *Hoffmann, supra* note 163.
[189] *Ibid., at* paragraph 8 of the judgment.

- It is stated on the new packaging by whom the product has been repackaged. [190]

Shortly after the *Hoffmann-La Roche* case, the Court was asked in *American Home Products*[191] to rule in the case where the importer sought not merely to repackage but also to affix a different trade-mark. In this judgment the Court drew a distinction between repackaging and re-branding. Whereas the former was held to be permissible if the owner's use of the trade-mark *contributed* to the artificial partitioning of the markets, the latter was only allowed if the owner *intended* to partition the markets artificially. The test therefore seemed to be subjective. American Home Products was the proprietor of the trade-marks SERESTA, registered in Benelux, and SERENID D, registered in the United Kingdom, both in respect of tranquilizers with identical therapeutic properties which it marketed in the Netherlands as SERESTA and in the United Kingdom as SERENID D. Centrafarm purchased tranquilizers in the United Kingdom and marketed them in the Netherlands in new packaging and under the mark SERESTA. American Home Products sought an order prohibiting such conduct; the Court was asked whether Articles 30 and 36 prevented the trade-mark owner from asserting his rights under national law to oppose such marketing.

The Court repeated its statement in *Hoffmann-La Roche* as to the specific subject-matter and essential function (as guarantee of origin) of a trade-mark. It continued:

> This guarantee of origin means that only the proprietor may confer an identity upon the product by affixing the mark. The guarantee of origin would in fact be jeopardised if it were permissible for a third party to affix the mark to the product, even to an original product. [...] The right granted to the proprietor to prohibit any unauthorised affixing of his mark to his product accordingly comes within the specific subject-matter of the trade-mark.[192]

The Court confirmed that the subjective test was a sufficient condition for relying on the second sentence of Article 36. *Centrafarm v. American Home Products* appears to

[190] See *Hoffmann, supra* note 163, at paragraph 12 of the judgment.
[191] See *American Home Products supra* note 186.
[192] *Ibid.,* at paragraphs 13, 14 and 17 of the judgment.

establish that in such cases the parallel importer is not entitled to substitute one mark for the other unless the use of different marks is deliberately intended to partition the market.[193] That reading was adopted by Advocate General Jacobs in the *Bristol-Myers Squibb* case.

In the cases *Bristol-Myers Squibb v. Paranova,* [194] *MPA Pharma,* [195] *Loendersloot v. Ballantine*[196] and *Pharmacia & Upjohn v. Paranova*,[197] subsequent to the *Hoffmann* decision the ECJ attempted to clarify the meaning of the condition that the use of the trade-mark will "contribute to artificial partitioning of the markets", further refining the ruling of that case.[198]

The most debated question following the decision in *Hoffman-La Roche* was whether Article 36 established a subjective or an objective test of artificial partitioning of the market. While it was clear that a trade-mark owner who intended to partition the market would not be able to rely on his trade-mark, it was not clear if this was a necessary condition (subjective test) or whether it was sufficient that the effect of the trade-mark owner's actions was in fact to partition the market (objective test). The Court ruled that to demonstrate artificial partitioning of the markets, the importer does not need to show that the trade-mark owner deliberately sought to partition the markets between Member States. Partitioning is 'artificial' if the trade-mark owner's reliance on his rights cannot be justified by the need to safeguard the essential function of the trade-mark. It is therefore an objective test. The Court thus clarified two aspects of the first condition for a

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193 *Ibid.*, at paragraph 21-23 of the judgment.
194 See *Bristol supra* note 153.
195 *MPA Pharma v Rhône-Poulenc Pharma* (No. 232/94) [1996] ECR I-3671
196 *Frits Loendersloot v. George Ballantine & Son Ltd*, (No 349/95) [1998] 1 CMLR 1015 [hereinafter *Loendersloot*]
197 *Pharmacia Upjohn v. Paranova A/S* (No 379/97) [1999] ETMR 937 [hereinafter *Upjohn*]
198 If the Court's analysis concentrated on Articles 28 and 30 EC rather than Article 7 of the Directive, it however made it clear that adoption of the Trade-marks Directive had not altered the substance of the case-law discussed above and that Article 7 had to be interpreted in the same way as Article 30 EC. See *Bristol supra* note 153 at paragraph 40 of the judgment.

disguised restriction on trade it had laid down in *Hoffmann-La Roche*, namely that the use of the trade-mark by the owner will contribute to the artificial partitioning of the markets. First, whereas in the earlier case there was a general reference to "having regard to the marketing system which [the trade-mark owner] has adopted,"[199] the later rulings give an example of such a marketing system: namely, where the owner has placed an identical pharmaceutical product on the market in several Member States in various forms of packaging and the product may not, in the condition in which it has been marketed by the trade-mark owner in one Member State, be imported and put on the market in another Member State by a parallel importer. Second, the Court confirmed that, as implicitly suggested in *Hoffmann-La Roche*, use by the trade-mark owner of his rights in order to safeguard the essential function of the mark will not be regarded as contributing to the artificial partitioning of the markets between Member States.

In *Frits Loendersloot v. George Ballantine & Son Ltd,*[200] the European Court of Justice in numerous quotations referred to its judgment *Bristol-Myers*.[201] Although the Court acknowledged that some of the criteria enunciated in that case were not applicable to re-labeling, it applied essentially the same proportionality test. In that case the European Court of Justice was invited to consider the practice of repackaging and re-labeling bottles of whisky for the purposes of parallel trade. The packaging and labeling used by the original producers bore both registered trade-marks and unique identification numbers. The identification numbers were intended to serve various purposes, such as meeting food safety requirements, facilitating product recall, providing evidence in relation to product liability claims, and combating counterfeiting. However, the identification numbers could also be used to trace the identity of any distributor who supplied the parallel market. The defendant had imported the plaintiff's whisky from low-price countries and had, before putting it on the Dutch market, replaced the original labels, thereby removing the name of the authorized importer and the identification

[199] See *Hoffmann*, *supra* note 163, paragraph 10 of the judgment.
[200] See *Loendersloot supra* note 196.
[201] *Ibid.*, paragraph 21 and following.

numbers. The defendant justified this practice by pointing out that the identification numbers enabled the plaintiff to locate the source where the defendant had acquired the goods. If the plaintiff could do so, the defendant's suppliers would be likely to terminate the supply as they might face sanctions by the producer.

The European Court of Justice held that where identification numbers are applied for the purposes of complying with a legal obligation or to realize other important objectives which are legitimate from the point of view of Community law, including measures to combat counterfeiting. The fact that an owner of trade-mark rights makes use of those rights to prevent third party from removing and then re-affixing or replacing labels bearing his mark in order to eliminate those numbers does not contribute to the artificial partitioning of markets between Member States. However, if identification numbers are also used as a means of exerting control over distribution networks, this practice may raise issues under competition law of the Community.[202]

The Court in *Bristol* confirmed that the importer must give notice to the trade-mark owner before the repackaged product is put on sale, and, on demand, supply him with a specimen of the repackaged product. That would enable the owner to check that the repackaging is not carried out in such a way as directly or indirectly to affect the original condition of the product and that the presentation after repackaging is not likely to damage the reputation of the trade-mark; it also affords the trade-mark owner a better possibility of protecting himself against counterfeiting.[203]

In an opinion issued on July 12 2001 in joined cases C-443/99 and C-143/00,[204] the Advocate General Jacobs stated that it is for the parallel importer in all circumstances to

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[202] In particular, exclusive and selective distribution agreements have given rise to extensive and complex bodies of law under Article 85(1) of the Treaty of Rome.

[203] See *Bristol, supra* note 153, at paragraph 78 of the judgment.

[204] Respectively *Merck, Sharp & Dohme GmbH v. Paranova Pharmazeutika Handels GmbH* and *Boehringer Ingelheim KG and others v. Swingward Ltd and others*. This opinion is available at the web site of the European Court of Justice: www.curia.eu.int

give the trade-mark owner reasonable advance notice (three to four weeks "will be normally regarded as reasonable") of his intention to market repackaged goods bearing the trade-mark. Failure to give notice in such a way will prevent the parallel importer from being able to rely on Article 30 EC or Article 7(2) of the trade-marks directive in proceedings brought against him for infringement.

The Court in *Bristol* followed the *Hoffmann-La Roche* principles and clarified that new packaging must clearly state who repackaged the product and the name of the manufacturer in print such that a person with normal eyesight, exercising a normal degree of attentiveness, would be in a position to understand. Similarly, the origin of an extra article from a source other than the trade-mark owner must be indicated in such a way as to dispel any impression that the trade-mark owner is responsible for it; however, it is not necessary to indicate that the repackaging was carried out without the authorization of the trade-mark owner.

The Court also gave some guidance on what it meant by an adverse effect on the original condition of the product, although this remains a matter for the national court to consider in the light of the nature of the product and the method of repackaging. The Court emphasized first that it was the condition of the product inside the packaging which was at issue. The trade-mark owner may therefore oppose any repackaging involving a risk of the product inside the package being exposed to tampering or to influences affecting its original condition. That is not the case where the repackaging affects only the external of two layers, leaving the inner packaging intact. The mere addition to the packaging of new user instructions or information, or the insertion of an extra article, the removal of blister packs, flasks, phials, ampoules or inhalers from their original external packaging and their replacement in new external packaging cannot therefore affect the original condition of the product inside the packaging.[205] The Court concluded that, if the repackaging is carried out in conditions which cannot affect the original condition of the product inside

[205] See *Bristol, supra* note 153, at paragraphs 58 to 61 of the judgment.

the packaging, the essential function of the trade-mark as a guarantee of origin is safeguarded: the consumer or end user is not misled as to the origin of the products and does in fact receive products manufactured under the sole supervision of the trade-mark owner. The trade-mark owner may not therefore rely on his rights as owner in order to oppose the marketing under his trade-mark of products repackaged by an importer.

In discussing the concept of artificial partitioning of the markets where the trade-mark owner had marketed an identical product in different packaging in different Member States, the Court in *Bristol-Myers Squibb* stated that the power of the trade-mark owner to oppose the marketing of repackaged products should be limited only in so far as the repackaging was necessary in order to market the product in the State of importation.[206]

Guidance as to the circumstances in which repackaging by the importer may be regarded as necessary may also be found in *Bristol-Myers Squibb*. The Court referred to the impossibility of marketing in the Member State of importation by reason, in particular, of rules or national practices, sickness insurance rules governing the reimbursement of medical expenses, and well-established medical prescription practices.[207] The Court did not however consider that repackaging would be necessary where the importer could achieve packaging which may be marketed in the Member State of importation by, for example, affixing to the original external or inner packaging new labels in the language of the Member State of importation, or by adding new user instructions or information in the language of the Member State of importation.[208]

Further guidance as to the meaning of objectively necessary has since been given by the Court in the decisions *Upjohn* and *Loendersloot*. The *Upjohn* case[209] clarified the *Hoffmann-La Roche and Bristol-Myers Squibb* principles noting that the test for

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[206] *Ibid.*, at paragraph 56 of the judgment.
[207] *Ibid.*, at paragraph 53 of the judgment.
[208] *Ibid.*, at paragraph 55 of the judgment.
[209] See *Upjohn supra* note 197.

permissible re-branding requires an assessment whether the circumstances prevailing at the time of marketing in the Member State of import make it objectively necessary to replace the original trade-mark by that used in the Member State of import in order that the product in question may be marketed in that State by the parallel importer. This case, which originated in Denmark, concerned the re-branding and repackaging of Upjohn's Dalacin C antibiotic product by parallel importer Paranova. Upjohn marketed this antibiotic product under the trade-mark DALACIN C in all Member States of the European Union except Denmark, Germany and Spain (where the trade-mark DALACIN was used) and France (where the trade-mark DALACINE was used). Paranova purchased the Dalacine product in France and the Dalacin C product in Greece and repackaged them as DALACIN for sale in Denmark. According to Upjohn, the trade-mark DALACIN was used for its products in Denmark because the Danish authorities objected to the use of DALACIN C on the basis that such use could create a misleading association with Vitamin C. Upjohn also explained that the trade-mark DALACINE was used in France so that the French pronunciation would be close to the English pronunciation of Dalacin.

The Court stated that the condition of necessity was satisfied if, in a specific case, the prohibition imposed on the importer against replacing the trade-mark repackaging hindered effective access to the markets of the importing Member State. That would be the case if the rules or practices in the importing Member State prevented the product in question from being marketed in that State under its trade-mark in the exporting Member State in the packaging used in the exporting Member State. In contrast, the condition of necessity would not be satisfied if replacement of the trade-mark repackaging was explicable solely by the parallel importer's attempt to secure a commercial advantage.[210]

In *Loendersloot* [211] the Court stated that, even where re-labeling (at issue rather than repackaging as such) was necessary for marketing in the State of import, it must be done

[210] *Ibid.*, at paragraphs 43 and 44 of the judgment.
[211] See *Loendersloot supra* note 196.

in such a way as to make parallel trade feasible while causing as little prejudice as possible to the specific subject-matter of the trade-mark right. Thus if the original labels comply with the relevant rules of the State of import but those rules require additional information to be given, it is not necessary to remove and reaffix or replace the original labels, since the mere application to the bottles in question of a sticker with the additional information may suffice.

4. Conclusion

As we have seen, the issue of parallel importation has rapidly given rise in the European Union to an extensive number of decision and doctrinal debates. The European Court of Justice has now strongly established the principle of community wide exhaustion and delimited its application, in consistency with the objectives of free movement of goods enshrined in the Treaty. Indeed the driving force behind permitting parallel imports inside the European Union is not trade-mark law but the creation of an internal market. In seeking to resolve the inherent conflict between enforcement of trade-mark rights and the free movement of good, the European Court of Justice have sought to look behind the mere territorial monopolistic nature of trade-mark rights so as to ensure that the owner of this monopoly granted under a country's laws exercises his right in a roper and fair manner. In this endeavour, the Court has used and refined the definition of the specific subject matter of trade-mark.

Chapter 5: Conclusion

The jurisdictions analyzed in this thesis have taken, as we saw, different legal paths in approaching the relationship between parallel imports and the exhaustion of exclusive trade-mark rights.

The issue of parallel import of trade-marked goods has not been completely resolved in Canada and the United States. The Canadian and American case law has proved to be unstable, changing successively the exhaustion doctrines applied. The conditions under which grey-market goods have been excluded by the American courts implement the territorial nature of trade-mark registration, and reflect a legal recognition of the role of domestic business in establishing and maintaining the reputation and goodwill of a domestic trade-mark. The American case law has however sometimes failed to place reasonable limits on the territoriality of trade-mark law in adopting in certain cases a rather lenient definition of material difference. This anti-competitive approach affords trade-mark owners an excessively broad protection against parallel importation, and fails to provide a fair balance between the interests of the trade-mark owner and the need to promote free market. It remains to be seen however whether or not the courts will change their approach towards a more stringent definition of material difference given the Final Rule issued by the Custom Services.

The Canadian case law on grey market goods, like its American counterpart have demonstrated very divergent and often contradictory approaches based at times on the need to protect intellectual property and, at other times, on the need to promote competition and free trade. Although the legal responses in Canada to the issue of parallel imports seem to be somehow ambiguous and scattered, the Canadian case law seems to have adopted recently a liberal approach towards parallel imports. Trade-mark infringement actions against parallel importers have indeed been significantly curtailed since the Federal Court of Appeal in the *Coca-Cola* case decided that the resale of legitimate goods does not constitute trade-mark use susceptible to deceive consumers as to the provenance of the goods. Similarly, the Federal Court of Appeal held in the recent *Smith & Nephew* passing off case that goods which originate in the stream of commerce with the owner of a trade-mark are not counterfeit or infringing goods simply because they may have arrived in a particular geographical market where the trade-mark owner does not whish them to be distributed. It remains to be seen how the Canadian courts will further develop this line of reasoning so as to take into fair consideration the legitimate interests of the trade-mark owners.

The driving force behind permitting parallel imports inside the European Union has not been trade-mark law but the creation of an internal market. Indeed, the development of the European case law on parallel importation stemed from the preoccupation of the European Court of Justice with ensuring the free movement of goods within the Community. In seeking to resolve the inherent conflict between enforcement of trade-mark rights and the free movement of good, the European Court of Justice have sought to look behind the mere territorial monopolistic nature of trade-mark rights so as to ensure that the owner of this monopoly granted under a country's laws exercises his right in a roper and fair manner. The European Court of Justice did so in focusing on protecting the specific subject matter of a trade-mark and the essential function of a trade-mark.

As we saw, the specific subject matter of a trade-mark is the guarantee that the right holder has the exclusive right to use that trade-mark for the purpose of placing products protected by the trade-mark into circulation for the first time. Its purpose is to protect the owner of the trade-mark from competitors who wish to take advantage of the status or reputation of the trade-mark. Article 36 in fact only admits of derogations from the free movement of goods where such derogations are justified for the purpose of safeguarding rights which constitute the specific subject-matter of the property. The Court has also applied the concept of the essential function of trade-marks to further define the scope of intellectual property rights under the trade-mark. Therefore, the court examined the specific subject matter of the trade-mark as well as its essential function when resolving disputes about possibly infringing practices.

The Court has infused the concept of origin as a safeguard against consumer confusion into the essential function of the trade-mark, at one point characterizing the essential function as a guarantor of the identity of the origin of the marked product to the consumer or ultimate user by enabling him without any possibility of confusion to distinguish that product from products which have another origin. The Court has used the concept of subject matter in a flexible manner to adapt to the particular situations, specially the repackaging cases, which came before it. The case law of European Court of Justice attests a real balancing of interest in the repackaging cases. The Court indeed introduced reasonableness and proportionality tests by holding that a trade-mark holder could oppose parallel imports of repackaged products where the inappropriate presentation of the repackaged product might harm the right holder's interests.

The advantage of the concept of specific subject matter is that it can evolve easily to respond to changing needs. Modifications of its concept may expand or narrow current exceptions from free movement rules under Article 36 of the EC Treaty to allow greater or lesser restrictions on parallel imports in certain cases. The specific subject matter concept is also necessary as it would not be impossible to address these concerns under Article 36 and determine circumstances in which the increased protection of trade-marks justifies trade restrictions.

The development of the concept of specific subject matter in the case law of the European Court of Justice has permitted and will continue to enable the Court to take into account in an accurate and fair manner all the diverse trade-mark policy considerations that may justify restrictions on intra-brand competition through parallel imports.

The European experience of integration provides an obvious basis for comparison with North American Free Trade Agreement. In fact European Union Treaty and the North American Free Trade Agreement are quite similar at least in their objectives. Indeed, both seek to eliminate trade barriers and to encourage fair competition and the free movement of goods between their territories. In both trade agreements too, the perennial balancing of the two objectives of the protection of intellectual property and the promotion of free trade is present. This balancing in the European Community led to the community wide exhaustion principle, a result in which the ultimate principle of free trade prevailed within the European custom union. A similar weighing of these objectives under the North American Free Trade Agreement would involve following the principles of free trade contained in the agreement to their logical end by legalizing parallel importation within the trading block. A move to the model on which the European Union operates would however require the creation of appropriate permanent and independent legislative and judicial structural structure similar to those existing in Europe.

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