NOTES

EXHAUSTION OF TRADEMARK RIGHTS BEYOND THE EUROPEAN UNION IN LIGHT OF SILHOUETTE INTERNATIONAL *SCHMIED V. HARTLAUER HANDELSGESELLSCHAFT*: TOWARD STRONGER PROTECTION OF TRADEMARK RIGHTS AND ELIMINATING THE GRAY MARKET

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I. AN INTRODUCTION TO THE GRAY MARKET

"The parallel importation of unauthorized genuine goods is commonly referred to as the gray market."[1] The gray market arises when an entrepreneur purchases legitimately trademarked goods in a lower priced market and then resells the goods in a higher priced market. Thus, the gray marketer reaps the benefit of higher profits by selling the products in a geographic area in which the proprietor of the trademark has authorized the sale of the product to certain individuals but not to the parallel importer. It is in this sense that gray market goods are unauthorized. Even though the imported goods are genuine, as opposed to counterfeit or pirated goods, the right to distribute the product in a particular geographic area is not allocated to the parallel importer.[2]

Even though the gray marketer is selling the trademarked goods at a reduced price, there are several reasons that the gray marketer is able to profit from this type of activity.

> First, some independent and unauthorized importers can take advantage of currency fluctuations and therefore buy when the time is right in a particular foreign market. Second, unauthorized importers take advantage of promotional and advertising campaigns paid for by the authorized distributors.

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[1] Richard M. Andrade, Comment, *The Parallel Importation of Unauthorized Genuine Goods: Analysis and Observations of the Gray Market*, 14 U. PA. J. INT'L BUS. L. 409, 409 (1993).

[2] *See id.*

> Third, the authorized dealers are responsible for service of the goods and sometimes an entire product line throughout the life of the product, whereas the unauthorized importer usually disappears after the first sale.[3]

To understand the gray market, one must have a basic understanding of the function of trademarks and the principle of exhaustion of trademark rights. A trademark is any "word, slogan, design, picture, or any other symbol used to identify and distinguish goods."[4] The Council of the European Communities has also defined the trademark: "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."[5]

The historical function of the trademark is, as these definitions suggest, to help consumers identify and distinguish goods in the marketplace. The earliest historical function of the trademark was to aid consumers in identifying the source or origin of the goods put on the market. As trading expanded and goods were transported to distant markets, the trademark took on the additional function of being a symbol of quality for consumers who were far removed from the producers of the trademarked goods.[6]

Additionally, trademarks protect the expectations of consumers with regard to goods because a trademark functions as a guarantee of a certain quality.[7]

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[3] Hillary A. Kremen, Note, *Caveat Venditor: International Application of the First Sale Doctrine*, 23 SYRACUSE J. INT'L L. & COM. 161, 162 (1997). As Judge Leval explained in *Osawa & Co. v. B & H Photo*, the phenomenon of taking advantage of marketing campaigns paid for by the authorized distributors, known as free riding, occurs when advertising expenditures and public relations efforts on behalf of the trademark owner to promote its product are taken advantage of by the gray market sellers who ride free on the owner's publicity. *See* 589 F. Supp. 1163 (S.D.N.Y. 1984); *see also A Grey Area*, THE ECONOMIST, June 13, 1998, at 61, 62 (quoting Hugh Hansen, a law professor at Fordham University, who argues the barriers to gray marketers are justified due to the fact that gray trade "involves nothing more than free riding by people who create nothing").

[4] J. THOMAS MCCARTHY, MCCARTHY'S DESK ENCYCLOPEDIA OF INTELLECTUAL PROPERTY 443 (2d ed. 1995).

[5] Council Directive 89/104/EEC, art. 2, 1989 O.J. (L 40) 1, 2.

[6] *See* Gregory W. Hotaling, Comment, Ideal Standard v. IHT: *In the European Union, Must a Company Surrender its National Trademark Rights When it Assigns its Trademark?*, 19 FORDHAM INT'L L.J. 1178, 1194-95 (1996).

[7] *See* John E. Somorjai, *The Evolution of a Common Market: Limits Imposed on the Protection of National Intellectual Property Rights in the European Economic Community*, 9 INT'L TAX & BUS. LAW. 431, 437 (1992).

Businesses also rely on the trademark "to establish their reputation, distinguish competitor's products, advertise, and market goods."[8] Thus, trademarks protect the expectations of consumers; however, unlike other intellectual property rights such as patents or copyrights, trademarks do not represent a significant investment in creative effort. A trademark is simply a unique symbol that differentiates one product from others.[9] This difference suggests that in some circumstances the trademark should be treated differently from patents and copyrights with respect to exhaustion because patents and copyrights do protect a significant investment in creative effort.

The principle of exhaustion prohibits a trademark owner from using its trademark rights as a barrier to other importers desiring to trade in its goods.[10] The doctrine functions as a limitation on intellectual property rights. Exhaustion provides that the rights, which an intellectual property holder acquires with respect to articles and which are patented, copyrighted, or trademarked, expire in certain cases after the first sale of the protected goods on the market.[11] The consequence is that a subsequent purchaser can resell the article without infringing on the intellectual property holder's rights under the mark.[12]

As previously noted, when goods are traded in contravention of the marketing scheme of the intellectual property right holder, they are called gray market goods or parallel imports. There is a critical link between parallel imports and the exhaustion of intellectual property rights, such as the trademark. Whether retailers are able to import gray market goods will depend on whether the intellectual property rights were exhausted by previous sales.[13]

Exhaustion occurs within the European Economic Area (EEA), the fifteen nations comprising the European Union (EU) plus Norway, Iceland, and Liechtenstein,[14] upon the first marketing of a trademarked good within the EEA.[15] Thus, subsequent sales of goods within the EEA are not fettered by proprietors of trademarks asserting their rights to block imports because their

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[8] Minde Glenn Browning, *International Trademark Law: A Pathfinder and Selected Bibliography*, 4 IND. INT'L & COMP. L. REV. 339, 339 (1994) (*citing* MCCARTHY'S DESK ENCYCLOPEDIA OF INTELLECTUAL PROPERTY 340 (1st ed. 1991)).

[9] *See* Hotaling, *supra* note 6, at 1195.

[10] *See* Rebecca Harrison, Silhouette vs. Hartlauer: *The End of Discounted Designer Labels?*, BRAND STRATEGY, July 24, 1998, at 23.

[11] *See* Darren E. Donnelly, *Parallel Trade and International Harmonization of the Exhaustion of Rights Doctrine*, 13 SANTA CLARA COMPUTER & HIGH TECH. L.J. 445, 447 (1997).

[12] *See id.*

[13] *See id.*

[14] *See* Harrison, *supra* note 10, at 23.

[15] *See* Donnelly, *supra* note 11, at 470-71.

rights under the mark are exhausted. In this way, the EU encourages the gray market within its borders.[16] However, the EU's position on the exhaustion of trademark rights pertaining to goods first marketed in a territory outside the EEA is quite different. Recently, in *Silhouette v. Hartlauer*, the European Court of Justice (ECJ) interpreted the European Community (EC) legislation pertaining to trademarks and concluded that the principle of exhaustion of rights does not apply when products are first marketed outside the EEA.[17] Thus, the proprietor of the trademark can restrain parallel imports from non-member countries.

The EC legislation relating to trademarks is contained in the First Council Directive 89/104/EEC of 21 December 1988.[18] The directive makes explicit its intent to harmonize the intellectual property laws regarding trademarks among the member states:

> Whereas the trade mark laws at present applicable in the Member States contain disparities which may impede the free movement of goods and freedom to provide services and may distort competition within the common market; whereas it is therefore necessary, in view of the establishment and functioning of the internal market, to approximate the laws of Member States.[19]

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[16] *See* John A. Tessensohn & Shusaku Yamamoto, *The BBS Supreme Court Case—A Cloth Too Short for an OBI and Too Long for a Tasuki*, 79 J. PAT. & TRADEMARK OFF. SOC'Y 721 (1997) (explaining that the principle of intra-community exhaustion has developed in the EU because of an express treaty obligation under articles 30 to 46 of the Treaty of Rome, discussed *infra*, that mandates member states to provide for the free movement of goods between the EU member nations); *see also A Grey Area*, *supra* note 3, at 61 (explaining the principle of intra-community exhaustion upon first sale developed "to ensure the free movement of goods within the EU's single market").

[17] *See A Grey Area*, *supra* note 3, at 61 (noting that the ruling will be controversial either way because "some will see it as a defeat for free trade: others as a victory for intellectual property rights").

[18] "Directives are addressed to member states which must modify or enact national laws so as to conform with the directive. They are issued when there is a need to lay down general principles and goals. Member states must take the necessary steps to achieve the results required by the directive." Beryl R. Jones, *An Introduction to the European Economic Community and Intellectual Properties*, 18 BROOK. J. INT'L L. 665, 678 (1992). Directives have had special significance in the area of intellectual property rights and have been used to drive the community's harmonization efforts. *See id.* at 679.

[19] Council Directive 89/104/EEC, 1989 O.J. (L 40) 1.

Article seven of the directive deals specifically with the exhaustion of the rights conferred by a trademark.[20] The directive calls for the exhaustion of trademark rights upon the first sale in the EU made with the proprietor's consent, provided that an exception does not apply. However, an open question remained with respect to national rules, which provided for international exhaustion—a question decided by the ECJ in *Silhouette v. Hartlauer*.[21] In typical fashion, the exhaustion case was brought before the ECJ on questions for preliminary rulings by national courts to further litigation pending before those national courts.[22]

Although EC legislation provides for national exhaustion of trademark rights once a product is first sold within the EU, it was unclear whether goods first sold in non-member countries could be subject to exhaustion upon first sale. Exhaustion in this scenario would be international exhaustion—the intellectual property holder's rights with respect to the trademark would expire upon the first sale of the goods regardless of whether or not they were first sold in a non-member state. A lack of uniformity in the national rules regarding exhaustion of trademark rights developed within the EU with some member states providing for international exhaustion of trademark rights and others not—a situation which would have led to internal markets being distorted.[23]

Silhouette arose out of the following facts. Hartlauer, an Austrian retailer capitalizing on its reputation for low prices, wanted to sell the high-end spectacles Silhouette produced. 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 and put them up for sale in Austrian stores without Silhouette's consent.[24]

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[20] *Id.* art. 7(1) ("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."). However, article 7(2) carves out an exception to community exhaustion if "there exist legitimate reasons for the proprietor to oppose further commercialization of the goods, especially where the condition of the goods is changed or impaired after they have been put on the market." *Id.* art. 7(2).

[21] Case C-355/96, Silhouette Int'l Schmied v. Hartlauer Hadelsgesellschaft, 1998 E.C.R. I-4799, [1998] 2 C.M.L.R. 953 (1998).

[22] *See* David C.L. Perkins & Marleen Van Kerckhove, *Licensing Intellectual Property Rights in the EU: The Community Exhaustion Doctrine*, *in* Patents 1997, at 419, 421 (PLI Pat., Copyrights, Trademarks, and Literary Prop. Course Handbook Series No. 490, 1997).

[23] *See Silhouette*, 1998 E.C.R. at I-4812.

[24] *See id.* at I-4806.

Silhouette brought an action against Hartlauer seeking to enjoin Hartlauer from selling the spectacles under Silhouette's trademark, 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.[25]

In a preliminary opinion issued by Advocate General Jacobs, he 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.[26] The Advocate General concluded that Directive 89/104/EEC did not require member states to impose a principle of international exhaustion.[27] Had that been the intention, article 7(1) would not have limited the trademark holder's right to prohibit the importation of goods that had first been marketed with his consent *in the EC*.[28] The Advocate General also reasoned that the language of article 7(1) implicitly precludes international exhaustion because of the language limiting article 7(1) to the EC.[29] The Advocate General concluded that article 7(1) should be read restrictively as being the only situation in which exhaustion should defeat a trademark owner's claim.[30]

The Advocate General reasoned that article 7(1) is a derogation from the rights conferred on, and guaranteed to, the trademark owner under article 5(1) of the directive and should therefore be construed narrowly.[31] Article 5 provides the rights conferred by a trademark:

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[25] *See id.* at I-4807-08.

[26] *See id.* at I-4802.

[27] *See id.* at I-4810.

[28] *See id.*

[29] *See id. But see* W.R. Cornish, *Trademarks: Portcullis for the EEA?*, 20 E.I.P.R. 172 (1998) (suggesting that the commission's original directive was intended to apply to imports from outside the EC—its goal was to provide for international exhaustion). Cornish notes that the commission was subsequently influenced to insert the provision "in the Community" in response to pressure from varying sectors of the EU and international industries. It is this provision that has created the controversy about international exhaustion. The supporters of the amendment maintain that the text of the directive grants the power to employ trademark rights to prevent parallel imports from non-EEA states. *See id.*

[30] *See Silhouette*, 1998 E.C.R. at I-4810 through 4811.

[31] *But see* Cornish, *supra* note 29, at 175 (arguing that the Advocate General is correct in viewing exhaustion principles as a derogation of intellectual property rights, but that it is inconsistent with the court's willingness to apply broad derogation principles with respect to the internal market to totally disregard this reality and interpret them so narrowly with respect to the international market). Cornish argues: "A derogation ought to be interpreted as broadly or narrowly as its policy imperatives require." *Id.* at 175 n.25.

> (1) The registered trade mark shall confer on the proprietor the exclusive rights therein. The proprietor shall be entitled to prevent all parties not having his consent from using in the course of trade: (a) any sign which is identical with the trade mark in relation to goods or services which are identical with those for which the trade mark is registered; (b) any sign where, because of its identity with, or similarity to, the trade mark and the identity or similarity of the goods or services covered by the trade mark and the sign, there exists a likelihood of confusion on the part of the public, which includes the likelihood of association between the sign and the trademark. (2) Any Member State may also provide that the proprietor shall be entitled to prevent all third parties not having its consent from using in the course of trade any sign which is identical with, or similar to, the trade mark in relation to goods or services which are not similar to those for which the trade mark is registered, where the latter has a reputation in the Member State and where use of that sign without due cause takes unfair advantage of, or is detrimental to, the distinctive character or the repute of the trade mark.[32]

The 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 trademarks "enjoy the same protection under the legal systems of all Member States."[33]

In addition, support for the Advocate General's conclusions may be found in the EC trademark regulation because of its parallels with the directive.[34] The regulation contains exhaustion principles similar to those in the directive that operate within what is clearly intended as a comprehensive regime for regulating protections of the EC trademark. The Advocate General concluded, in light of these factors, that article 7(1) of the directive precludes member states from adopting the principle of international exhaustion.

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[32] Council Directive 89/104/EEC, art. 5, 1989 O.J. (L 40) 1.

[33] Cornish, *supra* note 29, 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"). However, Cornish also criticizes the Advocate General's conclusion as being "quite unclear why this should be the general upshot." *Id.*

[34] *See* 1994 O.J. (L 11) 1.

The ECJ proceeded to decide the case in the same manner as the Advocate General's opinion, as is usually the practice.[35] To no avail, Hartlauer maintained before the ECJ that Directive 89/104/EEC of 21 December 1988 left member states free to provide in their national law for exhaustion, 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 trademark rights by selling the goods in Bulgaria.

The ECJ was called upon to determine whether "[n]ational rules providing for exhaustion of trade mark rights in respect of products put on the market outside the EEA [international exhaustion] under that mark by the proprietor or with his consent are contrary to Article 7(1) of the [directive]."[36] The court concluded that "the directive cannot be interpreted as leaving it open to the Member States to provide in their domestic law for exhaustion of the rights conferred by a trade mark in respect of products put on the market in non-member countries."[37] Thus, Hartlauer was blocked from selling the spectacles it had imported from Bulgaria because Silhouette's rights under the trademark were still viable.

The goal of harmonization of exhaustion principles with respect to trademarks proved critically important to the decision. Relying on the recital previously set out above in the preamble to the directive, the ECJ reasoned that the directive represented the complete harmonization of the rules pertaining to the rights conferred by a trademark.[38]

In addition, the ECJ, without further explanation, cautioned that a situation in which member states were free to provide for either international exhaustion or community exhaustion would pose a serious threat to free trade.[39] The ECJ suggested that allowing the alternative situation—where one member state could provide for international exhaustion while others did not—would tend to promote price differentials between member states, which, according to the court, is an undesirable consequence.[40]

Several consequences flow from the court's decision. The decision strengthened the value of the trademark rights of the manufacturer to the

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[35] *See A Grey Area*, *supra* note 3, at 61 (explaining that the full court usually endorses the judgments of the Advocate General).

[36] *Silhouette*, 1998 E.C.R. at I-4800.

[37] *Id.* at I-4801.

[38] *See id.* at I-4811-12.

[39] *See id.* at I-4812.

[40] *See id.*

detriment of the consumer.[41] By allowing the international exhaustion principle to apply, the trademark will function to divide the market and to exploit price differentials among different markets. The ECJ also limited itself to considering the matter solely in terms of the effect international exhaustion would have in relation to community law. The court did not consider the possible international ramifications of its decision for the world market.[42]

Several arguments have been advanced in favor of and against the right to engage in parallel importation. As previously noted, some commentators argue against parallel importation because gray marketers are, in essence, free riding on the trademark holder's investments. Others who support free trade in parallel imports reduce the issue, rather simplistically, solely to the consumer's interest in getting a good deal. The best approach to the thorny problem of parallel imports would be to recognize that the issues presented require a delicate balance of all the interests involved to arrive at a solution that accounts for the policies behind trademark restrictions.

In some cases there should be genuine concern about a thriving gray market. Legitimate reasons may exist for a brand owner to trademark slightly different products in different geographic areas under the same mark.[43] For example, a manufacturer of diesel fuels may alter the composition of the product to tailor the product for climactic conditions unique to a geographic area. In this situation "the gray market holds no protection for the consumer [who obtains a product not suited to his or her geographic region]. Indeed, the consumer is badly and dangerously served."[44] However, it is also hard to argue against exhaustion in the case where the branded goods are of exactly the same quality and composition as those marketed in different regions.[45]

This Note examines the reasons underlying the disparate treatment of the exhaustion of trademark rights and parallel imports with respect to goods first

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[41] *See A Grey Area*, *supra* note 3, at 61 (arguing trademark law allows right holders to limit competition on price that damages consumer interests).

[42] *See id.* (explaining that the international community has yet to establish international trade-rules dealing with trademark rights and other countries are likely to follow the ECJ's position with respect to international exhaustion). In addition, William Cornish, a specialist in intellectual property at the University of Cambridge, expressed his reservations about a blanket prohibition on international exhaustion because of the international effects that are likely to follow the court's decision. He is quoted as saying that " 'the EU is such a big market that other companies are bound to retaliate by copying us.' " *Id.*

[43] *See* Brian March, *Brand Names Bite Back*, THE LAWYER, Aug. 11, 1998, at 20.

[44] *Id.*

[45] *See id.*

marketed within the EEA and goods first marketed outside the EC as a consequence of the *Silhouette* decision.[46]

Part I of the Note will address the historical treatment of intellectual property rights, specifically the trademark, within the EC, the economic goals of the EC, and how the exhaustion principle developed with respect to intra-community trade against this background.

Part II will examine the developments in trademark exhaustion principles for goods first sourced outside the EC and why these goods have received distinct treatment under community law. Part II will also argue that the ECJ should rethink its blanket prohibition against international exhaustion in favor of an approach that reflects the current thinking of the court with respect to parallel importation between the member states.

Specifically, the question to be addressed is why the importation and subsequent distribution of legitimate goods from outside the EEA should be deemed an unlawful use in light of the fact that parallel imports of legitimate goods within the EC itself is lawful. Additionally, this Note will suggest that the answer to *when* parallel imports should be considered an unlawful use in all cases, whether within the EC or importing from sources outside the EC, should be answered by considering the purposes and policies behind the trademark and trademark legislation.

Part III will briefly survey the history of the trademark in the United States and United States case law regarding trademarks to determine whether an unbending non-exhaustion approach should be adopted by the EU with respect to internationally marketed goods, or, on the other hand, whether the case law of the United States on exhaustion provides guidance for the EU as far as to what circumstances to apply international exhaustion principles. In conclusion, this Note will examine the policy choices that alternatively support the protection of the trademark holder's interests and balance the interests of the manufacturers versus the consumers who will be hurt by the ECJ's inflexible approach to the international exhaustion question.

II. THE HISTORICAL DEVELOPMENT OF THE EXHAUSTION PRINCIPLE AS APPLIED TO INTRA-COMMUNITY TRADE

The European Economic Community arose out of the Treaty of Rome, otherwise labeled the European Economic Community Treaty (the EEC

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[46] *See Silhouette*, 1998 E.C.R. at I-4799.

Treaty), in 1957.[47] In order "[t]o achieve [European] integration, the Treaty creates four 'economic liberties' existing among the Community's member states, free movement of goods, free movement of persons, free movement of services, and free movement of capital."[48]

Articles thirty to thirty-six of the Treaty of Rome cover quantitative restrictions and measures of equivalent effect on imports and exports between member states.[49] 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.[50] Although a fundamental goal of the EEC Treaty is to promote the free movement of goods within the community,[51] exceptions under article thirty-six have been made that allow member states to restrict the free movement of goods in certain circumstances.[52] Specifically, article thirty-six recognized that member states must be able to "regulate imports and exports to the extent necessary to give effect to the national policies that member states considered of primary importance."[53] Because of this recognition, the EEC Treaty under article thirty-six justified certain import restrictions grounded in member state's laws based on intellectual property rights such as trademarks, copyrights, and patents.[54] Thus, a conflict developed between the goal of the EEC to promote the free movement of goods within the community and the protection of national intellectual property rights.[55] The EC has sought to resolve the tension between member states' laws regulating trademarks, which

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[47] *See* TREATY ESTABLISHING THE EUROPEAN ECONOMIC COMMUNITY, Mar. 25, 1957, 298 U.N.T.S. 11 [hereinafter EEC TREATY].

[48] Somorjai, *supra* note 7, at 433.

[49] *See* EEC TREATY, *supra* note 47, arts. 30-36.

[50] PETER OLIVER, FREE MOVEMENT OF GOODS IN THE EUROPEAN COMMUNITY UNDER ARTICLES 30 TO 36 OF THE ROME TREATY 1 (3rd ed. 1996).

[51] For example, articles 30 to 34 seek to eliminate measures that might be passed by member states that would amount to restraints on intra-community trade. EEC TREATY, *supra* 47, arts. 30-34.

[52] *See* Somorjai, *supra* note 7, at 434. Article 36 of the Treaty of Rome provides, "The provisions of Articles 30 to 34 shall not preclude prohibitions or restrictions on imports, exports, or goods in transit justified on grounds of public morality, public policy, or public security; the protection of health and life of humans, animals, or plants; the protection of national treasures possessing artistic, historic, or archaeological value; or 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." EEC TREATY, *supra* note 47, pt. 2, tit. I, art. 36.

[53] Somorjai, *supra* note 7, at 434.

[54] *See id.*

[55] *See id.*

operate as a restriction on free trade and the free movement of goods through trademark exhaustion principles.

III. A BRIEF HISTORY OF THE FUNCTION OF TRADEMARK RIGHTS WITHIN THE COMMUNITY

First and foremost, intellectual property rights are territorial.[56] National law defines the scope of their protection.[57] Thus their protections vary from nation to nation.[58] Additionally, these rights allow the intellectual property right holder to control the use and distribution of a work within a country.[59] For example, an individual who owns the copyright for a book in France cannot, relying on the French copyright, control the reproduction and sale of the work outside of France.[60] However, the intellectual property holder is permitted to block the distribution and sale of the work in France.[61] The work, which has been lawfully produced in another country, is a gray market good, and its importation will be barred unless the principle of exhaustion applies.

As previously noted, the exhaustion principle provides that intellectual property rights expire upon the first sale of the protected work or good.[62] As a result, the owner can no longer control the distribution or sale of his protected work or goods. The EC applies this principle to intra-community trade. Thus, once a protected intellectual property has been sold in the EC with the owner's consent, it can be freely imported into any other member state.[63]

Because applying for a trademark in each member state of the EC would be a cumbersome process, the community has sought to develop a trademark policy applicable throughout the community, thereby eliminating the need to apply for individual trademarks in each member state.[64]

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[56] *See* Jones, *supra* note 18, at 682-83.

[57] *See id.* at 683.

[58] *See id.*

[59] *See id.*

[60] *See id.*

[61] *See id.* at 683.

[62] *See supra* text accompanying note 11.

[63] *See* Jones, *supra* note 18, at 684.

[64] Council Regulation 40/94, art. 13, 1994 O.J. (L 11) 1, 2. Article 13 provides:

> 1. A Community 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.
>
> 2. Paragraph 1 shall not apply where there exist legitimate reasons for the proprietor to oppose further commercialization of the goods, especially where

In order to understand the EC's stance with regard to international exhaustion and to assess it critically, it is important to understand the traditional function of the trademark and the case law regarding the trademark with respect to intra-community trade. EC law has focused on protecting the specific subject matter of a trademark and the essential function of a trademark. The specific subject matter of a trademark is:

> the guarantee that the right holder has the exclusive right to use that trademark for the purpose of placing products protected by the trademark into circulation for the first time. Its purpose is to protect the owner of the trademark from competitors who wish to take advantage of the status or reputation of the trademark.[65]

The idea of protecting the specific subject matter of trademarks was first enunciated by the ECJ in *Centrafarm B.V. v. Winthrop B.V.*[66] This case involved Centrafarm, a parallel importer which sold pharmaceuticals in the Netherlands where the goods were priced higher than in the United Kingdom.[67] Winthrop, the producer, registered its trademark for the pharmaceuticals in both the United Kingdom and the Netherlands.[68] Winthrop relied on its Dutch trademark to argue that Centrafarm was prohibited under article thirty-six from importing and reselling the pharmaceuticals to take advantage of the price discrepancies.[69]

In order to determine the extent of Winthrop's trademark rights under article thirty-six, the court noted that "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."[70] The court reasoned that because Winthrop had put its pharmaceutical product in the market for the first time in the United Kingdom, the specific subject matter of the trademark had been protected.[71] Thus, Winthrop was barred from using Dutch trademark law to prevent

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> the condition of the goods is changed or impaired after they have been put on the market.

[65] Somorjai, *supra* note 7, at 440.

[66] Case 16/74, Centrafarm B.V. v. Winthrop B.V., 1974 E.C.R. 1183.

[67] *See id.*

[68] *See id.* at 1184.

[69] *See id.*

[70] *Id.* at 1190.

[71] *See id.*

Centrafarm from parallel importation.[72] According to the court, such an obstacle to the free movement of goods was not justified where the product had been put on the market in a legal manner in the member state from which it had been imported.[73] In other words, because the specific subject matter of the trademark had been protected by marketing the product in the United Kingdom and there could be no question of abuse or infringement of the trademark, Winthrop's rights under the trademark were exhausted throughout the EC.[74]

The position taken by the court in *Silhouette* with respect to international exhaustion clearly diverges from *Centrafarm*. Any reference to the protective function of the specific subject matter of the trademark or to the right to put the product into the market for the first time, does not appear anywhere in the court's analysis.

The court has also applied the concept of the essential function of trademarks to further define the scope of intellectual property rights under the trademark. Therefore, the court will examine the specific subject matter of the trademark 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 trademark, 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. . . ."[75]

In *Hoffman LaRoche v. Centrafarm*, Centrafarm reaffixed the original manufacturer's trademark to a pharmaceutical originally for sale in the United Kingdom and offered the repackaged product for sale in the Netherlands.[76] The court concluded that Centrafarm could not repackage Hoffman LaRoche's Valium pills that it had purchased in the United Kingdom and resell them in Germany without violating Hoffman LaRoche's German trademark rights. The court's reason was that the consumer was not adequately informed about the origin of the product and guaranteed of its condition.[77] Thus, the court

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[72] *See Centrafarm*, 1974 E.C.R. at 1190.

[73] *Id.*

[74] *See id.*

[75] Robert S. Smith, *The Unresolved Tension Between Trademark Protection and Free Movement of Goods in the European Community*, 3 DUKE J. COMP. & INT'L L. 89, 90 (1992) (*quoting* Case C-10/89, SA CNL-Sucal NV v. HAG GF AG, 1990 E.C.R. 3711, 3758, [1990] 3 C.M.L.R. 571, 608 (1990)).

[76] *See* Case 102/77, 1978 E.C.R. 1139, 1141, [1978] 3 C.M.L.R. 217, 220 (1978).

[77] *See id.* at 1163-64.

focused not only on the intellectual property holder's rights but also on the consumer's interest in being able to identify the origin of the product.

Ideal Standard v. IHT is another case involving trademark rights and the exhaustion principle.[78] Here, the court considered whether or not an assignment of trademark rights exhausted them. In reaching its decision, the court relied on the doctrine of consent set out in *Hag II*.[79] In refusing to hold that an assignment of trademark rights amounted to consent, the court infused the concept of control into its consent analysis. In *Ideal Standard*, construing the term "consent" quite differently from common understanding, the court reasoned that, due to a lack of control, consent to an assignment is not the consent required for exhaustion.[80]

Additionally, the court in *Ideal Standard* implicitly relied on the trademark's essential function in reaching its decision. The free movement of goods principle was subordinated to the essential function of the trademark—allowing consumers to identify the origin or quality of trademarked goods. The court's conclusion was necessary in the case of assignments because different quality goods could be manufactured under the same trademark—a situation that would create significant consumer confusion. Thus, the court's decision benefits consumers by protecting their expectations of quality and incidentally benefits proprietors of trademarks by allowing them to restrain parallel trade.

Given the reasons put forth by the court for choosing to either protect the intellectual property holder's rights under the trademark or for opting for exhaustion of the trademark rights, it is difficult to reconcile the EC's position with respect to intra-community trade with its position with regard to international trade recently enunciated in *Silhouette*. As previously noted, the EC examines several factors when determining whether to apply the principle of exhaustion to trademark rights.

In *Silhouette*, the issue was whether a trademark should be treated as exhausted by the marketing of goods abroad that legitimately bear the trademark. In resolution of the issue the court adopted an inflexible approach. It provided that the trademark on goods first marketed outside the EEA would not be exhausted in all cases without exception. It has been argued that this inflexible approach is the wrong position for the EU to adopt and that certain

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[78] Case C-9/93, IHT Internationale Heiztechnik v. Ideal-Standard, 1994 E.C.R. I-2789, [1994] 3 C.M.L.R. 857 (1994).

[79] In *Hag II*, the court adopted the doctrine of consent, stating that exhaustion of intellectual property rights occurs only with the owner's consent to putting its product into circulation. Case 10/89, SA CNL- Sucal NV v. Hag GF AG, 1990 E.C.R. 3711, [1990] 3 C.M.L.R. 571 (1990).

[80] *Id.*

exceptions should apply that carefully balance the policies and purposes behind trademark law.[81] For example, with respect to intra-community exhaustion principles upon first sale of trademarked goods within the EEA, certain exceptions do apply.[82]

To determine the precise delineation of which exceptions should apply and when they should apply under the EU's exhaustion doctrine, it may be helpful to examine the United States position on international exhaustion upon first sale. The United States approach may have some lessons for the EU and the ECJ's unduly restrictive point of view with respect to the principle of non-exhaustion recently laid out in *Silhouette*.

IV. THE HISTORY OF UNITED STATES LAW ON TRADEMARKS AND THE GRAY MARKET AND THE GUIDANCE IT PROVIDES

The United States does not apply the principle of international exhaustion in all cases. Rather, whether the principle of exhaustion will or will not apply turns primarily on whether the public is or is not likely to be confused or misled about the quality of the goods.[83] In gray market situations, there are often substantial similarities between the gray market and the authorized goods; however, in other cases, substantial differences exist. There are convincing policy reasons for choosing to treat these distinct situations differently with regard to the principle of exhaustion.[84] Material differences in the goods injure the local trademark holder's business, and gray market selling in this situation should be an actionable infringement.[85] But goods that are substantially similar present a different question. It borders on insensible to regard the importation of gray market goods as damaging to the local trademark holder provided "it can be proven that gray market goods are for all practical purposes the same as the authorized version. . . ."[86] The practice of selling these substantially similar goods should not be considered an actionable infringement.[87]

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[81] *See* Cornish, *supra* note 29, at 172.

[82] For example, in *Parfums Christian Dior v. Evora*, [1998] E.T.M.R. 26, [1998] R.P.C. 166, an exception to the community rule of exhaustion upon first sale was established by the court. This exception was grounded in the function and policies behind trademark law.

[83] *See* Cornish, *supra* note 29, at 173.

[84] *See* SETH E. LIPNER, THE LEGAL AND ECONOMIC ASPECTS OF GRAY MARKET GOODS 45 (1990).

[85] *See id.* at 46-47.

[86] *Id.* at 45.

[87] *See id.*

In the United States, trademark law developed in an attempt to accommodate the multiple purposes of the trademark—ensuring the quality and source of the product, as well as protecting the owner's investment in the trademark. Two sources of United States law may in some circumstances prohibit or prevent parallel imports, thereby protecting United States trademark rights after a first sale. Those provisions are section 42 of the Lanham Act and section 526 of the Tariff Act of 1930. These statutory provisions, discussed below, have applications for any discussion of parallel imports. The scope of these provisions will set the permissible boundaries for gray market activities in the United States.

The history of trademark law in the United States predates either statutory source of industrial property protections. Prior to the enactment of either provision, in *A Bourjois & Co., Inc. v. Katzel*, one of the earliest cases dealing with the parallel importation of goods, the Supreme Court set down many of the important precedents concerning the functions of trademarks in American law that endure today.[88]

In *Katzel*, the Supreme Court established the principle of the territoriality of trademarks.[89] Previously, a view of universality applied. Universality provided that if a trademark was lawfully affixed to merchandise in one country, the mark would follow the merchandise in the stream of commerce barring the possibility that the merchandise could infringe trademark rights although transported to another country where the exclusive right to the mark was held by someone other than the owner of the merchandise.[90] The consequence of this position was that trademark holders could not restrain parallel importation of genuinely marked goods purchased abroad and offered for sale in the United States. As a direct result of the decision in *Katzel*, today a principle of territoriality applies. The doctrinal implication of territoriality is that trademark rights guaranteed under United States law would not be exhausted by first sales outside of the United States.[91] In announcing the new principle of territoriality, the Supreme Court addressed the purposes and limitations of trademark law. Specifically, the Court sought to answer the following questions: whether a trademark is to be primarily protected for purposes of protecting local trademark owners' investment in their business

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[88] *See id.* at 13.

[89] A. Bourjois & Co., Inc. v. Katzel, 260 U.S. 689 (1923).

[90] *See* Walter J. Derenberg, *Territorial Scope and Situs of Trademarks and Good Will*, 47 VA. L. REV. 733, 733-34 (1961).

[91] *See* Donnelly, *supra* note 11, at 455 (explaining that this is not an accurate reflection of state of trademark law in the United States because the principle has been limited by subsequent decisions construing *Katzel* narrowly).

or whether a trademark is exclusively limited to guarding the public against confusion concerning the source and quality of the trademarked goods. Viewing the trademark as exclusively for the benefit of consumers without regard for the goodwill of businesses, which the trademarks are relied on to produce, is a limiting position that the Supreme Court did not embrace.[92] Rather, the Supreme Court took a more expansive view of the functions of the trademark.[93]

In *Katzel*, the plaintiff had purchased the United States business and trademark rights for JAVA, a French cosmetic powder manufactured in France by the seller who continued to operate its business in France.[94] The defendant, finding that the rate of exchange created a favorable climate for selling the face powder in the United States, purchased genuine JAVA powder in France, imported it into the United States, and sold it under the JAVA mark.[95] Even though the powders were substantially the same with respect to quality, the Court nevertheless held that the defendants were barred from making such sales because an infringement of the United States trademark rights would occur.[96] In so holding, Justice Holmes recognized the multiple functions of the trademark:

> 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 trademark here is that of the French house and truly indicates the origin of the goods. But that is not accurate. It is the trademark 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 good will of the business that the plaintiff bought.[97]

Holmes made clear in his opinion that trademarks "serve[] a function beyond that of mere source identifier, [and] that [they] represent broader concepts of

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[92] *See* LIPNER, *supra* note 84, at 17 (noting that by 1920 the Court seemed willing to protect a trademark owner's interest in goodwill).

[93] *See id.* at 18.

[94] *Katzel*, 260 U.S. at 689-90.

[95] *See id.* at 691.

[96] *See id.*

[97] *Id.* at 692.

business goodwill."[98] Here, a foreign firm sold the rights to register and use its trademark in the United States to an independent United States company only later to import and distribute its goods in the United States. Allowing the parallel imports in this scenario would work an injustice because the United States company had invested in developing the goodwill of the mark. However, it is equally clear that Holmes did not intend his opinion to be a blanket proscription on the importation and sale of gray market goods by his emphasis on the purchase of the company's goodwill. Therefore, the restriction against parallel imports enunciated by the Court in *Katzel* can be limited to the factual situation in which the trademark owner has purchased the goodwill of the business and is deserving of the protections which the trademark may afford to protect the owner's business. Thus, a complete prohibition of the parallel importation of genuine goods may be avoided.

Since the decision in *Katzel*, several sources of legislation have been passed that may in some circumstances prohibit or prevent parallel imports. For example, some protection for United States trademark holders after a first sale may be found in section 42 of the Lanham Act and section 526 of the Tariff Act of 1930.

Section 526 of the Tariff Act of 1930 provides:

> [I]t shall be unlawful to import into the United States any merchandise of foreign manufacture if such merchandise, or the label, sign, print, package, wrapper, or receptacle, bears a trademark owned by a citizen of, or by a corporation or association created or organized within, the United States, and registered in the Patent and Trademark Office.[99]

Section 42 of the Lanham Act provides that "no article of imported merchandise, which shall copy or simulate the name of the [sic] any domestic manufacture, or manufacturer . . . which shall copy or simulate a trademark registered in accordance with the provisions of [the Lanham Act] . . . shall be admitted to entry at any customhouse of the United States."[100]

Further, section 32 of the Lanham Act provides:

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[98] LIPNER, *supra* note 84, at 18.

[99] The Tariff Act of 1930 § 526, 19 U.S.C. § 1526(a) (1994). The Tariff Act was passed in response to the Court of Appeals decision in *A. Bourjois & Co., Inc. v. Katzel*, 275 F. 539 (2d Cir. 1921), *rev'd*, 260 U.S. 689 (1923), allowing for parallel imports of genuine goods bearing the same trademark as merchandise of the United States. *See* LIPNER, *supra* note 84, at 19.

[100] 15 U.S.C. § 1124 (1994).

> Any person who shall, without the consent of the registrant—(a) use in commerce any reproduction, counterfeit, copy, or colorable imitation of a registered mark in connection with the sale, offering for sale, distribution, or advertising of any goods or services on or in connection with such use is likely to cause consumer confusion, or to cause mistake, or to deceive . . . registrant. . . .[101]

Additionally, section 43(a) of the Lanham Act provides:

> (1) Any person who, on or in connection with any goods or services, or any container for goods, uses in commerce any word, term, name, symbol, or device, or any combination thereof, or any false designation of origin, false or misleading description of fact, or false or misleading representations of fact, which—
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> (A) is likely to cause confusion, or to cause mistake, or to deceive as to 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 . . . shall be liable in a civil action by any person who believes that he or she is or is likely to be damaged by such act.[102]

Sections 32 and 43 address when gray goods infringe upon a trademark. These provisions of the Lanham Act clearly require that a likelihood of confusion exist before a finding of liability is made. Further, section 42 of the Lanham Act addresses imported goods bearing infringing marks.

The Supreme Court has also examined the legality of the importation of genuine goods under section 526 of the Tariff Act in *K-Mart Corp. v. Cartier*.[103] Justice Kennedy, writing for the majority of the Court, explained the several contexts in which the gray market may arise: (1) where a domestic company "purchases from an independent foreign firm the rights to register and use" the foreign firm's trademark in the United States; (2) where a "domestic firm registers the United States trademark for goods that are

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[101] *Id.* § 1114(1)(a).
[102] *Id.* § 1125(a).
[103] 486 U.S. 281 (1988).

manufactured abroad by an affiliated manufacturer"; and (3) where the "domestic holder of a United States trademark *authorizes* an independent foreign manufacturer" to exclusively use the trademark in a particular foreign location, but not in the United States.[104] In the second example, 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."[105]

The Court concluded that customs regulations implementing section 526 of the Tariff Act did not bar the importation of all gray market goods.[106] The customs regulations at issue in *K-Mart Corp.* created two exceptions to the blanket prohibition on the importation of genuine gray goods. The first was the "common control" exception exemplified by the second example and the sub-classes. Second, the regulations created an "authorized use" exception as shown by the third example. The Court held the "authorized use" exception to be inconsistent with the plain language of section 526.[107] However, the Court upheld the "common control" exception.[108] Thus, the Court allows parallel imports of genuine goods where the United States trademark for goods manufactured abroad is registered by a domestic firm that is either (a) a subsidiary of the foreign manufacturer, (b) the parent of the foreign manufacturer, or (c) where the United States firm is operating a foreign plant which is not separately incorporated and owned by the domestic firm. The bottom line in both *Katzel* and *K-Mart* is the nature of the corporate relationship. Also, the Court will look to whether the firms structure their relationships in a way to reap the full benefit of their investments or whether the domestic companies would stand to lose the benefit of their investments if parallel importation were permitted.

United States courts have also interpreted the scope of trademark protections against parallel imports in the context of the Lanham Act. On several occasions, courts have concluded that the territorial protections of the Lanham Act will protect a merchant with a registered trademark in the United States where two merchants sell physically different products in the same market and under the same name.[109] The court in *Societe Des Produits Nestle* recognized the dual purposes of trademark law: protecting the bundle of

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[104] *Id.* at 286-87.
[105] LIPNER, *supra* note 84, at 113.
[106] *See* 486 U.S. at 281.
[107] *See id.* at 291.
[108] *See id.*
[109] *See* Societe Des Produits Nestle, S.A. v. Casa Helvetia, Inc., 982 F.2d 633 (1st Cir. 1992).

characteristics that consumers come to identify with a particular product so as to avoid consumer confusion and protecting the trademark owner's goodwill. Even though goods may be properly trademarked abroad, the court concluded that they still might be inappropriate for sale in the United States if physically different because of the likelihood of confusion standard under sections 43(a) and 32 of the Lanham Act.[110] Defining the difference that must exist between the products before the Lanham Act will come in to play to "honor[] the important linkage between trademark law and geography[,]"[111] the court stated the differences must be "material . . . between similarly marked goods. . . ."[112] In addition, the court stated that the material difference must be a difference "likely to confuse consumers. . . ."[113] Thus, unlike the current position of the ECJ, the United States courts have permitted products identical to a domestic product to be imported into the United States under the same mark because of the absence of Lanham Act violations.[114] The court went on to find material differences between the two similarly marked brands of chocolates based on the configuration, composition, and packaging of the chocolates.[115] The gray market chocolates manufactured for the domestic market were made of different ingredients, contained 5 percent more milk than their high-end counterparts, came in a larger variety of shapes, and were packaged differently.[116] Thus, the court concluded that a material difference existed between the products likely to cause consumer confusion and that the first sale doctrine did not apply to prevent the trademark holder from stopping the imports.[117]

In a case strikingly similar to *Silhouette*, the United States Court of Appeals for the Fifth Circuit in *Martin's Herend Imports, Inc. v. Diamond & Gem Trading USA, Co.*,[118] held that material differences could include mere differences in style between high-end products and their gray market

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[110] *See id.* at 637.

[111] *Id.*

[112] *Id.*

[113] *Id.* at 640.

[114] *See, e.g.*, Lever Bros. Co. v. United States, 877 F.2d 101, 107 (D.C. Cir. 1989) (distinguishing cases where gray market goods are "physically identical" to the authorized goods); Original Appalachian Artworks, Inc. v. Granada Elecs., Inc., 816 F.2d 68, 73 (2nd Cir. 1987) (barring importation of gray market dolls because the dolls were not intended for sale in the United States and were materially different from the dolls intended for the domestic market and sold in the United States). The court stated, "It is this difference that creates the confusion over the source of the product and results in a loss of [the trademark owner's] goodwill." *Id.*

[115] *See Societe Des Produits Nestle*, 982 F.2d at 642-43.

[116] *See id.*

[117] *See id.*

[118] 112 F.3d 1296 (5th Cir. 1997).

counterparts.[119] In *Martin's Herend Imports*, 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).[120] The owners of Diamond & Gem Trading USA, Co. (Diamond & Gem), the Juhaszs, obtained genuine Herendi goods bearing the mark from several sources and sold the figurines in the United States.[121] 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.[122] The court proceeded to note the minor stylistic differences between the authorized and the gray goods.[123] For example, some of the figurines were different shapes and were painted with different patterns and colors.[124] The court concluded that these differences were material and rejected an argument that the first sale doctrine protected the importation of the gray goods by Diamond & Gem.[125] Although the first sale doctrine generally protects a gray marketer from incurring liability for trademark infringement for subsequent sales of trademarked goods, the court declined to apply the first sale doctrine in the case of an unauthorized gray market importer.[126] The court apparently tried to strike a balance between the interests of trademark holders and consumers based on the policies behind trademark law. In doing so, however, the court derogated one of the most basic functions of trademark law—protecting the consumer from confusion.[127] Indeed, it is a bedrock principle that a likelihood of confusion must exist before an action for infringement may be maintained under the Lanham Act.[128] It is hard to see how the consumer could be confused by genuine goods that originated from the same Herendi factory in Hungary. Thus, the Fifth

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[119] *See id.* at 1301-02; *see also* Arif S. Haq, Martin's Herend Imports, Inc. v. Diamond & Gem Trading USA, Co.: *Gray Market Goods; Reason Makes a Run for the Border*, 23 N.C. J. INT'L L. & COM. REG. 381, 382 (1998) (discussing the court's opinion).

[120] *See* 112 F.3d at 1298.

[121] *See id.*

[122] *See id.* at 1302.

[123] *See id.*

[124] *See id.*

[125] *See id.* at 1302-03.

[126] *See id.* at 1303. *But see* NEC Elecs. v. CAL Circuit ABCO, 810 F.2d 1506, 1509 (9th Cir. 1987) ("Once a trademark owner sells his product, the buyer ordinarily may resell the product under the original mark without incurring any trademark law liability.").

[127] *See* Haq, *supra* note 119, at 403.

[128] *See id.* at 392. Specifically, Haq notes that "without a finding that consumers are likely to be confused by an allegedly infringing use, a plaintiff cannot recover for trademark infringement" under the Lanham Act. *Id.* at 391.

Circuit's decision undermines the policy behind the material difference standard—a standard intended to place limits on the territoriality of trademark law. The court erred in its conclusion that material differences existed between the authorized and unauthorized goods. The decision in *Societe Des Produits Nestle*[129] is the appropriate standard for material differences—where real differences exist in product composition that may likely confuse consumers.

V. CONCLUSION

Several solutions present themselves for the ECJ based on the foregoing analysis of United States trademark law. The ECJ should not follow the approach taken by the Fifth Circuit in *Martin's Herends Imports*. Instead, the ECJ should permit parallel imports, consistent with its policies within the EC, whenever consumer confusion is not likely to result from the parallel imports from abroad. Thus, a policy of non-exhaustion after an international first sale should only govern where a likelihood of confusion exists as to the source or quality of the imported merchandise. This would properly balance the interests of trademark law—protecting consumers against confusion and protecting the goodwill of businesses.

Recently, the ECJ passed up the opportunity to limit the applicability of *Silhouette* despite public sentiment in favor of a retreat from the strict non-exhaustion policy that emerged from that decision.[130] In *Sebago*, GB-Unic put genuine Docksider and Sebago shoes up for sale in Belguim. GB-Unic had purchased the shoes from a parallel importer in San Salvador and imported them without getting consent from Sebago. The Belgian court referred two questions in the matter to the ECJ: (1) whether article 7(1) provides for the principle of international exhaustion of trademark rights and (2) whether there is consent if the trademark proprietor markets one batch of a certain type of goods within the EEA of which exhaustion is claimed or whether the owner's consent must relate to each individual item of the product of which exhaustion is claimed. The issue came down to whether or not the mark owner must consent to the marketing of a product line or to each batch of a certain type of product.

Question one was basically moot before hearing. *Silhouette*, decided in the interim, settled the question that article seven does not provide for interna-

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[129] 982 F.2d 642.

[130] *See* Case C-173/98, Sebago Inc., Ancienne Maison Dubois et Fils SA v. G-B Unic SA, [1999] 2 C.M.L.R. 1317 (1999).

tional exhaustion or leave it open to member states to provide in their domestic law for exhaustion of the rights conferred by the trademark in respect of products put on the market in non-member countries.

In spite of the considerable controversy surrounding its *Silhouette* decision, the ECJ did not utilize the factual differences between the two cases to permit parallel importation of goods of exactly the same quality as those already on the market in the EC with the proprietor's consent. Because Silhouette was marketing particular styles of sunglasses in the EC, one could distinguish the *Sebago* case on the grounds that Hartlauer was parallel importing outdated models that Silhouette no longer wished to market in the EC. In *Sebago* it was undisputed that the shoes were genuine. But, rather than eliminating the non-exhaustion principle for genuine goods that do not exhibit a material difference from those already on the market, the court further entrenched the position it promulgated in *Silhouette*.

Ruling on the question of consent, the court considered the arguments of both parties. Sebago maintained that the trademark owner's consent must be obtained for each defined batch of goods. GB-Unic argued that the proprietor of the mark impliedly consents to the marketing within the EEA of the whole product line when the mark owner has consented to marketing of individual batches within the EEA.[131] In sum, GB-Unic maintained that parallel goods can be opposed pursuant to article 7(1) only when the mark owner has yet to commence marketing an identical or similar product within the EEA. The court rejected GB-Unic's argument, reasoning that to accept it would be to impose a de facto rule of international exhaustion.[132] Thus, all parallel imports would necessarily be admitted into the EEA. Perhaps recognizing this approach is more favorable to the consumer and that one would be hard pressed to come up with reasons why parallel imports of this nature should be excluded, the court explained that it would be overreaching to interpret article seven in order to achieve such an objective, stating that the court could not be expected to "stand legislation on its head."[133]

The ECJ did not retreat from its prior position in *Silhouette*, yet reform may still be sought at the commission level.[134] Indeed, the court referred to the appropriate remedy, in this case, should the directive be found to produce "unacceptable" results: take legislative action and amend it. Already the commission has announced its intention to conduct a study on the economic

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[131] *See id.* at 1325.
[132] *See id.* at 1326.
[133] *Id.*
[134] *See id.*

impact of the *Silhouette* decision.[135] This study will result either in new legislation favoring the parallel importer or in an endorsement of the policies behind the court's refusal to provide for international trademark exhaustion.[136] Until the results are in, the rules are black and white and, as they have been interpreted, leave little room for the gray.

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[135] *See* Anna Carboni, *Cases About Spectacles and Torches: Now Can We Seè the Light?*, 1998 E.I.P.R. 470, 473 (1998).
[136] *See id.* at 473.