S. HRG. 99-1009

GRAY MARKET IMPORTS

HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL TRADE

OF THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

JULY 29, 1986

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GRAY MARKET IMPORTS

TUESDAY, JULY 29, 1986

U.S. SENATE,
COMMITTEE ON FINANCE,
SUBCOMMITTEE ON INTERNATIONAL TRADE,
Washington, DC.

The hearing was convened, pursuant to notice, at 9:30 a.m., in room SD-215, Dirksen Senate Office Building, the Honorable John C. Danforth (chairman) presiding.

Present: Senators Danforth, Chafee, Heinz, Symms, and Grassley.

[The press release announcing the hearing, and the prepared written statements of Senators Roth and Chafee follow:]

[Press Release No. 86-058, July 1, 1986]

SENATE FINANCE COMMITTEE SETS HEARING ON GRAY MARKET GOODS BILL, S. 2614

Senator Bob Packwood (R.-Oregon), Chairman of the Senate Committee on Finance, announced today that the International Trade Subcommittee will hold a hearing on issues arising from the importation of "gray market" goods. Consideration will focus on S. 2614, introduced by Senator John Chafee (R.-Rhode Island). The hearing will take place on Tuesday, July 29, 1986, beginning at 9:30 a.m. in Room SD-215. Senator John Danforth (R.-Missouri), Chairman of the Subcommittee, will preside.

"Gray market" goods, or "parallel imports," are those foreign-made products bearing a genuine trademark but imported by a party other than the U.S. trademark holder or authorized importer. In announcing the hearing, Senator Packwood noted that "in most cases, the courts have upheld the U.S. Customs Service's policy of allowing importation of gray market goods. However, a recent decision of the D.C. Circuit Court of Appeals (*COPIAT* v. *U.S.*), struck down Customs' regulations as contrary to the statutory mandate, leaving that Circuit in direct conflict with recent rulings of the 2d and Federal Circuits. Legislative clarification of this important issue may be needed."

STATEMENT OF SENATOR WILLIAM V. ROTH, JR.

Mr. Chairman, as an original co-sponsor of S. 2614 I would like to express my strong support for this proposed legislation, which is virtually necessary to protect the important consumer benefits long provided by parallel imports.

Without the competition from parallel imports, foreign manufacturers will have no constraints against their dual pricing strategies. Where foreign manufacturers set two prices for their products—one for the rest of the world and a higher one for the U.S. market—independent U.S. importers can purchase the products abroad at the world price and import them "parallel" to the so-called "authorized" channels. The ultimate saving to U.S. consumers is enormous, generally 20 to 40 percent less than the "authorized" price. For example, a "Seiko" watch which is priced at $200 in an "authorized dealer" store can be purchased at $120 to $140 in a discount store or through a discount catalog. The result is savings amounting to billions of dollars a year.

The existence of competition from parallel imports exerts a downward pressure on manufacturers' discriminatory pricing. A dramatic example of that is now occurring in the 35mm camera market. Previously, a Nikon motor driven 35mm camera was priced at $230 by authorized dealers and could be purchased for $156 in a discount store, for example. Recently, however, the Japanese manufacturers have decided to reduce their U.S. prices to their world prices. As a result, the gray market in 35mm cameras has dried up.

The foreign manufacturers are also seeking in the U.S. a kind of protection which their own countries do not allow to U.S. manufacturers. All our major trading partners, including Japan, France, and Germany, allow parallel imports. U.S. manufacturers cannot price discriminatorily against consumers in those countries and avoid competition from their own lower-priced products purchased independently abroad.

Legislation is now needed because of the May 6, 1986, decision in *COPIAT* v. *United States* of the U.S. Court of Appeals for the D.C. Circuit, which struck down the longstanding Customs Service regulations allowing parallel imports. The *COPIAT* decision, which conflicts with all other court decisions on the issue, including those of two other Courts of Appeal, was based on a narrow reading of the legislative history of the 1922 and 1930 Tariff Acts. Because the decision turned on Congressional intent, not on specific factual issues, I believe Congress should address the issue affirmatively now and end the uncertainty which could chill the parallel market severely during the years it may take to get Supreme Court review. The Court of Appeals in the *COPIAT* case itself specifically invited Congress to address the policy issues of discriminatory pricing and international fairness which I have referred to.

Finally, let me emphasize that parallel imports are genuine products, not counterfeits, and there is no fraud or consumer deception.

Mr. Chairman, S. 2614 deserves prompt and favorable action, in the interest of U.S. consumers.

Statement by Senator John H. Chafee

Mr. Chairman, America has long been an "island" where high prices are charged for products available at moderate prices elsewhere. For many decades, some overseas manufacturers have been setting up subsidiary companies in the United States, which they own and direct. Then these foreign manufacturers designate their American subsidiaries as the exclusive importers and distributors of fine foreign perfumes, Swiss and Japanese watches, cameras, tires, electronic goods, and other such products in this country. This exclusivity has allowed the manufacturers to charge higher prices in the U.S. than they do elsewhere.

The foreign firms see the United States as a wealthy market where they can demand—and get—higher prices for their goods than anywhere else in the world. They set prices on their goods higher here than they do overseas—often by as much as 30 to 40 percent.

This price differential has resulted in the development of a parallel market whereby genuine trademarked goods enter the United States outside the designated channel at much lower prices. American consumers save billions of dollars a year due to this parallel market.

The designated subsidiaries of the foreign manufacturers have branded these parallel imports as "gray market" goods. It is true that they enter American commerce outside of "authorized" channels, but these are not counterfeit goods or cheap imitations of brand name, trademarked goods, nor are they any different, in most cases from goods imported by authorized distributors. They are genuine goods, manufactured by the foreign trademark holder and thus they do not infringe trademarks or otherwise violate intellectual property rights.

For many years, Customs regulations have permitted independent American importers to compete with these designated, foreign-owned importers. A recent court case, striking down the Customs regulations, would bring a halt to this parallel market and the savings it has provided for consumers. The bill I introduced along with Senators Roth and Rudman, S. 2614, would maintain these consumer savings.

Independent American importers, often small businesses, buy these popular products overseas on the open market at the lower "world" price. The independents can then pay to ship them back to the U.S., pay U.S. Customs duties, and still sell them to retailers for 30 to 40 percent less than the manufacturers' own distributors are charging for the same products.

The difference in prices is quite remarkable. A Seiko watch, for example, which is sold for $200 by an "authorized dealer," may be sold for $120 or $140 by a discount retailer who buys from independent importers. Similar savings can be made on imported perfumes. Opium perfume, which is sold to authorized U.S. dealers at $96 per ounce, can be bought retail in Paris by an independent importer, shipped to the U.S. and duty paid, all for $69—still far less than U.S. wholesale price. Even Dom Perignon Champagne can be purchased at a discount: $40 from the discounter purchasing in the parallel market versus $60 from a normal dealer.

Some authorized distributors say they are being unfairly treated and severely injured by unauthorized competition. They say the retailers of gray market goods enjoy a free ride on their substantial investment in advertising any promotion. We welcome testimony on that issue today. Whatever the validity of this free ride argument, this claim overlooks their real complaint, namely the high prices charged to American distributors by foreign manufacturers. This all smacks too much of the old "fair-trade" gimmick, a means of maintaining consumer prices at controlled, artificially high levels. Let's shed no crocodile tears for foreign manufacturers and their "official" distributors who expect Americans to stand still for over-priced goods sold only through "authorized" channels.

Most courts have upheld the longstanding Customs regulations against the attacks of the authorized distributors: the Court of Appeals for the Federal Circuit last year in *Vivitar* v. *United States;* and the Second Circuit Court of Appeals on June 9, 1986, in *Olympus* v. *United States.* However, a recent decision of the U.S. Court of Appeals for the D.C. Circuit, *COPIAT* v. *United States* (May 6, 1986), struck down these regulations on the basis of a narrow reading of the legislative history behind Section 526 of the Tariff Acts of 1922 and 1930. The Court explicitly acknowledged that consumer and other benefits would be lost, but stated that these arguments more properly should be addressed to Congress. Thus the law is in a state of great uncertainty.

As a result, this urgently needed legislation makes clear current Congressional intent in favor of parallel importation and avoids leaving it to the Supreme Court to divine what Congressional intent was more than 50 years ago.

First, this bill adds to Section 526 of the Tariff Act of 1930 a new subsection (f) which enacts into law the current Customs regulations and the 50-year-old policy allowing parallel importation of genuine, trademarked articles in the case where related parties own the trademarks here and abroad.

Secondly my bill settles the issue the same way in trademark infringement suits, most of which have followed the Customs regulations, by making clear that the Lanham Trademark Act of 1946 does not restrict the importation or sale of foreign-made articles bearing a genuine trademark.

Opponents of my legislation argue that gray market goods confuse the consumer, who is left without warranty or recourse if there is a problem with the product. Purchasers of parallel imports can in most cases look to the discount retailer from whom he purchased the product for warranty service. In fact, most discount retailers offer even more extensive warranties than the manufacturers.

Sales of parallel imports would not continue to rise year after year if consumers were being deceived or confused by buying from price-competitive sources. The market continues to rise because price conscious Americans who shop at these stores are saving billions of dollars annually. This bill will simply allow shoppers to maintain those savings.

Senator DANFORTH. Are Mr. Miller and Mr. Tuttle present? If you could come forward I would appreciate it.

First, Senator Rudman has just come in the room. Senator, we are delighted to have you here. You have been very interested in the gray market subject I know for some time. And this hearing is on a bill which I believe you have co-authored along with Senator Chafee.

Would you like to proceed?

STATEMENT OF THE HONORABLE WARREN B. RUDMAN, A U.S. SENATOR FROM THE STATE OF NEW HAMPSHIRE

Senator RUDMAN. Mr. Chairman, thank you.

Mr. Chairman, I am pleased to be here today to testify in support of legislation introduced by Senator Chafee, myself, and Senator Roth relating to parallel, or gray market, imports.

As you know, parallel imports are genuine products which are brought into this country by independent importers. For half a century, this practice has been permitted in certain limited circumstances by Customs Service regulations implementing the Tariff Acts of 1922 and 1930.

These regulations allow the Customs Service to exclude and forfeit goods bearing counterfeit trademarks or genuine goods which are imported without the consent of independent U.S. trademark holders. Only where the foreign and U.S. trademark holders are owned by the same or related entities or where the trademark is applied to a foreign-made product with the permission of the U.S. trademark holder do the regulations permit parallel imports.

In the view of the sponsors, the policy embodied in these longstanding regulations is sound because it prevents foreign manufacturers from isolating the U.S. market and charging substantially higher prices in the United States than they charge for the same products overseas.

Unfortunately, on May 6 of this year, the U.S. Court of Appeals for the District of Columbia Circuit, in its decision in *COPIAT* v. *United States,* struck down these regulations based on its interpretation of congressional intent when the Tariff Acts of 1922 and 1930 were passed by Congress.

This decision runs counter to the decisions of two other Federal circuit courts of appeals in the cases of *Vivitar* v. *United States,* and *Olympus* v. *United States.* Moreover, this decision flies in the face of a 50-year-old, consistently applied Customs Service policy which has been left unchanged by Congress.

However, notwithstanding my belief that *COPIAT* was wrongly decided, I recognize that the decision has cast doubt on the validity of the regulations. For this reason, I strongly urge Congress to pass this legislation in order to clarify the law and congressional intent with regard to the entire issue of parallel imports. S. 2614 merely writes the Custom Service regulations into law. It does nothing to alter the practice followed by the Customs Service for the last 50 years and it does not authorize the importation of any item which is excludable under current law.

Mr. Chairman, a market for parallel imports exists in this country only because foreign manufacturers continue to charge U.S. consumers more than they charge consumers in the rest of the world for the same or comparable items.

As a result, independent importers are able to take advantage of this price discrepancy by purchasing items abroad at low prices and importing them into this country. Even after shipping costs and Customs duties, these items may still sell for 30 to 40 percent less than the price charged by the manufacturer's authorized distributors. It is clear that parallel imports benefit the consumer by making available genuine, foreign-made products at prices below that offered by the manufacturer's authorized distributor.

By way of illustration, a Seiko watch sold by the authorized dealer for $200 might be sold for $120 to $140 by a retailer who purchases the same watch from a parallel importer. Opium toilet water sold by the manufacturer's authorized distributor would generally cost about $42 for a 2-ounce bottle. The comparable gray market item would sell in this country for about $30.

Yet another example of how the gray market works to the benefit of consumers is the case of the Olympus camera. Formerly, an

Olympus camera was price at $325 in authorized stores, while being sold for $290 through the gray market. In response to price competition, Japanese manufacturers have now dropped their prices in the United States to the world price, thereby drying up the gray market for these cameras. Moreover, in some cases, the gray market allows the consumer access to models of an item which is available in the world market but not sold in the United States.

Mr. Chairman, the parallel import market currently saves U.S. consumers billions of dollars each year. I see no reason to sacrifice these billions in consumer savings to protect the profits of foreign manufacturers by sanctioning their discriminatory pricing policies. In fact, all of our major trading partners permit parallel imports into their countries. What we see here is an effort by foreign manufacturers to do in the United States what their own countries will not permit U.S. manufacturers to do and what U.S. manufacturers cannot do within the United States.

I urge this committee and Congress to adopt the legislation. I would be pleased to answer any questions.

Mr. Chairman, I would first like to make some additional comments. In a long series of legislative negotiations last year involving the importation of automobiles, we found that under the two-tier pricing practice perpetrated by foreign manufacturers, the difference between what people would pay for a car sold by an authorized dealer and an identical car purchased overseas, by a gray market importer even adding on conversion costs necessary to meet U.S. safety and emission control standards, were exhorbitant.

Interestingly enough, as the dollar has weakened the market forces have taken over, and that particular gray market has shrunk. That is fine because the free market is operating as it should.

The point that I want to make here is that the only people who will benefit from shutting down the gray market as advocated by some are the foreign manufacturers who will simply add to their profits, and thus increase U.S. balance of payments, which I hardly think is a worthwhile aim of the Congress.

And I will be happy to answer any questions, Mr. Chairman.

Senator DANFORTH. Thank you, Senator Rudman.

Let me just give you one example and ask you how you think we should deal with this.

Let's suppose that a foreign-made product is sold in this country by its authorized distributor for $300, and that the distributor has, himself, spent for that product $50 promoting it, advertising it, and he has advertised the brand's name. And then K-Mart goes over to the other country, and buys the product cheaper, and comes into this country and sells the product for, say, $275. Do you think there is any problem in that, that K-Mart would be getting a free ride at somebody else's advertising expenses?

Senator RUDMAN. I think unquestionably the argument of free ride in that hypothetical cannot be refuted. Obviously there is a free ride to some extent, although marketing costs do not account for the entire price discrepancy. But the answer, it seems to me, is to make sure that the authorized distributor gets the kind of a price break for that product that K-Mart was able to achieve by buying it at the lower European price.

I am a great believer in free markets, and it seems to me that if the product was offered through the authorized dealer at the kind of a price that was competitive in the world market, then the expenses to the authorized dealer for promotion and so forth might be less.

I think a great example is Japanese cameras. You cannot buy a camera in this country that is not manufactured in Japan, with some small exceptions. I think 90 percent of the cameras sold in this country are Japanese.

There was a terrific two-tier pricing system—I noticed it myself when I was in the Far East about 3 years ago and made comparisons, being a photographer as a hobby. And sure enough, when enough of these cameras were imported by parallel importers, the legitimate dealers worked something out with the various Japanese camera manufacturers and the price differential immediately was shrunk to almost nonexistent for most cameras. Now the gray market in cameras is a lot less attractive than it was before.

So I say that the free market ought to operate.

Senator DANFORTH. Thank you.

[The prepared written statement of Senator Rudman follows:]

STATEMENT OF SENATOR WARREN B. RUDMAN OF NEW HAMPSHIRE

Mr. Chairman, I am pleased to be here today to testify in support of legislation introduced by Senator Chafee, myself and Senator Roth relating to parallel, or gray market, imports.

As you know, parallel imports are genuine products which are brought into this country by independent importers. For half a century, this practice has been permitted in certain limited circumstances by Customs Service regulations implementing the Tariff Acts of 1922 and 1930. These regulations allow the Customs Service to exclude and forfeit goods bearing counterfeit trademarks or genuine goods which are imported without the consent of independent U.S. trademark holders. Only where the foreign and U.S. trademark holders are owned by the same or related entities or where the trademark is applied to a foreign-made product with the permission of the U.S. trademark holder do the regulations permit parallel imports.

In my view, the policy embodied in these long-standing regulations is sound because it prevents foreign manufacturers from isolating the U.S. market and charging substantially higher prices in the United States than they charge for the same products overseas. Unfortunately, however, on May 6, 1986, the U.S. Court of Appeals for the District of Columbia Circuit, in its decision in *COPIAT* v. *United States*, struck down these regulations based on its interpretation of congressional intent when the Tariff Acts of 1922 and 1930 were passed by Congress. This decision runs counter to the decisions of two other Federal Circuit Courts of Appeals in the cases of *Vivitar* v. *United States* and *Olympus* v. *United States*. Moreover, the decision flies in the face of a 50 year old, consistently applied Customs Service policy which was left unchanged by Congress. However, notwithstanding my belief that COPIAT was wrongly decided, I recognize that the decision has cast doubt on the validity of the regulations. For this reason, I strongly urge Congress to pass this legislation in order to clarify the law and congressional intent with regard to the entire issue of parallel imports. S. 2614 merely writes the Customs Service regulations into law. It does nothing to alter the practice followed by the Customs Service for the last 50 years and it does not authorize the importation of any item which is excludable under current law.

Mr. Chairman, a market for parallel imports exists in this country only because foreign manufacturers continue to charge U.S. consumers more than they charge consumers in the rest of the world for the same or comparable items. As a result, independent importers are able to take advantage of this price discrepancy by purchasing items abroad at low prices and importing them into this country. Even after shipping costs and customs duties, these items may still sell for 30 to 40 percent less than the price charged by the manufactures' authorized distributor.

It is clear that parallel imports benefit the consumer by making available *Genuine*, foreign-made products at prices below that offered by the manufacturer's authorized distributor. By way of illustration, a Seiko watch sold by the authorized dealer for $200 might be sold for $120 to $140 by a retailer who purchases the same watch from a parallel importer. Opium Toilet Water sold by the manufacturer's authorized distributor would generally cost about $42 for a two ounce bottle. The comparable gray market item would sell in this country for about $30. Yet another example of how the gray market works to the benefit of consumers is the case of the Olympus camera. Formerly, an Olympus camera was priced at $325 in the authorized stores, while being sold for $290 through the gray market. In response to this price competition, Japanese manufacturers have now dropped their prices in the United States to the world price, thereby drying up the gray market for these cameras. Moreover, in some cases, the gray market allows the consumer access to models of an item which is available in the world market but is not sold in the United States.

Mr. Chairman, the parallel import market currently saves U.S. consumers billions of dollars each year. I see no reason to sacrifice these billions in consumer savings to protect the profits of foreign manufacturers by sanctioning their discriminatory pricing policies. In fact, all of our major trading partners permit parallel imports into their countries. What we see here is an effort by foreign manufacturers to do in the United States what their own countries will not permit U.S. manufacturers to do and what U.S. manufacturers cannot do within the United States. I urge this Committee and the Congress to adopt this legislation and would be happy to answer any questions.

Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman.

First of all, I want to thank Senator Rudman who is a cosponsor with me on this legislation. I think Senator Rudman has put his finger on the essential point here, and that is that the manufacturer, in Japan or wherever it is—in France making the champagne—has set a two-price tier level. They are selling it domestically a lot cheaper than they are selling it to the distributor in the United States, or the distributor is very substantially raising his price.

Now you put your finger on a problem and we are going to hear a lot about that here today.

Oh, we are doing the heavy promotion in the United States, and this fellow is coming in and buying it overseas at the cheaper rate, and bringing it in, getting a free ride on our advertising. Well, that applies to everything in the United States; that somebody can advertise to come to Stowe, VT, to ski, and a certain group puts in money and others do not, and the fellow who has the lodge that does not advertise gets something out of it.

But there are ways of targeting the advertising so that the distributor over here can get the benefit of it. Please buy your Seiko watch at Annand Hope. That is where you can get a buy. And if K-Mart wants to say they are advertising it at a cheaper price, so be it. That happens constantly in the United States.

So I just don't think we want to spend a lot of crocodile tears worrying about that particular problem.

Now, another point on which there is liable to be some confusion: this has nothing to do with counterfeits or imitations. What we are dealing with strictly are the legitimate goods made by the manufacturer overseas.

I will put my statement in the record, Mr. Chairman, but I do want to thank Senator Rudman for his support, and I want to thank you, Mr. Chairman. I know that we are working on a tight time schedule, so I would put my statement in the record, as I say.

But I want to thank the cosponsors. Senator Rudman is also a cosponsor of this. Thank you.

Senator DANFORTH. Senator Heinz.

Senator HEINZ. Mr. Chairman, I simply want to put my opening statement in the record. I won't detain the committee any further, or Senator Rudman.

Senator DANFORTH. Senator Rudman, thank you very much.

Senator RUDMAN. Mr. Chairman, thank you.

I just want to say to my good friend from Rhode Island that I don't think anyone can fault someone who wants to bring good—and I emphasize "good"—but cheap champagne and perfume to the American people. [Laughter.]

Senator CHAFEE. Let me just say that the Senator is a former Attorney General and, of course, our chairman is also. This whole business reminds me of the fair trade legislation that used to be on the books. When I started practicing law in a large firm my job was to represent the manufacturers who were being undercut by their goods from not maintaining fair trade.

I will never forget, I wrote a very stern letter to a liquor distributor for not observing the fair trade prices and undercutting those prices. And he promptly posted my letter on his cash register, where everybody saw it, to back up his claim that he was selling below prices. [Laughter.]

Senator DANFORTH. Thank you, Warren.

Next, we have a panel consisting of Robert Miller, president of Charles of the Ritz Group, and president of the Coalition to Preserve the Integrity of American Trademarks; and James Tuttle, of K-Mart Corp., on behalf of the Association of General Merchandise Chains and the Coalition for Competitive Imports.

Mr. Miller, would you like to begin, please?

STATEMENT OF ROBERT H. MILLER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, CHARLES OF THE RITZ GROUP, LTD., NEW YORK, NY, AND PRESIDENT, COALITION TO PRESERVE THE INTEGRITY OF AMERICAN TRADEMARKS, ACCOMPANIED BY SCOTT D. GILBERT, ESQ.

Mr. MILLER. Thank you.

My name is Robert H. Miller. I am president and chief executive officer of Charles of the Ritz Group, Ltd., a wholly owned U.S. subsidiary of Squibb Corp., a publicly owned U.S. corporation.

I am appearing on behalf of the Coalition to Preserve the Integrity of American Trademarks [COPIAT], which represents more than 12,000 businesses throughout the United States.

We strongly oppose S. 2614, which would radically alter our trademark laws by codifying and expanding current Customs Service regulations. I would like to make four fundamental points.

First, the gray market affects not only U.S. distributors of foreign products, it also affects U.S. manufacturers which market trademarked consumer products both in the United States and abroad.

Second, the principal issue here is not price but trademark rights, which prevent consumer confusion and deception and preserve trademark owners' goodwill and abilities to obtain economic returns on their investments. This provides incentives for product development, marketing investments, and the maintenance of product integrity.

Allegations that gray market imports are caused by international price discrimination or resale price controls are blatant misrepresentations. Many gray market products sell at or above the prices of authorized products.

Third, gray market goods deceive consumers. The gray market products on the table to my left are just a few examples of how the consumer is being deceived.

Here are bars of Dial and Camay soap. They were purchased from gray market outlets where they were found in bins mixed with authorized products manufactured for the U.S. market, all selling for the same price. Each smells different than the American product, and the Philippines-made Dial contains color additives routinely used in that country but banned in the United States.

These are gray market Duracell batteries from Belgium which are sold at the same price as U.S. Duracell batteries. Batteries are perishable products requiring temperature control. And these were already starting to leak acid when they were purchased from a gray market retailer.

Here is a tube of Colgate toothpaste imported through the gray market from Brazil. It contains chalk and is lacking a key element in Colgate toothpaste, fluoride. And here are some Portuguese gray market Johnson & Johnson products. Consumers complained that this one is thin and runny, smells bad and does not pour right.

Here are others from the gray market. These contain the ingredient red dye No. 2, acceptable in the country of manufacture but banned in the United States.

Here are two gray market beverages, Pepsi Cola and Kahlua, produced according to foreign formulas. They taste different from their American counterparts. In fact, I would invite you to taste and smell the difference.

Senator DANFORTH. Not this early in the day. [Laughter.]

Mr. MILLER. Well, perhaps a little later.

Here are gray market Procter & Gamble detergents made in Venezuela and sold in Puerto Rico. Given different phosphate requirements, this detergent does not clean properly and fouls automatic washing machines.

I could go on with many more examples, but I hope these few illustrate my point.

Consumers of gray market products often do not get what they think they are buying.

Fourth, the gray market depends on free riding. It exists only where trademark owners have made substantial investments in product quality and awareness identified by their trademarks. We have no objection to gray marketeers importing our products and selling them however and at whatever prices they choose if they remove or cover our trademarks as the law currently permits.

As these examples demonstrate, demarking can be performed by gray marketeers in a cost effective manner that does not impair the physical product. Just such a demarking policy presently is being considered by the administration. Mr. Chairman, the antitrademark policy of S. 2614 would be bad for U.S. trademark owners, the U.S. economy and the U.S. consumer. America's intellectual property laws are an important cause of our economic strength and prosperity. They must not be destroyed.

Thank you.

Senator DANFORTH. Thank you, sir.

[The prepared written statement of Mr. Miller follows:]

BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL TRADE
COMMITTEE ON FINANCE
UNITED STATES SENATE

STATEMENT OF ROBERT H. MILLER
IN OPPOSITION TO S. 2614
July 29, 1986

My name is Robert H. Miller, and I am the President and Chief Executive Officer of Charles of the Ritz Group Ltd., a wholly-owned United States subsidiary of Squibb Corporation, which, in turn, is a publicly-owned United States corporation. I am appearing today on behalf of the Coalition to Preserve the Integrity of American Trademarks ("COPIAT"), a non-profit association consisting of 47 United States companies and seven trade associations, which together represent more than 12,000 businesses throughout the United States. While some COPIAT members are subsidiaries of foreign corporations, other members are United States-owned. All of COPIAT's members are United States companies; many have large manufacturing facilities in this country. COPIAT members include Procter & Gamble, Duracell, Seiko, Hasselblad, American Cyanamid and Greyhound. The members of COPIAT unequivocally oppose S. 2614, which would repeal, in large part, Section 526 of the Tariff Act and Section 42 of the Lanham Trademark Act as they apply to gray market goods.

I asked to appear before the Subcommittee because I strongly support the importance of United States trademarks and the fundamental purposes they serve, and because I believe that the gray market as an institution undermines free and fair competition in this country. Like the numerous trademark owners and authorized distributors that I represent, I have been encouraged under our free market system to make substantial investments in the goodwill and integrity of my trademarks in order to present a recognizable, well regarded symbol to the American public. Those trademarks and, I would submit, the very foundation of our intellectual property system are threatened by the legislation before this Subcommittee.

This gray market legislative challenge to our trademark laws is not a new one. In 1954, Congress was presented with a bill that, like S. 2614, would have made Section 526 inapplicable when the United States trademark owner was affiliated in any way with the foreign trademark owner. This effort was unsuccessful. See H.R. 9476, 83d Cong., 2d Sess. 9 (1954). Similarly, in 1959 a concerted effort was made to repeal Section 526 altogether. This effort also failed. See H.R. 7234, 86th Cong. 1st Sess. (1959). We would ask the Subcommittee likewise to rebuff this latest attempt to co-opt and alter our basic trademark system.

I. THE GRAY MARKET IS AN ISSUE OF TRADEMARK

The issue presented by S. 2614 is fundamentally a matter of trademark law. To put the issue in perspective, I would like at the outset to review briefly the function of a trademark and the purposes served by affording it protection.

As Congress has reaffirmed many times, our trademark laws serve two distinct but related purposes:

> "One is to protect the public so that it may be confident that, in purchasing a product bearing a particular trade-mark which it favorably knows, it will get the product which it asks for and wants to get. Secondly, where the owner of the trade-mark has spent energy, time and money in presenting to the public the product, he is protected in his investment from its misappropriation by pirates and cheats."

S. Rep. No. 1333, 79th Cong., 2d Sess. 3 (1946).

By preventing consumer confusion and deception and preserving a trademark owner's goodwill and his ability to obtain economic returns on his product and marketing investments, trademarks provide incentives for product development, marketing investments and the maintenance of product integrity. See generally, J. McCarthy, Trademarks and Unfair Competition § 2.1 (2d ed. 1984); A. Miller and M. Davis, Intellectual Property, Part II (1983). This, in turn, results in better informed consumer choice and increased inter-brand competition among products. Indeed, as the Lanham Trademark Act legislative history also states:

> "Trade-marks, indeed, are the essence of competition, because they make possible a choice between competing articles by enabling the buyer to distinguish one from the other. Trade-marks encourage the maintenance of quality by securing to the producer the benefit of the good reputation which excellence creates. To protect trade-marks, therefore, is to protect the public from deceit, to foster fair competition, and to secure to the business community the advantages of reputation and good will by preventing their diversion from those who have created them to those who have not."

S. Rep. No. 1333, supra.

The dual functions of a trademark -- avoiding consumer confusion and preserving trademark owner goodwill -- underlie the principle of "territoriality" of trademarks, a principle of trademark protection enunciated more than 60 years ago by Justice Holmes in the seminal case of A. Bourjois & Co. v. Katzel, involving gray market face powder:

> "[This] deals with a delicate matter that may be of great value but that easily is destroyed, and therefore should be protected with corresponding care . . . 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 stakes the reputation of the plaintiff upon the character of the goods."

260 U.S. 689, 692 (1923) (citations omitted).

As explained by Judge Leval in Osawa & Co. v. B&H Photo, 589 F. Supp. 1163, 1173 (S.D.N.Y. 1984), the basis of this principle is "that a mark may have not only a separate legal basis but also a different factual significance in each separate country where the local mark owner has developed an independent goodwill." Thus, rather than simply specifying the origin or manufacturer of a good, the lawful function of a trademark is "to symbolize the domestic goodwill of the domestic mark holder so that the . . . reputation (the value of the mark) will not be injured through use of the mark by others in domestic commerce." Id. at 1172. This principle and the basic functions of a United States trademark are frustrated by the gray market.

Like counterfeiting, the gray market has been with us as long as there have been valuable property rights in a trademark. And, like counterfeiting, the gray market has reached truly epidemic proportions in our national market place of strong, well-recognized brand names. In the case of products bearing our Yves Saint Laurent Opium trademark, for example, gray market goods make up approximately one third of all United States sales.

Gray market goods include virtually all types of consumer products. Our Yves Saint Laurent Opium and Beaute lines as well as Dial soap, Procter & Gamble detergent, Seiko, Rolex and Citizen watches, Nikon, Hasselblad and Canon cameras, Sony, Maxell and Panasonic electronic equipment, Reach toothbrushes, Colgate toothpaste, Duracell batteries, Johnson and Johnson baby powder, Michelin tires, Pepsi Cola, Kodak film, Mercury outboard motors, Rossignol skis, Michelin tires and Lladro porcelain are traded on the gray market, to name but a few. While the prices, types and functions of these products vary widely, all share one common characteristic: a valuable and well-known trademark. By free-riding on these trademarks and tapping markets created by the trademark owner, the gray market deceives American consumers and misappropriates trademark owner goodwill.

A. Consumer Deception

Gray market goods are inherently confusing and deceptive. Because they are not intended for shipment to or consumption in the United States they are most always different from United States trademarked products in one or more important respects. Because they bear trademarks identical to United States trademarks, however, gray market goods are almost certain to appear to the consumer to be indistinguishable from goods marketed directly by United States trademark owners and their authorized distributors.

Consumers purchasing a gray market product usually do not realize that the product is being sold outside the United States trademark owner's authorized distribution channels. In fact, in a random survey of consumers, 77 percent of those surveyed did not even know there was a gray market. Collado Associates, Inc., The Economic Impact of Diversion, at 52-53 (September 1984). Similarly, the International Trade Commission concluded from the results of a consumer survey prepared by Response Analysis Corporation on behalf of Duracell, Inc., that American consumers are likely to be confused into believing that foreign DURACELL batteries sold through gray market outlets in the United States are sponsored for sale by Duracell in the United States. _In re Certain Alkaline Batteries_, 6 I.T.R.D. 1849 (Nov. 5, 1984).

Documented consumer problems with gray market goods run the gamut from non-conforming merchandise and illegal ingredients to lack of factory authorized warranty or other post-sale services. _See_ _The Economic Impact of Diversion_, _supra_, Appendix 2. Indeed, consumer problems with the gray market have prompted New York City and states such as New York, New Jersey, Connecticut, Florida and California to consider legislation requiring that consumers be warned about the pitfalls of gray market products. They also have caused widely-read periodicals such as _Family Circle_ and _Good Housekeeping_ and well-known consumer columnists such as Sylvia Porter to publish prominent warnings about the dangers of buying gray market products.

Warranty problems are a case in point. Contrary to gray market assertions, the plain fact is that many gray market products simply are not entitled to factory authorized warranty service in the United States. Yet consumers purchasing gray market products often are not informed or are misinformed concerning the availability of United States warranties. This is the reason that the state laws noted above require explicit disclosure by gray market distributors of the lack of United States warranties, among other things.

As documented consumer problems show, however, lack of warranty service is but one facet of gray market consumer deception. For example, gray market goods may not conform to United States specifications. Cameras may be calibrated metrically rather than in feet and inches: electronic products may operate only with foreign voltage requirements and may not be serviceable in the United States; and photographic and electronic components may not correspond or be adaptable to United States product lines. See The Economic Impact of Diversion, supra, Appendix 2. A related problem exists with respect to precision products such as watches that must have certain internal markings in order to be imported legally into this country. See 19 C.F.R. § 11.9. Because gray market watches are not manufactured for importation into the United States, they lack the required markings. Gray market importers therefore must open and mark the watches themselves, often in uncontrolled and unsterilized environments, thereby greatly increasing the risk of defective performance. See The Economic Impact of Diversion, supra, Appendix 2.

In addition, gray market goods may not have been packaged for international transshipment, and are not subject to the inspection, transit and quality controls of United

States trademark owners and their distributors. As a result, batteries may have a shortened life, the flavor of beverages may deteriorate due to improper temperature controls during transit, and detergent may be ruined by excessive moisture from packaging inadequate for overseas transshipment. Similarly, cameras, watches and electronic equipment may suffer internal damage not readily detectable by the consumer at point of sale. See id.

Gray market products that are ingested or applied, such as food, cosmetics, fragrances and pharmaceuticals, may be prepared differently for foreign markets and thus in the case of beverages may have an entirely different taste. Many such products do not comply with United States ingredient labeling requirements. Others like gray market Procter & Gamble detergent may lack ingredients essential to proper performance under water conditions in the United States. Still others may contain ingredients prohibited by federal law because they may cause severe allergic reactions or may be carcinogenic. For example, 50,000 units of Oil of Olay imported through the gray market were recalled from the shelves of local retailers because they contained Red Dye No. 2, legal in the county of manufacture but banned in the United States. See FDC Reports, Toiletries, Fragrances and Skin Care 7 (Oct. 22, 1984). We at Charles of the Ritz have recently discovered in the Washington, D.C. area Yves Saint

Laurent Beaute cosmetics that were imported through the gray market and contain organic dyes, which while permitted in the country of manufacture, France, and elsewhere in Europe, are prohibited in the United States. Moreover, these products are over-labelled by the gray market with an ingredient statement that does not list the prohibited ingredients.

Other common deficiencies of gray market products include foreign-language instruction manuals; inadequate warranties and service by gray market distributors and unavailability of replacement parts and inventory. See The Economic Impact of Diversion, supra, Appendix 2. In fact, an article in the May 6-17 issue of New York City Business reported that one of the largest gray market camera distributors in New York is the leader -- by nearly 2-to-1 -- in complaints filed with the Department of Consumer Affairs.

I could continue with a litany of adverse consumer experiences with gray market goods that have been communicated to and compiled by trademark owners. The plain fact, however, is that consumers buying gray market products are not getting what they believe they are buying -- the quality, integrity, and service that the trademark represents. This is the difference between a mere physical product and an authorized product bearing our trademarks -- it is what our trademark laws are all about.

B. Misappropriation of Trademark Goodwill

In order to create the goodwill in our trademarks, to establish our brand reputations and to develop consumer markets, United States companies like mine make significant, essential investments in this country. These investments in goodwill are numerous and include: Extensive brand advertising; launch campaigns; in-store promotional activities, including sales force training, counter and window displays, gift-with-purchase programs and customer samples; external promotions such as trade show exhibits and sponsorship of sports or other events; research and development operations, including design of models and products tailored to the United States markets; packaging design; development of special testing and service equipment; United States market research; test marketing; United States manufacturing, assembling and packaging operations; sales forces; United States inventories, including replacement parts, subassemblies, assemblies, and accessories; warranty service departments and service centers; and customer relations, including customer training courses, product information centers, product literature and owner's clubs.

Indeed, since 1968, Charles of the Ritz Group has spent over $102 million on advertising and promoting our Yves Saint Laurent brand, which is 35 percent of our net sales for that period. And we are not unique. It has been estimated that the foregoing types of investments by trademark owners range up to 27 percent of the retail price of the products in question. In our industry, for example, fragrance and cosmetic companies are reported to have risked up to $35 million to introduce a single new product into the market. See The Economic Impact of Diversion, supra, at 28-29, 30-33 (September 1984).

A trademark owner's brand advertising and promotion is designed to create the market for a particular brand of product and must be substantial to be successful. In contrast, the kind of retail advertising and marketing that gray marketeers engage in is quite different. Such retail advertising depends upon creation of the market by the trademark owner's brand advertising. It is used to attract consumers to particular stores selling the branded product in question but only after the market for the product has been established by the trademark owner's promotional activities. See John D. Burke, Advertising in the Market Place 47 (McGraw-Hill 1980); Robert E. Oliver, Advertising at Work in the Modern Market Place 13 (McGraw-Hill 1976). A gray market importer thus relies on the trademark owner's substantial brand advertising and promotion to create the demand for a particular trademarked product. Through retail advertising it then uses the market created by the trademark owner without incurring any brand advertising costs. This type of free-riding is the reason why the gray market is able to exist.

The investments of my company and other trademark owners are precisely the kind of investment activity that the trademark laws, in creating a definable property right, are supposed to encourage. Gray market importers benefit from the reputation of our trademarked products without having incurred any of these investments. They thus deprive American trademark owners of some part of the expected return on our investments. To the extent that gray market goods displace sales of United States trademarked products, disrupt our marketing mechanisms and substantially decrease our economic returns, as they in fact do, they significantly diminish the value of our trademark goodwill and correspondingly diminish our incentives to continue to make these investments. The result will be bad for us but equally unfortunate for the United States consumer, who presently, due to the incentives created by our intellectual property system, has an opportunity to make an informed choice among quality products at competitive prices.

II. THE GRAY MARKET IS NOT A FUNCTION OF PRICE OR OF OFFSHORE CONTROL

It is our substantial investments in the trademark that make the free-riding of the gray market both possible and lucrative, and it is the consumer's recognition of the goodwill symbolized by our trademarks that enables gray marketeers to deceive them into buying products never intended to be distributed or consumed here. It is precisely these outcomes that the trademark law is intended to avoid. Now that I have discussed what the gray market issue is, let me turn briefly to what it is not.

A. Price

The price issue is a red herring. The gray market is simply and demonstrably not a function of price, either in terms of resale control or discrimination. The trademark laws that currently protect trademark owners and consumers from gray marketeers are intended to create investment, product and marketing incentives and thereby to promote interbrand competition for both the short and long run benefit of the public in terms of more and better products and lower prices. To date the important, substantive rights trademark law confers have been successful in providing these benefits. Trademarks, and the good will they represent, are treated to various protections irrespective of the price at which potentially infringing goods may be sold. As noted by the court in Osawa Co. v. B&H Photo, 589 F. Supp. 1163, 1176, 1178 (S.D.N.Y. 1984), the trigger of statutory trademark protection is the mark itself, not price.

Indeed, the members of COPIAT would not object to gray marketeers importing products and selling them in any manner and at whatever price they choose so long as they do so without free-riding on our trademarks and deceiving consumers. Current trademark law provides such a remedy. See 19 U.S.C. § 1526(c). Thus, if a product were "demarked," i.e., the trademark removed or covered, gray marketeers could import and sell these products on the basis of their marketing investments and post-sale services. In fact, enforcement of Sections 526 and 42 under just such a demarking policy is one of two alternatives presently being considered by the Administration "which might address certain of the economic problems created by parallel imports" in its formulation of a cohesive policy. 51 Fed. Reg. 22005 (June 17, 1986). In this regard, COPIAT will be providing detailed data to the Customs Service on demarking to demonstrate its feasibility and cost-effectiveness.

To date, however, gray marketeers have refused to demark products and have opposed the concept of demarking outright. The reason for their ardent opposition would seem to have nothing to do with price -- rather demarking would mean that (1) sellers of gray market products would have to stop free-riding on our investments and instead make their own and (2) gray marketeers would be unable to deceive consumers and instead would have to explain why the product does not bear a trademark. This would substantially curtail free-riding and permit the consumer to make an educated buying decision -- it is unpalatable to gray marketeers.

1. Resale Price Control

Gray marketeers attempt to convey the impression that discounted goods are synonymous with gray market goods. Nothing could be further from the truth.

First, manufacturers and their authorized distributors sell to all variety of retailers, e.g., discount houses, catalogue merchandisers, department stores and small mom-and-pop stores. For example, catalog merchandisers such as Best Products and Service Merchandise, are authorized distributors of Seiko watches and Minolta cameras, and regularly discount these and other products; in the Washington area Ritz Camera, Penn Camera and Pro Photo are authorized distributors of many well-known photographic products -- they commonly advertise discounts. And K-Mart, one of the major discount chains, is an authorized distributor of the products of many COPIAT members.

Second, it is a fact that gray market goods often do not sell for less than legitimate United States trademarked products. For example, in the case of batteries, gray market goods often sell at the manufacturer's suggested retail price. See Certain Alkaline Batteries, 6 I.T.R.D. 1849 (Nov. 1984). This also is the case with gray market fragrances. Charles of the Ritz Group conducted a random survey of 124 stores throughout the country selling our fragrances on the gray market and found 62 percent were selling at or above our suggested prices. Similarly, with respect to products such as watches and cameras, at some gray market retail outlets asserted discounted prices may actually turn out to be higher than the manufacturer's actual suggested retail price.

Thus, the issue of enforcement of intellectual property rights in the context of the gray market is far different from the issue that arose in the 1960's with respect to the "fair trade laws." Those laws were designed to permit a manufacturer to enforce the price at which its goods could be sold at retail. The enforcement of our intellectual property laws has nothing to do with the price at which the trademarked goods or infringing merchandise is sold at retail. Indeed, the plethora of authorized retailers that routinely discount their products suggests the absence of any scheme by United States trademark owners to engage in resale price maintenance. Moreover, United States trademark owners are not immune from the antitrust laws. It is a *per se* violation of the antitrust laws for any companies to set retail prices. To the extent that any companies violate these laws, they subject themselves to liability. *See* *Goldfarb* v. *Virginia State Bar*, 421 U.S. 773 (1975); *Brief for the United States of America in Bell and Howell*: *Mamiya Company* v. *Masel Supply Company*, 82-7857 (2d Cir. Feb. 25, 1983).

2. Price Discrimination

Similarly, the gray market issue is not one of price discrimination. In this regard, I would commend to Members of the Subcommittee a detailed economic analysis prepared by the highly regarded economic consulting firm of Lexecon, Inc. at COPIAT's request. As this study indicates, and as we believe the additional detailed economic data to be submitted to the Administration in response to its June 17 Federal Register request will show, the gray market fundamentally is a matter of free-riding and not price discrimination.

First, there simply is no empirical evidence to support the notion of widespread price discrimination against the United States. To the contrary, existing data show that United States prices are lower, not higher than prices in foreign economies. See Irving B. Kravis and Robert E. Lipsey, Toward an Explanation of National Price Levels, Princeton Studies in International Finance, No. 52 (November 1983) at 2, 12.

Second, our data indicates that many United States trademarked products are sold to authorized United States distributors at prices that are less than those charged by the manufacturer to distributors overseas. Moreover, it is elementary economics that price discrimination is feasible only to the extent that a manufacturer is free from competition in the market where it is charging the higher price. In most markets subject to gray market importation, however, manufacturers face intense competition from other manufacturers of similar products who would profit from undercutting the manufacturer's higher United States price. In the highly competitive fragrance market, for example, I am unaware of a company with greater than a seven percent market share for any particular brand. Our Yves Saint Laurent Opium brand, which ranks second in the United States market, has only a four percent market share.

It also bears mention that gray market importation is an international phenomenon, and not confined to the United States. The gray-market controversy exists in Japan, Great Britain, West Germany and other nations, as well as here. If the United States were being discriminated against, this would not be true: gray-market importation would be a one-way street leading to the United States. It is not.

In fact, in closely examining a gray market import case several years ago where the gray marketeer claimed that the gray market was merely a response to price discrimination, the Antitrust Division of the Justice Department concluded otherwise:

> "Indeed, the legislative history of the Lanham Act reflects a legislative determination that protection of investments in goodwill and product quality as well as preventing consumer deception were statutory goals . . . The same trademark policy

> considerations apply whether or not the U.S. trademark owner is controlled by a foreign producer of the trademarked product. A vertically integrated manufacturer, like an independent United States distributor of a foreign product, needs to protect its investment in advertising and promotional activities in the United States . . . Federal trademark and antitrust policies are complimentary, not antagonistic. There is no need to arbitrarily narrow trademark protection in order to advance antitrust policy. On the contrary, the use of trademarks, and their consequent protection under federal statute, generally enhances competition by improving consumer awareness."

Brief for the United States of America in Bell and Howell: Mamiya Company v. Masel Supply Company, 82-7857 (2d Cir. Feb. 25, 1983) at 11, 12, 16.

B. Overseas Control

The gray market also is not a function of the failure of United States trademark owners to control distribution overseas. Gray market goods are imported into the United States through many different countries, including Japan, Panama, Europe, South America, China, Hong Kong, Korea, Singapore and Canada. Oftentimes the direct source of the gray market goods is a country other than the country of original manufacture or initial sale. To prevent the importation of gray market products, many United States trademark owners enter into foreign licensing agreements that bar the unauthorized exportation to the United States of trademarked products. In addition, many United States trademark owners use sophisticated technology to attempt to trace the origin of gray market products. Charles of the Ritz Group alone has spent more than $500,000 on a laser coding system; sophisticated gray marketeers, however, have produced the means to eradicate these codes.

Our company has had an extremely difficult time ascertaining the sources of diverted Yves Saint Laurent Opium products. We have spent over $1 million in the past few years hiring private investigators, implementing a computer tracking system and taking similar measures, all to little or no avail.

In the few instances where we have identified either foreign authorized customers who sold to diverters or foreign-based exporters of gray market merchandise, we have taken decisive action. We have terminated such accounts based on a valid and enforceable provision in our franchise agreements that prohibits them from selling for export and have brought several successful suits in France against these accounts as well as exporters for trademark infringement and unfair competition.

The fact is, however, that these actions by us and other trademark owners have not stemmed the massive flow of gray market goods into the United States. Indeed, the sophistication and secrecy of the gray market has given rise to another problem, namely, a link between the gray market and counterfeiting. See Drug Diversion, a Staff Report by the Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce, U.S. House of Representatives, 99th Cong., 1st Sess. (June 1985). Since the advent of the gray market, a number of fragrance companies have found counterfeit goods turning up in gray market channels. For example, in 1985, over 12,000 counterfeit bottles of Chloe were taken from the inventories of major gray market wholesale distributors and destroyed. Counterfeit Paco Rabanne fragrance has been found in gray market channels twice recently, and the bulk of the Yves Saint Laurent Opium counterfeits seized in 1985 were in the gray market distribution chain at the time of seizure.

This is compelling testimony to the effectiveness and stealth of the gray market network -- an international institution that is virtually impossible to control beyond the borders of the United States.

III. THE CUSTOMS SERVICE GRAY MARKET REGULATIONS HAVE NO POLICY BASIS

From the standpoint of the United States trademark owner who has experienced firsthand the misappropriation of his property rights and the deception of American consumers through the gray market, a United States trademark is of little value if its fundamental purposes cannot be fulfilled. That is why the protections afforded by Sections 526 and 42 to

United States trademark owners against the gray market are so important.

The Customs Service regulations that S. 2614 would codify and expand from the realm of government enforcement to third-party actions effectively deny these long-standing statutory protections to most United States trademark owners affected by the gray market. It therefore would be an understatement for me to suggest that, simply as a matter of trademark law, a codification of these regulations would signal a major recasting by Congress of the fundamentals of our intellectual property system.

There is another reason, however, why even those less sympathetic to the plight of trademark owners and consumers should reject the proposed legislation. Quite simply, the distinctions drawn by the regulations and S. 2614, i.e., involving the ownership of a trademark abroad or the relationship of the United States trademark owner to a foreign trademark owner, really have nothing to do with an evaluation of the disadvantages or advantages of the gray market as a matter of national policy.

After all, the Customs Service regulations, promulgated in 1972, are not the continuation of any longstanding, informed or cohesive enforcement policy. To the contrary, the present Customs Service regulations follow 50 years of checkered enforcement of Section 526 that has been neither consistent nor coherent. As stated by the District of

Columbia Circuit in Coalition To Preserve the Integrity of American Trademarks v. United States, No. 84-5890, Slip. Op. (D.C. Cir. May 6, 1986). "Neither the 1923 nor the 1931 regulations had recognized any exceptions to the broad mandate of Section 526 . . . Events of the 1950s reveal the Custom Service's profound confusion about the scope of Section 526 . . . ." Slip Op. at 23, 25. And in Vivitar Corp. v. United States, 761 F.2d 1552 (Fed. Cir. 1986), the Federal Circuit concluded that:

> "Customs has had and continues to have changing views of the role of Customs in enforcing Section 1526(a) . . . Rather than the consistent policy of administration over the years, it appears that Customs has had continuing questions concerning the reading of the statute."

Id. at 1565, 1568.

Moreover, it is not an exaggeration to say that present Customs Service regulations effectuate no discernible policy. In fact, the present regulations have been questioned on trade policy grounds by United States Trade Representative William Brock. See Letter to Commissioner of Customs, October 5, 1982. The Antitrust Division of the Department of Justice, joined by the Chief Counsel of the Customs Service itself, also has questioned on trademark and antitrust grounds the distinctions drawn by the Customs regulations. Brief for the United States of America in Bell and Howell: Mamiya Company v. Masel Supply Company, 82-7857 (2d Cir. Feb. 25, 1983) at 11, 12, 16, 17.

In addition, virtually every court that has considered the regulations has found them to be ill-advised and unsound as a matter of policy. In Osawa & Company v. B&H Photo, 589 F. Supp. 1163, 1178 (S.D.N.Y. 1984), Judge Leval characterized the distinctions drawn by "these crude regulations" to be "unsound both as antitrust policy and as trademark law." In Coalition To Preserve the Integrity of American Trademarks, Slip. Op. at 29, the District of Columbia Circuit stated that the regulations do not "display the necessary 'thoroughness and consistency' to merit judicial acceptance," characterizing Customs interpretation as "supported by [nothing] more than poorly articulated and vacillating reasoning." And, most recently, in Olympus Corporation v. United States, No. 85-6282 Slip Op. at 10, 11 (2d Cir. June 9, 1986), the Second Circuit, although sustaining the regulations on the dubious grounds that they merely guide the Customs Service's enforcement discretion, concluded that they are of "questionable wisdom," noting that modern antitrust law "would seem to make reassessment of section 133.21(c) appropriate at least insofar as those regulations rest on antitrust considerations."

In fact, although the three United States Courts of Appeals that have considered the validity of the Customs regulations reached different conclusions as to the latitude of the Customs Service in enforcing Section 526, all three courts determined that the Customs Service regulations do not define the rights of United States trademark owners under the trademark law in private actions against gray market distributors. See Olympus Corp. v. United States, supra; Coalition to Preserve the Integrity of American Trademarks v. United States, supra; Vivitar Corp. v. United States, supra. Thus, even the courts that felt constrained to uphold the regulations on narrow legal grounds expressly refused to hold that the regulatory exceptions carved out by the Customs Service constituted binding interpretations of the governing statute in third party actions. S. 2614 would expand the reach of the regulations in such cases as well.

* * *

In view of the foregoing, we believe it would be sheer folly to emasculate the most important statutory trademark protections against the gray market. However, irrespective of one's views on the substance of the gray market controversy, it makes no sense to enact into law regulations that have been so repeatedly and seriously questioned by both the courts and officials of the Administration.

Thank you for the opportunity to appear. I would be glad to answer any questions that the members of the Subcommittee may have.

Senator DANFORTH. Mr. TUTTLE.

STATEMENT OF JAMES C. TUTTLE, ASSISTANT GENERAL COUNSEL, ANTITRUST AND INTERNATIONAL, K-MART CORP., TROY, MI, ON BEHALF OF THE ASSOCIATION OF GENERAL MERCHANDISE CHAINS, INC., AND THE COALITION FOR COMPETITIVE IMPORTS, ACCOMPANIED BY STEPHEN KURZMAN

Mr. TUTTLE. Mr. Chairman, and honorable members of the subcommittee, my name is James Tuttle, assistant general counsel, antitrust and international for K-Mart Corp. I am testifying today on behalf of the Association of General Merchandise Chains, and the National Mass Retailing Institute has endorsed this testimony as well.

The terms, "parallel import" and "gray market merchandise" refer to trademarked brand name merchandise manufactured overseas by foreign makers or licensees and owners of trademarks which are promoted worldwide. More often than not, the owners of the trademarks are foreign-based manufacturers of cameras, watches, fragrances, and similar specialty hard-line merchandise bearing world-famous brand names.

Don't let the term "gray market" fool you. Such goods are genuine, not copied merchandise that the trademark owner has had made to his specifications. They are goods that the trademark owner initially sells overseas in foreign markets usually—not always but usually—at a much lower first-cost price than he sells the same item to retailers and distributors in the United States.

This you can understand is the economic cause for parallel importation by independent, free-market distributors inside the United States. Free market is a much more accurate term than the misnomer, gray market.

Lower distribution prices overseas and unfortunate attempts to set artificially high—and, if you please, fair trade style—manufacturer-controlled retail prices inside the United States create a magnet-like effect on the overseas free-market merchandise I have mentioned. This pulls such items toward importation into the United States.

Parallel imports have been and today are fully lawful, proper, and ethical practices which promote retail competition. Price, the quintessential mechanism on a market economy, is the most obvious reason for independent distributors to import free market merchandise. There are others, obviously. This enables K-Mart and other discount merchants to distribute at least some branded merchandise to millions of Americans at a fair price.

A further competitive reason underpins the importance of parallel imports of free-market branded merchandise. It is the fact that many manufacturers refuse to deal with or to sell to discount retailers, such as K-Mart. Refusals to deal prop up high, fixed retail prices. Refusals to deal are not hypothetical.

Last year, for example, Ralph Lauren Co. sued a Florida distributor for the allegedly unauthorized importation and sale of genuine Ralph Lauren colognes, claiming a violation of the copyright laws. Lauren lawyers stated in open court in the Federal District Court, Southern District, Florida, "We do not want Ralph Lauren products at K-Marts. And this is a right that Ralph Lauren has statutorily."

Based on such statements, the Federal court denied Ralph Lauren's motion for injunctive relief.

Above all, the American consumer is entitled to the same good deal on branded merchandise that is available to other consumers around the world, and most notably in the Western democratic economic markets in Europe. Continued freedom of parallel imports gives that good deal to American citizens.

In September 1984, Market Probe International, a private survey company in New York, conducted a consumer opinion survey related to parallel import distribution. Consumers were interviewed with a stratified sampling in six important retail markets: Atlanta, Boston, Chicago, Houston, Los Angeles, and Phoenix. Consumers were indifferent as to whether the item was imported by the trademark owner or by a free market distributor or was produced inside the United States.

Despite the clear benefits to consumers and their preferences I have outlined, trademark manufacturer-owners have recently mounted an unprecedented lobby assault on Government policies and Customs Service regulations which, for five decades, have allowed freedom of parallel import merchandise.

Any proposals to water down S. 2614 should be rejected. Such proposals as demarking, removal, or obliteration of the name brand or trademark, warning labels and the like, serve only to injure competition and are a plain attempt to give a black eye—the kiss of death, so to speak—to such merchandise.

I thank you gentlemen. And if you have any questions at all, I shall be pleased to try to answer them today or at a later time.

Senator DANFORTH. Thank you.

[The prepared written statement of Mr. Tuttle follows:]

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TESTIMONY

OF THE

ASSOCIATION OF GENERAL MERCHANDISE CHAINS, INC. (AGMC)

TO THE

SUBCOMMITTEE ON INTERNATIONAL TRADE

COMMITTEE ON FINANCE

U.S. SENATE

ON S. 2614

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Mr. Chairman and honorable members of the Subcommittee, my name is James C. Tuttle, assistant general counsel - antitrust and international for K mart Corporation, where I have been employed for 18 years. I am testifying on behalf of the Association of General Merchandise Chains (AGMC) in this matter.

The Association of General Merchandise Chains represents the nation's price-competitive general merchandise retail industry. AGMC's membership includes retail companies that operate more than 20,000 discount, variety, dollar, junior department, family center, off-price, factory outlet, catalog showroom and other general merchandise stores. Its members range in size and include many of the nation's largest retail chains as well as companies active in one or more regions of the country. AGMC member company stores are located in all 50 states and account for over $50 billion in annual sales.

My testimony today will cover: (1) benefits to competition, (2) benefits to consumers, and (3) reasons why no weakening amendments should be allowed to S. 2614, a bill which will codify Customs Service policy and Regulations which have been in force for 50 years.

I. Benefits to Competition

The terms "parallel imports" and "gray market" merchandise refer to trademarked, name brand merchandise manufactured overseas by foreign owners or licensees of trademarks which are promoted worldwide. More often than not, the owners of the trademarks are foreign-based manufacturers of cameras, watches, fragrances, and similar specialty merchandise bearing world famous brand names.

Don't let the term "gray market" fool you. Such goods are genuine (not copied) merchandise that the trademark owner has had made to his own specifications. They are goods that the trademark owner initially sells overseas in foreign markets, at a much lower first-cost price than he sells the same item to retailers or distributors in the United States. This, you can understand, is the economic cause for "parallel" importation by independent "free market" distributors located in the United States.

"Free market" is a more accurate term than the misnomer "gray market."

Lower distribution prices overseas and unfortunate tendencies to set artificially high and manufacturer-controlled retail price levels inside the United States, create a magnet-like effect on the overseas "free market" merchandise. This pulls such "free market" merchandise toward importation into the United States.

For nearly fifty years under Customs Service policy and Regulations, independent importation of "free market" merchandise on a basis "parallel" to imports by U.S. subsidiaries, licensees, "authorized" distributors, or trademark owners themselves, has been freely allowed. The practice of "parallel importation" has been, and is today a fully lawful, proper, and ethical practice which promotes retail competition. Such parallel imports are completely lawful under all trademark and antitrust laws in the United States.

Competition is promoted in that parallel importation of "free market" merchandise means that world famous brand and designer-label goods can be purchased by discount retail dealers such as K mart. Otherwise we are directly foreclosed from purchases of such branded goods from the overseas-based manufacturers.

In many cases the trademark owner, whether originating from Japan or somewhere else overseas, does not "intend" for the competitive branded goods to be sold in the United States. They are instead predestined for and shipped to some other market (Europe for example), often at a much lower first-cost price than the very same merchandise is sold by them in the United States.

There is no reason why British, French, or West German consumers should pay less than Americans do for branded cameras, watches, fragrances, and tires, to name a few of the more significant items which K mart or importers in the U.S.A. may purchase through "parallel" or "dual" distribution channels that are competitive. "Free market" dual distribution in a market economy is based on open competition rather than some artificial structuring such as manufacturer-dictated division of, and monopoly of, markets.

Price, the quintessential mechanism of a market economy, is the most obvious reason for independent distributors to import "free market" merchandise on a parallel basis. This enables K mart to distribute at least some branded merchandise to millions of Americans at a fair price.

In practical terms, if several leading manufacturers tend to dominate a successful branded goods industry and have similar price lists, or want to impose retail price maintenance upon retailers, parallel importation of that merchandise offers the only real competitive window to help keep prices down. It also keeps some brands on our shelves for the public. But even if there may be vigorous competition at the producer level, we find prices of branded merchandise in foreign markets are often substantially lower than those inside the United States market, even with today's weaker Dollar foreign exchange rates.

I have spoken of price, and its importance cannot be understated. But a further competitive reason underpins the importance of parallel imports of "free market" branded merchandise: it is the fact that many manufacturers of name brand merchandise refuse to deal with, or sell to discount retailers such as K mart. They decide to restrict their distribution of certain branded merchandise to dealers who tacitly comply with the manufacturer's "list" or suggested retail prices. Refusals to deal prop up high, fixed retail prices. This phenomenon is the incarnate vestige of the old "fair trade price" fixing theories of the 1930's. That practice lasted through the 1950's when the notion fell off and then was overwhelmingly repealed by Congress in 1974.

Apart from the periodic ebb and flow of quantitative volumes of "parallel" imports of "free market" merchandise, policymakers have always recognized the <u>qualitative</u> element of competition dynamics which freedom of parallel importation provides. This quality of competition provides the oil which lubricates the engine driving a free market economy. And it allows greater democracy and less economic snobbery in resulting consumption patterns. It creates bargains for American consumers.

2. <u>Benefits to Consumers</u>

Related to competition benefits, the other side of the coin is the benefit of parallel imports to us as consumers. The general benefits to the consumer are obvious: a greater selection of branded merchandise, at lower prices.

Above all, the American consumer is entitled to the same good deal on branded merchandise that is available to other consumers around the world. Continued freedom of parallel imports gives that good deal to American citizens.

Let me give you some examples of K mart's retail prices for parallel imports. A Seiko watch retailing for $195 at an "authorized dealer" supplied by Seiko's United States trademark licensee would cost a K mart shopper only $100-$120 when imported through parallel channels. A Citizen brand watch with a suggested retail price of $110 would be sold by K mart at $50-$60 as a parallel import. On average, K mart offers discounts of 30%-50% on parallel imports wherever possible.

In September 1984, Market Probe International, a private survey company in New York, conducted a consumer opinion survey related to parallel import distribution of four product categories (cameras, wrist watches, fine perfumes, and quality automobile tires).

A total of 602 consumers were interviewed with a stratified sampling that spread age, income, sex, family and employment status, education, and ethnic characteristics over a systematically distributed pattern. The consumers were interviewed in the six important retail markets of Atlanta, Boston, Chicago, Houston, Los Angeles and Phoenix.

While the consumers felt it was very important for certain complex branded products to have some type of written warranty, they were relatively indifferent as to whether the item was imported by the trademark owner or by a free market distributor, or was produced within the United States. Origin-distribution was the least important factor in consumers' purchasing decisions in the sample survey.

Overall, 79% of the surveyed consumers wanted to receive the best value for their money, and 67% of them perceived the best value to be a price-discounted "parallel" import with a third-party, not the manufacturer's, written warranty. In other words, by a margin of better than 2 to 1, consumers would clearly prefer to pay a lower price for an item and receive a product warranty from a distributor or retailer rather than pay a high retail price and receive a manufacturer's warranty.

This consumer opinion survey is confirmed by substantial consumer buying patterns. The annual volume of parallel imports has been estimated by Fortune Magazine (January 7, 1985, page 89) to be $6 billion.

3. <u>No weakening amendments to S. 2614 should be allowed</u>

Despite the clear benefits to consumers, and the consumer value preferences outlined above, trademark manufacturer-owners have recently mounted an unprecedented assault on government policies and regulations which have for so many decades allowed and encouraged parallel imports of "free market" merchandise.

Any proposals to water down S. 2614 and the underlying regulation permitting continued importation of "free market" merchandise should be rejected. Such proposals as "demarking" (removal or obliteration of the name brand or trademark), warning labels, and the like, seek only to injure or dampen competition and to withhold genuine branded merchandise from consumers. The object of such proposals is to give "free market" merchandise a black eye, or the kiss of death, so to speak. In turn, consumer choices and bargains would be dashed, and competition injured beyond repair.

Any such amendment proposals would, we respectfully submit, mark the death knell of free distribution in our market economy. If market dynamics were removed from the economy and replaced by artificial government structures, then all of us will be the losers.

Certain trademark owners, many based in Japan and overseas, have seen that their high first-cost prices (and the listed or suggested retail prices) which they have decreed for the United States market are caught in competitive dynamics of "parallel" imports from a lower-priced foreign market. Those imports are sold in discount outlets such as K mart. This is as it should be. It is for those reasons they have mounted an anti-competition and anti-"free market" parallel import lobby. It must fail, as it always has heretofore. And it is further for these reasons that any weakening amendments to S. 2614 should be steadfastly rejected by Congress.

Conclusion

Let me conclude my comments by saying that the Association of General Merchandise Chains, and K mart, hope that policymakers will give firm and speedy support to S. 2614 to preserve parallel imports. That will provide continued savings for american consumers, stimulate competition, and preserve time-honored recognition of free market forces in our distribution economy. It will prevent unjustified enrichment of foreign brand manufacturers, and foreign consumers, at the expense of needy American customers.

For the subcommittee's information, several of AGMC's previous submissions on this important issue are attached to our statement today. These include comments filed September 20, 1984 in the Administration's inquiry, and a September 6, 1983 letter to Mrs. Faith Ryan Whittlesey, who was then Assistant to the President for Public Liaison.

If you have any questions at this time, or at any later time, I shall be pleased to try to answer them. Thank you.

Senator DANFORTH. Mr. Tuttle, why should K-Mart get a free ride if, let's suppose, Mr. Miller is importing his perfume. Is that what it is?

Mr. MILLER. Yes, sir.

Senator DANFORTH. He is importing his perfume, and half the cost of the perfume is advertising. It is all marketing.

Mr. TUTTLE. It is simple. We don't receive a free ride, Senator. You know, there is no empirical support for the free ride notion because there is none possible. This sort of thing cannot be quantified, whether it is a ski resort in Stowe, VT, or some other industry.

Senator DANFORTH. But I mean your customers would never have heard of Mr. Miller's product had he not advertised it.

Mr. TUTTLE. Well, you see, K-Mart performs its own advertising as well and spends large sums.

Senator DANFORTH. But, clearly, it is a pittance compared to what Mr. Miller would spend on his perfume.

How much money did you spend on Mr. Miller's perfume, advertising it last year?

Mr. TUTTLE. I haven't any idea of the amount of this from a business extent.

Senator DANFORTH. But it would be miniscule, wouldn't it, really, honestly? In other words, people have not heard of Mr. Miller's perfume because of your efforts, but because of Mr. Miller's efforts.

Mr. TUTTLE. Well, that is true of every product made in the United States or anywhere in the world, of course, Senator.

Senator DANFORTH. But he owns the trademark. I mean, why shouldn't he be able to—I mean, if he is going to put money into advertising and promotion and trying to build a product and the identification of the trademark, why shouldn't he get the benefit? Why should you get as much benefit as he does? Why should you be able to undersell him to drive him out of business?

Mr. TUTTLE. Well, obviously everyone should be able to reap whatever benefits they can in a free market economy.

Senator DANFORTH. Not by stealing somebody else's product.

Mr. TUTTLE. There is no theft involved, of course, Senator. It is the pricing mechanism that must be allowed to remain free, the retail price.

Senator DANFORTH. Well, I am going to tell you, if I made a product in the United States and somebody began making it elsewhere and selling it with my trademark, I would be filing a lawsuit against him.

Mr. TUTTLE. Well, usually it is yourself making it elsewhere, Senator, in these cases.

Senator DANFORTH. But not as far as the importer is concerned. He is just the importer. Don't you think that there is a problem of fairness here instead of sponging off of somebody else's effort?

Mr. TUTTLE. No, I don't. You certainly, for example, would not repeal the first amendment of the Constitution because you may perceive some imperfection of free speech.

Senator DANFORTH. Well, if it is a constitutional issue then you should file the lawsuit. Maybe you have got a winner. But I would doubt it because I think the trademark laws have been recognized since the beginning of the country.

Mr. TUTTLE. Well, we have been winners in most all the lawsuits and proceedings to date and I am pleased to note that.

I think Mr. Kurzman, if it is agreeable to you, Senator, would like to add a note, if he may.

Mr. KURZMAN. Mr. Chairman, just to add on this to what Mr. Tuttle has said. The free rider argument was at the heart of the fair trade laws, as Senator Rudman has already testified, and Senator Chafee has noted. Those were completely discredited in the 1950's. There has never been an American trademark law, or indeed in foreign trademark law, the concept that the trademark holder has the right to control the price of his product. These are entirely genuine. He placed the trademark on the product overseas, put the product onto the world market and reaped a profit from it. It wasn't given away; he got a profit for it. He has no right, under our law, to control the price at which that product is sold or indeed how it is marketed after he sold it.

Senator DANFORTH. Do you think Mr. Miller just made a mistake? He is in the wrong business?

Mr. KURZMAN. No. I think he has tried to get the benefit of higher prices in the United States and elsewhere in the world for the same product.

[The prepared written statement of Mr. Kurzman follows:]

STATEMENT

BY

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AMERICAN FREE TRADE ASSOCIATION

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL TRADE

COMMITTEE ON FINANCE

UNITED STATES SENATE

JULY 29, 1986

Dear Mr. Chairman:

We appreciate the opportunity to appear before you today to discuss parallel imports (sometimes pejoratively called "grey market" goods), a significant element of international trade which brings enormous savings to consumers in the United States. We enthusiastically support S. 2614, the Price Competitive Products Act of 1986, introduced by Senators Chafee, Roth and Rudman, which would permit continued parallel importation in spite of the threat presented by a recent U.S. Court of Appeals decision. We will also discuss briefly the impact on parallel imports of the intellectual property provisions of H.R. 8600, the House-passed Trade Bill.

The American Free Trade Association is a trade association of some 50 independent American importers, distributors and wholesalers of parallel import fragrances, colognes, and health and beauty aids such as shampoos, soaps and other items commonly purchased in drug stores. Mary of the Association's members are small businesses. They are located throughout the United States and employ more than 1,500 people. The members in turn supply other distributors, wholesalers and retail outlets which employ many thousands more. For example, one of the drug store chains supplied by Association members has 1,500 stores with many thousands of employees and annual sales in excess of $2 billion. Many of the Association's members have been in the parallel import business for more than 10 years.

The American Free Trade Association is a member of the Coalition for Competitive Imports, an ad hoc coalition of four trade associations and a number of individual companies which are independent American importers, distributors and retailers of parallel imports. The Coalition's membership includes, in addition to the American Free Trade Association, the Association of General Merchandising Chains, Inc., National Association of Catalog Showroom Merchandisers, K mart Corporation, Jewelcor, Inc., 47th Street Photo, American Consumer Trade Council, Progress Trading Corporation, Best Products Co., Inc., Cal Circuit Abco, Inc., and Revco D.S., Inc. My colleagues here today from K mart Corporation, representing the Association of General Merchandising Chains, Inc., and Jewelcor, Inc., and I collectively present our testimony on behalf of all the members of the Coalition for Competitive Imports.

What are Parallel Imports?

Parallel imports are genuine trademarked consumer products, such as fragrances, 35 mm cameras, and watches, which are manufactured abroad and imported by independent American importers rather than by the so-called "authorized" U.S. importers and distributors. Parallel imports exist only because the manufacturers, for reasons of their own, seek higher prices for their products in the United States than elsewhere in the world. They do this by creating wholly-owned subsidiaries in this country, designating those companies as the exclusive "authorized" importers and distributors for those products here, and refusing to sell to retailers who will not maintain the higher prices for the products.

The obvious result in a free enterprise, free trade market is that independent American importers can purchase the same products overseas at the world price, often even directly from the manufacturers' "authorized" distributors abroad. The foreign manufacturers' price differential for the U.S. market is so great that, even after paying shipping costs and U.S. Customs duties, the parallel importer can offer the identical articles for 20 to 40 percent less than the U.S. "authorized" distributor. A Seiko watch, for example, which retails in full-price, "authorized dealer" stores for $200, sells for $120 to $140 in a price-competitive store which buys from independent importers. A 1.7 ounce bottle of "cacharel Anais/Anais" perfume sells for $18 in full-price stores while the parallel import sells for $11.99.

The result is a saving to American consumers amounting to billions of dollars a year. Another result is the availability of popular products to a much wider spectrum of Americans who do not live in the large cities where the "exclusive" authorized stores are generally located. A substantial American industry of importers, distributors, retailers and catalog-showroom merchandisers, with hundreds of thousands of employees, serves the millions of American consumers who buy these popular foreign-made products at the prices they would pay if they could shop for them abroad. The parallel import industry is responsible for total consumer sales of $100 billion a year. It also makes an enormous investment in the goodwill of trademarked products through its own widespread advertising and marketing of these products.

Only importation of foreign-made products is involved here. American companies which manufacture only in the United States are not affected by parallel imports; nor are manufacturers which price their products the same wherever they are sold and thus do not discriminate against consumers in the

U.S. market.

Furthermore, only genuine products are at issue here. Parallel imports are manufactured in the same plants as the "authorized" imports, and the manufacturer has placed its trademark on them just as it has on the "authorized" imports. However, in their campaign to stop parallel imports, foreign manufacturers often seek to create confusion in the public mind between parallel imports and counterfeits. This is a smokescreen. The Congress recognized this when it clearly distinguished parallel imports from counterfeits during enactment of the Trademark Counterfeiting Act of 1984. (See "Joint Statement on Trademark Counterfeiting Legislation", Congressional Record, October 10, 1984, pp. H12076-12080.) The merchants who sell parallel imports have just as much to lose from counterfeit goods as do the "authorized" distributors and dealers. Neither can afford to lose the confidence of the consumer in the genuineness of the products they sell. Indeed, that is the function of a trademark: to identify the source of the product.

Long-Standing U.S. Import Law and Policy Favors Parallel Imports

The law and policy of the U.S. Government has approved parallel importation for nearly half a century. Customs Service regulations, based upon the Tariff Acts of 1922 and 1930, allow parallel importation only under specific circumstances, where the foreign and U.S. trademark holders are the same company or under common ownership or control or where the U.S. trademark owner has authorized the placing of the mark on the product. 19 CFR 133.21(c).

The logic of this long-standing Customs policy and regulation is unassailable. Without such a provision, a single, worldwide entity could bar the independent importation of its own products by simply registering its trademark here and demanding that the U.S. Customs Service exclude such imports, under Section 526 of the Tariff Act (19 U.S.C. 1526). The foreign manufacturer would then have monopoly power to control the price of its product in the United States and to discriminate against U.S. consumers by setting a higher price for that product here than elsewhere in the world.

The logic of the Customs regulation is fully consistent with long-standing antitrust policy and law. The primary purpose of U.S. antitrust laws as interpreted by the Supreme Court is the protection of price competition in the United States. A seller of goods should not be able to price his goods differently for different territorial markets and expect the government to enforce his discriminatory pricing upon successive buyers and sellers. Thus the Robinson-Patman Act (15 U.S.C. 13) prohibits discriminatory pricing in domestic U.S. trade. And, for the same reason, state "fair trade" laws, which had allowed manufacturers to fix the prices of their products when resold by retailers, were invalidated in 1975under Federal antitrust laws. (The Consumer Goods Pricing Act of 1975, P.L. 94-145, §2, 89 Stat. 801.) Those who oppose parallel imports are seeking to have the U.S. Government now enforce in international trade a form of monopolistic price-fixing that has long been outlawed in domestic trade in this country.

The Customs regulation is also soundly based upon long-standing trademark law. There is no basis for the contentions of opponents of parallel imports that such imports somehow endanger the valuable intellectual property right in their trademarks. The flaw in their argument is that American trademark law has never permitted the holder of a trademark to control the price of his product once he has sold it. There is no such trademark "right" in this country, and even the opponents of parallel imports concede that there is no such "right" in most other countries.

The foreign manufacturers' "intellectual property rights" argument is the same "free-rider" argument that manufacturers used in trying to sustain "fair trade" laws in this country, and that argument has been firmly rejected. The argument is no more valid in this case. There is no evidence whatever that the cost of advertising, selling or servicing trademarked imports in this country justifies the enormous manufacturers' price differentials which lead to parallel importation.

As in the case of our antitrust laws, the foreign manufacturers are in effect seeking a revolutionary change in U.S. trademark law, to be enforced at the border by the U.S. Customs Service, which is not available to U.S. manufacturers of trademarked articles.

The fact of the matter is that, if parallel imports were prohibited, the already unjustified price differential would only increase. There would be no competitive pressure to keep the foreign manufacturers from setting even higher discriminatory prices for the U.S. market.

One of the extraordinary ironies is that the foreign manufacturers are seeking in the United States a benefit which their own countries do not allow to U.S. manufacturers. All the major trading partners of the United States permit parallel importation, including the countries where most of the foreign manufacturers of parallel imports are headquartered: Japan, France, Germany, and Italy. There is also a recent United

Nations resolution, which was sponsored by the United States, favoring parallel importation. We will submit for the record a memorandum detailing the rulings of our major trading partners upholding parallel importation into their countries. The memorandum demonstrates that, contrary to arguments made by opponents of parallel imports, parallel importation is not limited to members of the European Economic Community or only within the borders of the Community.

Why is Legislation Necessary?

Foreign manufacturers and their U.S. affiliates have for the past several years mounted a massive, well-financed attack on parallel importation, challenging the Customs regulation administratively, in the courts, before the U.S. Trade Commission, and in the Congress. They have also brought a number of individual suits on trademark, copyright and other theories. So far, virtually all of their challenges have failed.

Their attempts to have the Customs regulation repealed have resulted in an Administration review of the parallel market, in which there have been two Federal Register notices requesting data and information, but no change in the regulation. 49 Federal Register 21454, May 21, 1984; 51 Federal Register 22005, June 17, 1986.

A petition by Duracell, Inc. before the International Trade Commission resulted in disapproval by President Reagan on January 4, 1985, of the ITC recommendation. The President cited the longstanding Treasury Department interpretation of the law in this area and the Administration's support for that interpretation in the numerous pending court cases, as well as the on-going Administration review.

With one exception, lawsuits directly challenging the Customs regulation have resulted in rulings upholding it. A number of U.S. District Courts, the U.S. Court of International Trade, and two U.S. Courts of Appeal have all sustained the Customs regulation.* Similarly, most of the suits challenging

* Vivitar Corp. v. United States, 585 F. Supp. 1419 (Ct. of Int'l. Trade 1984) and 593 F. Supp. 420 (Ct. of Int'l. Trade 1984), affirmed, 761 F.2d 1552 (Fed. Cir. 1985); Olympus Corp. v. United States, 627 F. Supp. 911 (E.D.N.Y. 1985), affirmed, 2d Cir., June 9, 1986; COPIAT v. United States, 598 F. Supp. 844 (D.D.C. 1984), reversed, 790 F. 2d 903 (D.C. Cir. 1986).

parallel importation on trademark and other theories have failed.**

However, a few courts have decided against parallel importation. The most serious of these challenges was the decision on May 6, 1986, by the U.S. Court of Appeals for the District of Columbia Circuit in COPIAT v. United States, in which the Customs regulation was held to be contrary to Congressional intent in enacting Section 526 of the Tariff Acts of 1922 and 1930.

The Court based its decision on a very narrow reading of the meager legislative history of those enactments more than half a century ago. On the basis of its reading of that legislative history, the Court also chose to disregard the Customs Service interpretation of the statutes, dating back to 1936, which has allowed parallel importation under the narrow limitations outlined above.

However, the Court in COPIAT also explicitly acknowledged the policy arguments made on our side of the issue and concluded that these were arguments which the Congress should address. The Court stated:

> The intervenors argue with great vigor that Section 526, as we interpret it, would deprive American consumers of the benefit of imports at prices lower than those maintained by foreign producers through exclusive distribution by their American subsidiaries. That may well be so. They further contend that other nations, particularly our trading partners and competitors, do not permit American producers to maintain prices in their countries in this fashion, and that Section 526 in today's international market constitutes a sort of economic unilateral disarmament. That may also be so. Moreover, it is certainly true that economic and trading conditions have changed a good deal since 1922, and it may now be possible for foreign producers

** Bell & Howell: Mamiya Co. v. Masel Suppply Corp., 719 F.2d 42 (2d Cir. 1983); Parfums Stern, Inc. v. U.S. Customs Service, 575 F. Supp. 416 (S.D. Fla. 1983); Monte Carlo Shirt, Inc. v. Daewoo International (America) Corp., 707 F.2d 1054 (9th Cir. 1983); Diamond Supply Co. v. Prudential Paper Products Co., 589 F. Supp. 470 (S.D.N.Y. 1984); El Greco Leather Products Co., Inc., d/b/a Candie's International v. Shoe World, Inc., d/b/a Gussini, 83 Civ. 5376 (E.D.N.Y. Dec. 20, 1984).

> with an exclusive distributorship in the United States to maintain artificially high prices on desirable imports in a manner quite unforeseen sixty years ago. <u>All of these arguments are properly addressed to Congress</u>; it is not open to the Customs Service, still less the Judiciary, to modify the law to take into account these considerations. 790 F.2d at 917. (Emphasis added.)

It is our view, of course, that the law is otherwise, as virtually all other courts have agreed, and the <u>COPIAT</u> decision will be appealed to the Supreme Court. However, the process of appeal could take years. Meanwhile parallel importers, whose business necessarily requires long lead times, must commit their resources despite enormous uncertainty as to whether the goods will be allowed entry when they arrive at U.S. ports. Retailers, especially catalog retailers, have even longer lead times for printing their catalogs and will also have the problem of anticipating whether goods will be available to them at the time their mailings reach their customers. Catalog companies, as you know, must by law be able to assure their customers of the availability of the merchandise offered in their mailings. The result of all this uncertainty is that retailers may avoid making commitments to parallel imports, and the importers, which typically are small businesses, may as a result be bankrupted before the legal issue is resolved.

Secondly, it makes little sense for the Congress to leave the issue to a Supreme Court resolution of what Congressional intent was more than 60 years ago. As the court in <u>COPIAT</u> suggested in the language quoted above, the basic economic and policy issues are ones which Congress should address under contemporary conditions. We submit that the Congress should also address the issue in the light of the long-standing Customs policy and regulation permitting parallel importation, the existence of a substantial U.S. parallel import industry, and the enormous savings and widespread availability of these products to which American consumers have become accustomed.

For all these reasons, positive legislation is urgently needed now. We strongly support S. 2614, introduced by Senators Chafee, Roth and Rudman, which would state current Congressional intent in favor of continuing parallel importation and avoid leaving it to the Supreme Court to divine what Congressional intent was 60 years ago. The legislation would protect parallel importation and consumer savings in several important ways.

First, Section 2 would add to Section 526 a new subsection (f), which would enact into law the current Customs regulation and the 50-year-old policy allowing parallel importation of genuine, foreign-made trademarked articles in the case where related parties own the trademarks here and abroad. Subsection (f) would not only require Customs to continue its practice of allowing parallel imports to enter U.S. ports, but it would also prevent private suits based on Section 526 to block parallel importation. The possibility of such suits has been referred to in some of the judicial decisions which have upheld the Customs regulations, and at least one such suit is already pending. Obviously, it would make no sense as a matter of policy for the Congress to direct Customs to allow the parallel imports into the country but to leave the importers, distributors and retailers open to lawsuits blocking their re-sale of the products.

For the same reason Section 3 of S. 2614 would settle the issue the same way in trademark infringement suits, most, but not all, of which have approved parallel imports, as noted above. Section 3 would amend the Lanham Trademark Act, defining parallel imports with the same related-party language that is in the current Customs regulation and in Section 2 of the bill.

Again, the same reason, the need to settle the issue once and for all, we urge the Finance Committee, when it considers S. 2614, to add a further amendment to address another threat to parallel importation, which has been presented under the copyright laws. Some foreign manufacturers have tried the subterfuge of registering their trademarks with the Copyright Office and then filing copyright infringement suits against parallel importers. One such case is also pending before the International Trade Commission. The caselaw as to parallel importation, because of conflicting provisions of the Copyright Act, is mixed. Accordingly, we would be happy to suggest language to the Committee which would avoid this subterfuge by amending the Copyright Act to permit parallel importation despite registration in the Copyright Office of the trademark, label, package, design, instructions for use, or other accompanying material.

Again, for the same reason, we urge for the Committee to scrutinize carefully the intellectual property provisions of the House-passed Trade Bill, H.R. 4800, to ensure that those provisions do not, however inadvertantly, result in opening still other avenues for foreign manufacturers to block parallel imports. The Ways and Means Committee report on the bill clearly states that the changes made in Section 337 are not intended to change existing law or practice regarding parallel imports. In general, we believe that the provision regarding trademarks will achieve this result.

However, we urge that the Committee adopt in the copyright provision of the bill the same language used in the trademark provision which has the effect of protecting parallel imports. We refer to the language in Section 142 which would add to Subsection 337(a)(1)(C) the phrase, "if the manufacture or production of the article was unauthorized." Language should also be added to Subsection 337(a)(1)(B)(i) in order to avoid the copyright subterfuge which has been discussed above.

<u>Consumers Are Fully Protected When They Buy Parallel Imports</u>

The foreign manufacturers of these products and their captive U.S. distributors contend that somehow consumers are "deceived" when they purchase parallel imports because those products may carry lesser warranty or service protection than the "authorized" items. This contention is entirely baseless. Moreover, whatever warranty or service problem the parallel import buyer may encounter when "authorized dealer" service is denied is in fact a problem created by the manufacturers themselves in defiance of U.S. law, and is in no respect created by the parallel import importers, distributors, or retailers.

First and foremost, all the available evidence is that consumers are just as satisfied with the performance of parallel imports as they are with higher-priced, so-called "authorized" imports. This is only to be expected, since the products are made by the same manufacturers in the same plants and are identical in every respect except price.

An extensive network of Federal, state, and municipal consumer protection laws and agencies, as well as private sector consumer "hotlines", already exists to handle any consumer complaints about defective products, from the Federal Trade Commission at the Federal level to state and local consumer protection bureaus in virtually every state and city in the United States and radio, television, and newspaper consumer spokespersons.

Under existing Federal law, the Magnuson-Moss Warranty Act (15 U.S.C. 2301, <u>et seq</u>.) and implementing regulations (16 C.F.R. 700), manufacturers of consumer products sold in the United States are required to honor the written warranties they provide with their products unless they explicitly disclaim those warranties in writing. Thus, if a foreign manufacturer wishes to disclaim its warranty on products it does not intend to sell on the U.S. market, it has the right to do so by so labeling those products. If the manufacturer chooses not to limit its warranty, it is required by Federal law to honor it. In addition, many state laws impose similar obligations on manufacturers.

Manufacturers or their "authorized" distributors and dealers who refuse to honor their warranties on the ground that parallel imports were bought from "unauthorized" retailers are therefore violating Federal law, and the Federal Trade Commission should take legal action against them. They may also be subject to similar state and local action as well as private suits. By refusing to honor their warranties, the manufacturers are indeed creating a "consumer protection problem" with parallel imports, but they can hardly be taken seriously when the "problem" is created by their own illegal act.

There is ample economic justification for enforcing Federal and other warranty laws against the manufacturers. They have sold their products abroad at a profit, having calculated into their price some margin for repair, replacement or refund for defective products. If the product required repair in the manufacturer's own country or in some other country, the manufacturer would expect to incur the cost of repairing it. There is no reason for the manufacturer to escape that cost if its defective product is sold abroad and finds its way to the United States.

Nor can the manufacturer argue that requiring its "authorized" distributor in the U.S. to incur the warranty cost is somehow unfair to the distributor because the product was sold through parallel, not "authorized" channels. There is no unfairness whatever, since the "authorized" distributor is part of the same economic entity as the manufacturer. If the "authorized" distributor were not owned or controlled by the foreign manufacturer, there would be no parallel imports, since under those circumstances the independent exclusive distributor could have parallel imports barred from entry under Section 526 and the long-standing Customs regulation. Thus in the case of a defective parallel import, the warranty cost borne by the "authorized" distributor is in fact being borne by the manufacturer, just as it would have been if the defective product had been returned for repair in the manufacturer's own country or some third nation.

Moreover, data submitted by manufacturers in the Administration's ongoing review of parallel importation show that warranty costs amount to no more than two percent of the sales price. Yet the difference in price between parallel imports and the "authorized" products is between 20 and 40 percent. Obviously, warranty cost has no relationship to the manufacturers' price differentials.

The purchaser of a parallel import actually has a wider range of remedies than a purchaser from the "authorized" dealer. As stated above, he is entitled to warranty protection from the manufacturer, just as if he had bought the product from an "authorized" dealer, if the manufacturer has not disclaimed its warranty. Moreover, the purchaser can also look to the retailer from whom he purchased the parallel import for warranty service. All the consumer protection laws referred to above also apply to the discount retail seller of the product to the consumer.

In fact, most discount retailers, including all the retailer members of our Coalition (some of whom are the largest retailers in the U.S.) offer even more extensive warranties than the manufacturers. Many have a "satisfaction guaranteed" or "satisfaction always" policy. Parallel import distributors and importers in turn provide their own warranties to their customers.

There is no evidence whatever that, when the consumer seeks redress from the discount retailer, he receives lesser service than if he seeks redress from the "authorized" dealer or distributor. Both distribution systems generally rely on independent contractors to provide warranty repair service. In fact, in our submission to the Administration study we submitted sworn testimony from a major retailer which has found the repair service provided by parallel import distributors on a popular watch line to be far superior to the repair service provided by the "authorized" distributor.

One suggestion that has apparently been made by the foreign manufacturers is that parallel imports should carry a label stating that they "may not be covered by the manufacturer's warranty." In view of the warranty obligations imposed on manufacturers by Federal, state and local law, such a statement would be entirely inappropriate, if not false and misleading. Its sole purpose and effect would be to stigmatize the item as second class merchandise and thereby to chill its sale so that the manufacturers can maximize their monopoly profits.

Another suggestion is that parallel imports should carry a label stating that they are "being sold without authorization of the manufacturer." Like the suggested warranty language, this would serve no purpose except to chill sales of parallel imports and unjustifiably shift to the parallel import industry the cost of labeling which the manufacturers can themselves place on their product, if they choose to do so.

The fact is that purchasers of parallel imports are well aware that they are buying genuine, trademarked articles at far lower prices than they would pay for them in the "authorized" retail stores. A survey of consumers, which our Coalition also submitted as part of our submission to the Administration study, showed that, given the choice between a higher priced article with a manufacturer's warranty and the same article at a lower price but with the discount retailer's warranty, a large majority chose the latter.

Perhaps the most compelling evidence that there is no consumer protection problem with parallel imports is that sales of parallel imports continue to rise year after year. Clearly, this would not be the case if consumers were being deceived or confused by buying these products from price-competitive sources.

Even if there were some justification for additional consumer information on parallel imports, there is no reason for the Federal government to impose such regulatory requirements. States and localities have traditionally dealt with that subject. Recently, for example, New York State enacted a specific warranty disclosure requirement applicable to parallel imports. Notably, the New York statute exempts from the requirement sales of parallel imports where the seller provides a warranty as good as or better than the warranty provided by the manufacturer.

In short, there is no consumer protection problem created by parallel imports, except when the "authorized" dealers and distributors illegally and unjustifiably refuse to honor their and the manufacturers' warranties on them. They should be required to meet their obligations under U.S. law. Even if they do not, consumers are also fully protected by the discount retailer and his sources. The manufacturers' relabeling suggestions are thinly-disguised efforts to shift the cost of labeling to parallel importers and to chill the sales of parallel imports by stigmatizing them as second-class products.

If manufacturers genuinely wish to protect American consumers, they have many options entirely within their own power: they can end their discriminatory pricing; they can label differently the products they do not intend to be sold on the U.S. market, for example by specifically disclaiming their warranties on such products; or they can honor the warranties which they placed on their products when they sold them, at a profit, abroad.

<u>The Manufacturers' "Demarking" Proposal Amounts to a Ban on Parallel Imports</u>

Foreign manufacturers have proposed alternatively that parallel imports be required to be "demarked", either by having the trademark obliterated or "temporarily" covered over somehow. This proposal is often characterized as a "compromise." It is clearly no compromise. Instead it would have the effect of ending parallel importation altogether, leaving the foreign manufacturers free to charge U.S. consumers higher and higher prices without fear of competition.

"Demarking" would truly confuse and deceive American consumers, because without a trademark they would have no way of knowing who had manufactured the product. Consumers want to know the identity of the manufacturer, since that is the primary source of their confidence in the quality of the product. If the trademark were removed, consumers would have no way to distinguish between the genuine article and a counterfeit, manufactured by someone in whose capacity they have no confidence. In effect, "demarking" would create a hybrid which is neither genuine nor counterfeit in the consumer's eyes. Consumers would become suspicious of such articles and would not buy them. This, of course, is exactly what the foreign manufacturers have been seeking.

"Demarking" would increase the opportunities for counterfeiting since there would be another genuine article, with the trademark defaced, to simulate, and it would be a much easier item to simulate than the trademarked item.

"Demarking" sounds simple as the manufacturers describe it, but it would be physically and economically devastating in practice. For example, the word "Seiko" appears in at least five different place on a Seiko watch. To obliterate the trademark which Seiko put on it would require mutilating or replacing the watch face, the back of the watch, the inside surface of the watchstrap, and the watchstrap clasp, as well as opening the watch case and deleting the name internally.

Ironically, Seiko (a leading opponent of parallel imports) has always argued in other contexts that the watch should not be opened because it will break an important seal. One can only imagine the damage to the product that could occur from all these "demarking" operations. Even if the consumer were not made suspicious by the absence of information about the source of the product, he would have good cause for suspicion that the "demarking" process itself had damaged the product.

The process of "demarking" obviously would be costly. There is no reason whatever for shifting the burden of this process onto the importer or retailer when the manufacturer has full control: it put the product on the market with his trademark on it. If it did not wish to have the product imported into this country with its trademark on it, it has many alternatives, which have been described throughout this testimony. There is no need to have the U.S. Customs Service undertake a new enforcement program and to place a new and costly burden on independent American importers and retailers.

Conclusion

We strongly urge enactment of S. 2614, with the addition we have proposed, as quickly as possible in order to settle the uncertainties about parallel importation and continue the enormous consumer savings they bring. We also urge that the intellectual property provisions of H.R. 8600 be amended to protect parallel importation fully.

We also urge that the so-called "solutions" proposed by the foreign manufacturers be rejected. Those manufacturers already have a number of ways to end parallel imports, all wholly within their power:

1) Foreign manufacturers of trademarked articles can end their price discrimination against U.S. consumers.

2) Foreign manufacturers can sell to any U.S. importer who wishes to buy from them, rather than restricting importation to their own subsidiaries.

3) Foreign manufacturers can label those of their products which are not intended for the U.S. market in different ways from the way they label their products intended for the U.S. market. One alternative is for the manufacturer to "demark" at the time of manufacture, that is, to leave the trademark off the articles not intended for the U.S. Under those circumstances there would be no defacing of the product and no chance of damage to the product.

4) Foreign manufacturers can label their non-U.S. products with a different trademark. Cameras intended for the U.S. could be labeled "Nikon", while cameras not intended for the U.S. could be labeled "Nikoff", or *vice versa*.

5) Or they can label both with the same trademark but add some distinctive style or color to differentiate them.

All of these alternatives are entirely within the power of foreign manufacturers. Any of them would end parallel imports. However, if the manufacturers do not see fit to take any of these steps, they should not be permitted to block parallel imports and get the U.S. Government to enforce their price-fixing conspiracy against U.S. consumers. For such cases, S. 2614 is urgently needed.

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Senator DANFORTH. Senator Chafee.

Senator CHAFEE. Mr. Miller, let's go back a minute to your products here. Johnson's baby powder is manufactured, you say, in Brazil, is it? Well, let's say Brazil.

Mr. MILLER. The baby powder is from Brazil; yes, sir.

Senator CHAFEE. All right.

And there is no argument that Johnson & Johnson has given them permission to sell the product in Brazil, right, to manufacture it in Brazil with the Johnson trademark? Right?

Mr. MILLER. It might be their own company. I am not sure, sir.

Senator CHAFEE. But I mean, this discussion must be based on the authority coming from the manufacturer to the owner of the trademark permitting the manufacturer to manufacture it with that trademark. Otherwise, we are into imitations. We are into conterfeits. And that has nothing to do with this legislation.

So the assumption I am making here is that Johnson & Johnson authorized the manufacturer in Brazil to put the Johnson & Johnson trademark on it. Now, what you are saying is that this is an inferior product; in some way that product is a bad product—the batteries, or whatever the product might be.

Now, what the gray marketeer has done has gone down and bought the product and is selling it up here. It is a Johnson & Johnson legitimate product. So what is the problem?

Mr. MILLER. Well, Senator, I do believe that trademark laws relate to specific countries. I believe that that is the way the U.S. trademark laws are constituted.

The specific product in question is not an inferior product with respect to the standards for the country of Brazil. Trademarks and products relate to different countries. In different countries you are restricted to particular ingredients available for local manufacture. And in the specific case that you mentioned, they must use talc from Brazil, which is different from talc made for the United States.

I am unaware of any basis in our trademark law that relates trademarks in one country to those in another.

Senator CHAFEE. Well, let me ask you—all right. Let's go to the Seiko watch thing. Seiko is making the product. It is a trademark of Seiko. It is manufactured in Japan. Now, somebody goes over, and Seiko has a system apparently of two different selling prices. In Japan, they sell it for *x* dollars—let's say a hundred dollars—and they want to get $140 for it in the United States. Somebody goes over and buys a bunch of these Seiko watches and brings ~~them over and sells them here. They are a legitimate Seiko prod-~~ uct. There is not an iota of difference in them from the product that the Seiko dealers sell here.

Now what is the matter with that?

Mr. MILLER. Senator, I would like to have Mr. Gilbert, of Covington & Burling, show you a watch.

When watches come into the United States they must be marked. Watches made by Seiko for the U.S. market are marked in the factory under proper conditions. Watches brought into this country are marked under improper conditions and the result is what you see here.

The watches that come into this country under the brand name Seiko are different. They are not marked in the same conditions, factory conditions, and are subject to greater damage than those that come through the American——

Senator CHAFEE. They are Seiko watches, aren't they?

Mr. MILLER. They are Seiko watches, not made for—I fail to see the relevance, sir, of the point of the trademark, that they are Seiko watches under a trademark made for use in another country.

Senator CHAFEE. The seller here says "I'm selling a Seiko watch." It is a Seiko watch. Go ahead, Mr. Gilbert.

Mr. GILBERT. Senator, first the Seiko trademark has no significance to the U.S. consumer until that watch enters the United States. The physical product made at the Seiko factory is in a sense a different product because it does not contain the same package as the trademarked product that enters the United States.

Second, not only is there absolutely no support for the notion of international price discrimination against the United States in the case of Seiko, but the facts demonstrate that quite the reverse is true. And we would be glad to provide you with those facts.

Senator CHAFEE. Well, you came to my office the other day, Mr. Gilbert, with Seiko watches absolutely the same. And the complaint was that the customer could not tell the difference. And indeed he could not tell the difference because there was no difference. But there was a price that one came in through the Seiko-U.S. distributor and had a guarantee and the other had a K-Mart guarantee. And so be it. The person is getting a Seiko watch. If he does not like it, if he gets down on K-Mart selling an inferior product, he is not going to deal with K-Mart. But he has got the guarantee. He got just what he was seeking.

Mr. GILBERT. Senator, if I might respectfully state, there was one other difference between the watches, and that is that the legitimate Seiko watches sold for less than the gray market ones.

Senator CHAFEE. That is right. In some instances they did sell for less, but that is not the point before us. What you want to do is have legislation continued that would prevent the import by others of these Seiko watches.

Mr. GILBERT. Senator, we would like to continue 60 years of trademark law that is designed to prevent free riding and ultimately to protect consumers.

Senator DANFORTH. Senator Heinz.

Senator HEINZ. Thank you, Mr. Chairman.

Let me ask Mr. Tuttle to clarify something for me. I don't pretend to be an expert in all of this like you and Steve Kurzman are. Let's assume I am the Pepsi Co., and I sign an agreement with Mexico that they can make Pepsi Cola in Mexico and sell it only in Mexico, not in the United States. And the reason I do that is they have slightly different taste down in Mexico, and I don't want Americans getting this different tasting Pepsi Cola. Maybe that is pretty much what Mr. Miller said. I am not sure.

Now, people in Mexico get a hold of this Pepsi Cola. It is cheaper. Wage rates are lower in Mexico. Sugar prices are lower in Mexico. And it somehow gets into the United States and starts showing up on K-Mart shelves, or wherever. And it is being sold. But the consumer thinks it is regular old Pepsi Cola. And they taste it and it tastes awful, and they think that Pepsi Cola has pulled a fast one, you know. They have changed from classic Pepsi Cola [laughter] to something new, different, unexpected, and awful.

Now, is it your position that Pepsi Cola has no right to prevent that?

Mr. TUTTLE. Senator Heinz, I believe it is fair to say that our position is that Pepsi Cola or any other manufacturer of general, nonprescription merchandise has no right to dictate or determine ultimate distribution control of such a product, no matter which country they are marketing it in.

Senator HEINZ. Now wait 1 minute. I am Pepsi Cola, and I signed an agreement with these people down in Mexico.

Mr. TUTTLE. Yes, sir.

Senator HEINZ. And the agreement was on paper and it said, "We, Pepsi Cola of Mexico, are not going to sell Pepsi Cola any place except in Mexico." And some fly-by-night distributor somehow gets a hold of—you know, he is paying somebody off at the warehouse. Not that this ever happens in Mexico, mind you. So the Pepsi Cola is being smuggled out of the country, and someone is making a lot of money.

Are you saying that Pepsi Cola in the United States should just lump it? Is that what you are saying?

Mr. TUTTLE. No, sir.

Senator HEINZ. Then what are you saying? It is just not clear to me what your position is.

Mr. TUTTLE. I am saying, if one can speculate, the usual course of events is that that contractually controlled Mexican distributor is more apt, lawfully, within the terms of the license or distribution agreement, to sell to some other party inside Mexico who then, without any strictures on distribution, turns around, resells to an importer in the United States, an exporter in the country of Mexico somewhere, and then distribution is concluded to wherever in the world that product may be marketable and acceptable to markets and consumers.

There is no breach of the agreement and no damages to Pepsi Cola. Pepsi Cola realizes the price and other value it puts into a product when it sells that merchandise at first cost to its contractual, captive, if you please, distributor or maybe more likely a subsidiary wholly owned by, in this hypothetical, that company—American company—inside Mexico.

Senator HEINZ. So if I understand your answer, the answer is if Pepsi Cola cannot get the Mexican Government to prosecute and put Mexicans in jail to enforce the agreement an American company had with a Mexican company, tough.

Mr. TUTTLE. No, sir. There is no breach of law so there should be no one going to jail. These are colorful examples of payoffs and ballot-box stuffing, Senator. I submit to you that while they are colorful they are not realistically——

Senator HEINZ. Whether they are realistic or not, apparently someone is importing Pepsi Cola.

Mr. TUTTLE. I have no knowledge of that.

Senator HEINZ. There is one there. I don't know where it comes from.

So regardless of exactly how it got there, what you are saying is, as I understand what you are saying, if the country where the agreement was signed will not enforce the agreement or cannot enforce the agreement because it cannot take the trouble of finding the midnight distributor, tough.

Mr. TUTTLE. Well, there is no midnight distributor. When he sells the product to another distributor there is no cradle-to-grave protection you receive from the manufacturing plant into the ultimate consumer's hands. That is the whole concept of a market economy. If there were, our market would be administered like it is in the Soviet Union, you see.

Senator HEINZ. So your position, just to clarify it, is that no U.S. manufacturer who signs an agreement with a manufacturer in another country giving them a certain exclusive right to manufacture and sell in an exclusive geographic area should do that in the expectation that that piece of paper means anything, because you do not believe that kind of piece of paper should mean anything.

Mr. TUTTLE. I think such a contract means everything and is enforceable, Senator. The point is that that set of relationships is only early on in the chain of distribution. Later sales and resales to others are not and cannot be controlled, at least under American antitrust laws.

Senator HEINZ. Well that is what I mean. Once it leaves the factory——

Mr. TUTTLE. Well once it leaves the first controlled distributor——

Senator HEINZ [continuing]. It doesn't mean anything. It is all over.

Mr. TUTTLE. No, sir. You misunderstood me in that case. Once it leaves the factory it is very importantly controlled if there is a distributorship agreement as to the distribution. But the later descent, if you please, and redistribution of those goods are not so controlled by contractural arrangements and cannot be lawfully.

Senator HEINZ. My time has expired. Thank you.

Senator DANFORTH. Senator Grassley.

Senator GRASSLEY. Mr. Tuttle, I would like to ask K-Mart's position on the Anticounterfeiting Act.

Mr. TUTTLE. Anticounterfeiting——

Senator GRASSLEY. Act.

Mr. TUTTLE. Act.

The Federal criminal law in this country. That is a matter of——

Senator GRASSLEY. Well, no. I wanted to know K-Mart's position on that. Were you for it or against it?

Mr. TUTTLE. We supported it with amendments, Senator Grassley, which removed the price fixing aspects of the original, the earlier bills.

Senator GRASSLEY. All right.

Mr. Miller, how long has the problem of grey marketing existed, and what are you doing in your company to control it if indeed it is a problem for you?

Mr. MILLER. Well, Senator, the gray market has existed probably for as long as there has been merchandise available for sale with a branded name. The problem took on major proportions around 1980 when the U.S. dollar strengthened. And I should point out, sir, that it is precisely the strengthening of the U.S. dollar that brought on the massive influx of goods into this country into the gray market, which, in itself, refutes the allegation of price discrimination as a basis for this bill.

With respect to our own company, sir, we spend a considerable amount of money. In the last several years, we have spent in excess of $1 million in terms of lawyers, private investigators, coding systems, and what have you to identify the source of our gray market goods.

We invested in excess of $500,000 for special laser coding equipment to code our products to identify the source of the merchandise. However, the gray marketeers have been extremely effective in removing those laser codes.

Where we have been effective, we have instituted legal actions in France, and have been successful. And I would also like to correct the statement made previously.

In France, under the EEC, or in the EEC common market countries, retailers of authorized distributors—authorized retailers may resell their products to other countries in the EEC but they may be prohibited from selling them outside of the EEC.

And when those retailers re-ship merchandise to the United States, and we have uncovered who they were, we have taken legal action against them. And I can say, Senator, we have been successful in every case thus far.

It is an absolutely inaccurate statement to say that manufacturers do not attempt to control their distribution overseas.

Senator GRASSLEY. Can gray marketeers import products into the country and charge whatever price they want to if they either cover or remove the trademark?

Mr. MILLER. Well, Senator, that is the whole basis of what we consider to be demarking. And, in fact, that is the way section 526 is currently written. We have no objection to that. And I think this is the point where we must make it very clear. The issue here is not one of price.

If the gray marketeers are interested in giving the American public the lowest possible price, there is no reason why they cannot import those goods. And we have examples on this table that can show you how products can be demarked, how labels can be removed without damaging the physical appearance.

The consumer would then truly have a 2-tier pricing structure where they would have the opportunity to buy goods at a lower price without the trademark, and/or buy the trademark goods at the higher price.

The gray marketeers, as you have heard, absolutely oppose that particular solution, and the reason they oppose it is because they are free-riding, because they know that without the trademark on those products, they cannot sell them. That is the concept of free-riding. A manufacturer or a distributor creates the market. That is the advertising that creates the market demand for the product. The retailer simply says that product is available for sale here. That is what free-riding is all about. And that is why they are opposed to that concept.

Senator GRASSLEY. I would like to ask both of you, what would be the impact upon American business if this legislation passes. Mr. Niller and then Mr. Tuttle.

Mr. MILLER. I would be very sanguine about the impact on American business if this particular bill passed.

One of the great foundations of our free market economy is trademarks. And if trademarks are destroyed, if a manufacturer does not have the opportunity to reap the return on his investment in that trademark he loses the incentive for making further investments in trademarks. If that happens, whatever short-term benefit exist today to the consumer, which I suspect, as you can see here, is quite doubtful, the long-term impact is a lesser number of products available to the consumer.

Senator GRASSLEY. Mr. Tuttle.

Mr. TUTTLE. Senator, first, just as there is no free lunch in this economy there is no such actual demonstrable thing as a free ride.

All advertising, and promotion and distribution costs are borne by those who pay prices that allocate such costs.

As for the first part of your question, the impact on businesses in this economy if S. 2614 is passed that is one side of the coin. The other side, and perhaps the more important side of the coin is, what is the impact on American comsumers?

We feel that the first impact of passage of the bill will be preservation of at least the availability of some branded merchandise in a number of hard-line merchandise categories at fair prices.

The impact on both business and consumers, if S. 2614 is not passed, or if the existing Customs regulations are somehow undermined, would be, we submit, severely inflationary on consumer prices.

Senator DANFORTH. Senator Symms.

Senator SYMMS. No questions at the present time, Mr. Chairman.

Senator CHAFEE. Mr. Chairman, I have a couple more questions, if I might.

Mr. Miller, if I do say, I think you have got a red herring here in this trademark business. There is no question that in every case we are citing the trademark owner has produced the goods. In other words, if we are talking Rossenel skis or Michelin tires or Mercury outboard motors or Johnson & Johnson, there is no infringement on the trademark. The trademark owner has licensed the manufacturer to make the goods. Now can we agree on that? I mean, whether Seiko watches or champagne, the legitimate owner of the trademark has manufactured the goods that are coming in the gray market. Is that true or false?

Mr. MILLER. In the case of the products you mentioned, the legitimate manufacturer or its authorized distributor, yes, sir.

Senator CHAFEE. Has manufactured the goods.

Mr. MILLER. Yes, sir.

Senator CHAFEE. All right.

So I would like to set aside this trademark argument. To my knowledge, trademark has never been used to protect an advertisor's investment, to protect the owner of the trademark's advertising investment. Trademarks are to prevent the counterfeit production of goods.

So what we see taking place is, in Rossenel ski the manufacturer of the Rossenel ski in France has produced the skis, and somebody goes over and buys a whole bunch of these skis, and brings them into the United States and sells them.

Now you do not like that because you want those skis only to come through the American trademark owner of those skis. And what you are trying to do is to have the Customs act as a protective device for you to prevent the importation of these skiis. And I think it is an outrageous demand, myself.

Mr. MILLER. Well, Senator, with all due respect, I would like to read to you——

Senator CHAFEE. Briefly.

Mr. MILLER. Very briefly, sir, as noted by the Senate committee report that accompanied the Lanham Act, trademark protection serves two distinct but related purposes:

One is to protect the public so that it may be confident that in purchasing a product bearing a particular trademark which it favorably knows it will get the product which it asks for and wants to get.

Senator CHAFEE. Which they are getting in this case.

Mr. MILLER. No, they are not, sir.

Senator CHAFEE. Well, you just admitted that——

Mr. MILLER. Excuse me, sir. The trademark but not the product, sir. The trademark but not the product.

Secondly, where the owner of the trademark has spent energy, time and money in presenting the product to the public, he is protected in his investment from its disappropriation by pirates and cheats. This is the well established rule of law, protecting both the public and the trademark owner.

Senator CHAFEE. In everyone of these instances the goods have been manufactured—you admitted that—by a legitimate entity, either a licensee or the owner of the trademark, whether it is Rossenel skis or Johnson & Johnson baby powder.

Mr. MILLER. With one criteria, sir. To the standards of manufacture for that particular country which, in many instances, are different than those in the United States.

Senator CHAFEE. So in that case, if Johnson & Johnson, a United States company, has this manufactured in Brazil, and there is a different kind of talc in there, they ought to require their licensee in Brazil clearly to put on every can, "for distribution solely in Brazil." But they do not choose to do that.

And now what you are asking is that the United States somehow, through its Customs, enforce that, or that you have a right to enforce it up here. And if they do not choose to make that contractural obligation with their Brazilian subsidiary, or licensee, then that is their tough luck.

All that is happening is some ingenuous American is going down there and purchasing this, and bringing it up and selling it. And what is wrong with that?

Mr. MILLER. Well, what is wrong with it, Senator, is many times the ingredients that are used overseas are not acceptable for sale in this country.

Senator CHAFEE. In that case, why doesn't the manufacturer require that his licensee put that on the can? This product, Dial soap, is suitable only for Mexicans. [Laughter.]

Mr. MILLER. Well, Senator, you know, many companies do put on ingredient statements which clearly indicate that the products have ingredients that are not possible for sale in the United States.

I have here in front of me, Senator, a particular product, Yves Saint Laurent lipstick, that contains red dye No. 19 which is not permitted in the United States. This product is available for sale in the Washington area, I might add, with ingredients fraudulently over applied.

Senator DANFORTH. Well I think we are going to have to wind it up with this panel.

I do want to say, Mr. Miller, I think that you have stressed the wrong point. I would assume that there are other legal remedies available in the case of the sale of products that have red dye number whatever in them, and products that do not meet the same standards. I would assume that there are other remedies under the law.

I think really the question is, assuming identical products, whether the trademark owner in the United States or the authorized distributor should have a right to protection. I mean, to me, that is the nub of the question. Not whether there are two different products, but assuming it is the same product.

Gentlemen, thank you very much.

Next, we have Seymour Holtzman, president of Jewelcor; Bernard Gassin, president of G-K-G; Nathan Lewin, on behalf of 47th Street Photo; and Steven P. Kersner, on behalf of Original Appalachian Artworks, Coleco Industries, Martin's Herend Imports, and Vivitar Corp.

Mr. Holtzman.

STATEMENT OF SEYMOUR HOLTZMAN, PRESIDENT, JEWELCOR, INC., ACCOMPANIED BY RICHARD B. KELLY

Mr. HOLTZMAN. Good morning. I am Seymour Holtzman, president of Jewelcor Inc., a New York Stock Exchange company doing business in retailing, importing, and wholesaling. With me is Richard B. Kelly, general counsel of the National Association of Catalog Showroom Merchandisers.

Parallel imports are genuine legally imported goods. They exist because some foreign manufacturers charge their authorized U.S. distributors substantially more than they charge outside the United States. A company such as ours can buy products from overseas distributors, import them, pay duty, and sell to retailers at prices that permit them to sell at 20 to 40 percent below full margin retailers who buy from so-called authorized U.S. distributors.

For example, here are pages from Jewelcor retail's five most recent annual catalogs.

From 1982 to 1985, we sold domestic or authorized Seiko watches to consumers at about 25 percent off manufacturer's suggested retail prices.

Our 1986 catalog features Seiko watches at 40 percent off, and our margins are about the same because we now use parallel import Seikos.

Foreign manufacturers call us "free riders," saying we do not offer all the services a so-called authorized dealer does. This is simply untrue.

They say we sell shoddy merchandise. Here are two watches manufactured by Seiko. One was intended for sale in the United States; the other outside the United States. The only difference between them is that the last digit of the 8-digit case number on the one intended for the United States is 9. The other is zero.

They say the product might not be warranted. Indeed, Seiko will not honor its 1-year warranty on a watch intended for sale outside the United States if it was purchased here. Every Seiko watch we sell in our catalog showrooms is warranted for at least 1 year, and our importing company warrants all Seiko watches it parallel imports for 2 years, with no service charge.

Here are copies of both warranties.

These manufacturers say that they want to stop parallel imports, and their organization, COPIAT, is a high-powered, well-financed lobby. However, in the past, Seiko sold both domestic and international watches to us at favorable prices, and I have copies of these invoices I would like to submit.

Foreign manufacturers sell more products to non-U.S. distributors than they could sell in their territories. They must know that these distributors sell excess stock to parallel importers.

Some opponents advocate labeling. This would frighten the consumer away from a favorable purchase. Others advocate demarking. This would confuse consumers and make counterfeiting easier. In both cases, the ultimate result would be to eliminate parallel imports and raise consumer prices. Without parallel imports, foreign manufacturers would have a monopoly over U.S. distribution of their products. This violates the spirit of our free enterprise system and would raise consumer prices. It must not be permitted to happen. I strongly urge passage of Senate bill 2614.

Thank you.

Senator DANFORTH. Thank you, sir.

[The prepared written statement of Messrs. Holtzman, Borda, and Purdy follow:]

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TESTIMONY SUPPORTING S.2614
by
SEYMOUR HOLTZMAN
President, Jewelcor Incorporated

SUBCOMMITTEE ON INTERNATIONAL TRADE
COMMITTEE ON FINANCE
July 29, 1986
9:30A.M.

Dirkson Senate Office Building
Room 215

My name is Seymour Holtzman. I am President of Jewelcor Incorporated, a New York Stock Exchange Company which is a nationwide retailer and through a subsidiary, Gruen Marketing Corp., with principal offices in Secaucus, New Jersey, New York, New York, and Houston, Texas a national and international distributor of watches including parallel import watches. Jewelcor is a member of the National Association of Catalog Showroom Merchandisers which represents the $10 billion catalog showroom industry. NACSM endorses my testimony, and I respectfully request permission to submit for the record a brief additional statement from NACSM. I am a former Board Member of the National Association of Catalog Showroom Merchandisers, an organization my company helped create 13 years ago. I am also a member of the Industry Sector Number 4 Advisory Committee for Trade Policy Matters of the U.S. Department of Commerce.

We support S.2614 because it will protect the consumer against higher prices.

A good example of the difference between parallel imports and authorized imports can be seen in the watch industry. Almost all watches are manufactured outside the United States. Last year our watch distributing company imported and sold approximately three million six hundred thousand medium priced watches comprising more than 20 brands to about 10,000 retail outlets throughout the United States. In ordering watches we endeavor to obtain the best quality, the most attractive styles and, of course, the lowest prices possible. We operate on very small margins, enabling us to pass along substantial price savings to our retail customers and ultimately to consumers. Our Company's retail customers cover the entire spectrum of the retail market including Bloomingdale's, Sears & Roebuck and K-Mart, as well as the catalog showrooms our Company operates.

Our retail stores buy parallel import watches from our own wholesale company and from other importers. They are independent American businessmen who buy the products overseas, bring them into the United States, pay all duties, and sell to us at prices, well below the prices charged by the so-called "authorized United States distributors." The foreign manufacturers who own these distributors have two different prices for their products: One for the United States and one, substantially lower, for the rest of the world.

If the United States Government eliminates parallel imports it will be granting these foreign manufacturers a monopoly on the distribution of their products. We would be letting them control products from manufacture to use by the consumer, obviously violating the spirit of our free enterprise system. And, since they often attempt to restrict distribution to high margin retailers, consumers would have to pay more.

About 25% of our wholesale watch sales consist of so-called parallel market imports which we are able to purchase at favorable prices. For example, we purchase parallel market import Seiko watches at prices that enable our retail customers to sell Seiko watches to consumers at 20% to 40% less than the prices at which comparable Seiko watches are sold by so-called "authorized" dealers.

The watches are identical to the ones sold by the authorized distributors. In some cases the Seiko watches we buy were manufactured by Seiko-Japan for distribution other than through its authorized United States distribution company, Seiko Time. We have also been able to buy at favorable prices even those watches that were intended by Seiko Japan for distribution through Seiko Time in the United States. In all cases the Seiko watches we purchase and sell were manufactured by Seiko-Japan and are lawfully imported into the United States.

These foreign manufacturers and their lobbying organization, ... Copiat, try to justify prices that are higher in the United States than in the rest of the world by talking about free-riders-- a discredited theory -- about protecting consumers from shoddy merchandise and about warranties.

Are they saying that the products they intend for distribution outside the United States are of a lesser quality than what they intend to be sold here?

Warranties bother me because that issue reflects how these foreign manufacturers treat the American consumer. Seiko refuses to honor its one-year limited warranty on a watch it intended for sale outside the United States if that watch was purchased in the United States. Every Seiko watch we sell in our retail stores is warranted for at least one year.

Our importing company even offers a warranty with our Seiko watches that is superior to Seiko Time's. Our warranty is a two (2) year consumer warranty with no service fee. Seiko Time issues a one (1) year warranty and charges a service fee.

Seiko Time is a founding member of COPIAT. In fact, in its own words, Seiko "... launched this coalition ... to fight against the grey market," and it, along with Charles of the Ritz, Michelin and others, has been in the forefront of a well-organized and financed effort to stop the importation of parallel market goods. One might infer from this that these companies, in addition to their lobbying efforts and court actions, are doing everything they can to control or stop the importation and distribution of merchandise by anyone other than their authorized distributors. This is simply not true.

For example, Seiko-Japan (Kabushiki Kaisha Hattori Seiko, trading as, Hattori Seiko Co., Ltd.) consistently permits its non-United States distributors throughout the world to order more product than they can sell in their respective territories. These distributors, in turn, sell their excess product anywhere in the world including the United States. Seiko has said that if it could control distribution, it would do so, but its actions, however, do not reflect such a policy.

Seiko-Japan, through another subsidiary, Hattori Corporation of America, imports watches into the United States. Some of these watches are sold to Seiko Time Corp., its authorized distributor, but most of these watches have been sold by Hattori Corporation of America to other distributors at prices below the prices paid overseas by United States parallel importers. We know this to be true because last year, our wholesale company purchased substantial quantities of Seikos, some originally intended for sale through Seiko Time in the United States and some not so intended. In both cases we paid prices substantially lower than the prices offered by Seiko Time to its customers.

So, while Seiko Time is spending a great deal of money fighting parallel market imports and telling its customers that such imports are inferior, Seiko-Japan, through Hattori Corporation of America, is bringing into the United States watches intended for sale outside the United States and selling them to non-authorized distributors along with watches that were originally intended for Seiko Time. I have attached for your inspection, copies of ads placed by Seiko Time deprecating the parallel market watches its own parent is causing to be imported into the United States. I also have copies of invoices from Hattori Corporation of America to my company proving that they sold such watches to us.

In addition, we have examples of virtually identical Seiko watches. One was intended for sale to Seiko Time in the United States and the other was not so intended. The only difference between the watches is that the last digit of the eight-digit case number for the watch intended for Seiko Time is "[illegible]" while the last digit of the case number for the watch not intended for Seiko Time is "0". The watch sold through Seiko Time retailed for about $250.00. The other watch retailed for about $165.00. The "inferior merchandise" argument is followed by many other foreign manufacturers. Upon inspection, however, it simply does not hold up. The argument is a sham.

Those opposed to parallel imports are advocating labeling or de-marking as an alternative to an outright ban on parallel imports. Both would cause confusion in the consumer's mind and de-marking would pave the way for counterfeiters. Without the brand name or identification, the effect would be virtually the same as banning parallel imports. Labeling or de-marking would confuse the consumer, would be anti-competitive, would increase consumer prices and ultimately eliminate parallel imports.

While we have talked about hypocrisy here, and while our company is involved in selling parallel imports, the most important reason for passage of S.2714 is to continue to protect the American consumer. Parallel market imports are an accepted and uncontested way of commercial life outside the United States. There is no reason why Seiko or similarly situated foreign companies should be permitted to engage in monopolistic price fixing practices in this country. Let the marketplace continue to protect the consumer.

I urge your support for S.2614 which preserves the right of the American consumer to have a choice.

We have provided specific examples of the benefits price competition provides U. S. consumers. As noted above we respectfully refer the Committee to the statement of Richard B. Kelly, General Counsel of the National Association of Catalog Showroom Merchandisers which discusses in more general terms the need for the Congress to clarify the existing law on the subject that parallel imports are lawful.

CONSUMER ALERT

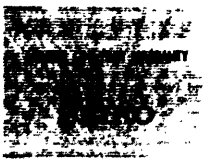
SEIKO TIME CORPORATION WOULD LIKE YOU TO KNOW THE FOLLOWING INFORMATION ABOUT THE SEIKO WATCH YOU MAY HAVE PURCHASED DURING

JEWELCOR'S SEIKO SALE

1. The SEIKO watches on sale there may not have been covered by an authorized manufacturer's warranty which can only be issued by Seiko Time Corporation.
2. The SEIKO watches on sale there were not imported nor authorized for sale in the United States by Seiko Time Corporation.
3. As Seiko Time Corporation publishes suggested retail prices only on SEIKO watches authorized for sale in the United States, we cannot validate pricing of these watches prior to the sale.

Therefore, if you purchased a watch at the recent Jewelcor sale, we strongly suggest that you examine the package and the enclosed warranty. If your warranty is not identical to the one pictured below, you have not received an authorized manufacturer's warranty. We feel this is important for you to know.

You get the best of SEIKO only where this warranty is available.

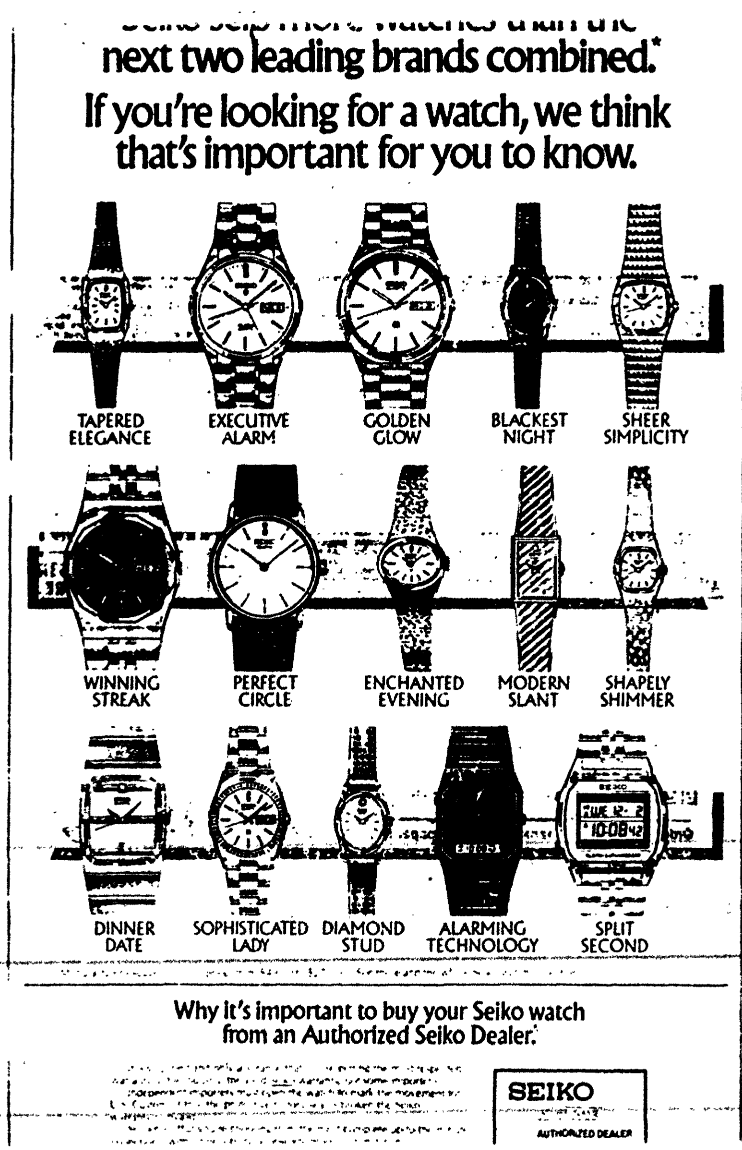


When you buy your SEIKO anywhere else, someone could be getting the best of you.

Seiko Time Corp 1983

[redacted]

Times Leader 12/6/83


next two leading brands combined.*
If you're looking for a watch, we think that's important for you to know.
TAPERED ELEGANCE
EXECUTIVE ALARM
GOLDEN GLOW
BLACKEST NIGHT
SHEER SIMPLICITY
WINNING STREAK
PERFECT CIRCLE
ENCHANTED EVENING
MODERN SLANT
SHAPELY SHIMMER
DINNER DATE
SOPHISTICATED LADY
DIAMOND STUD
ALARMING TECHNOLOGY
SPLIT SECOND
Why it's important to buy your Seiko watch from an Authorized Seiko Dealer.*
SEIKO
AUTHORIZED DEALER

CONSUMER ALERT

SEIKO TIME CORPORATION WOULD LIKE YOU TO KNOW THE FOLLOWING INFORMATION ABOUT THE SEIKO WATCH YOU MAY HAVE PURCHASED DURING

Sibley's Christmas Sale

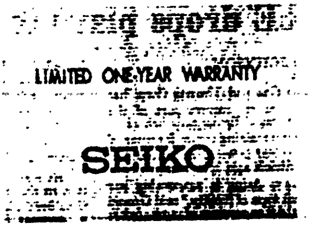
1. The SEIKO watches on sale there may not have been covered by an authorized manufacturer's warranty, which can only be issued by Seiko Time Corporation.

2. The SEIKO watches on sale there were not imported nor authorized for sale in the United States by Seiko Time Corporation.

3. As Seiko Time Corporation publishes suggested retail prices only on SEIKO watches authorized for sale in the United States, we cannot validate pricing of these watches prior to the sale.

Therefore, if you purchased a watch at the recent Sibleys Christmas sale, we strongly suggest that you examine the package and the enclosed warranty. If your warranty is not identical to the one pictured below, you have not received an authorized manufacturer's warranty. We feel this is important for you to know.

You get the best of SEIKO only where this warranty is available.



When you buy your SEIKO anywhere else, someone could be getting the best of you.

Agmc ASSOCIATION OF GENERAL MERCHANDISE CHAINS, INC.
1625 EYE STREET, N.W., WASHINGTON, D.C. 20006 (202) 785-2060

STATEMENT

OF

THE ASSOCIATION OF GENERAL MERCHANDISE CHAINS, INC. (AGMC)

TO THE

U.S. CUSTOMS SERVICE

DEPARTMENT OF THE TREASURY

CONCERNING

PARALLEL IMPORTS

Submitted by:

Edward T. Borda
President, AGMC

September 20, 1984

The Association of General Merchandise Chains, Inc. (AGMC) submits this statement in response to the Department's inquiry into the subject of parallel imports, announced in the May 21 Federal Register (49 Fed. Reg. 21453).

AGMC believes that competition, retailers and the nation's consumers would suffer if parallel imports were no longer available. We challenge those who would abolish parallel imports to demonstrate*/ how consumers or the economy would benefit from higher prices and reduced competition -- which would inevitably follow if parallel imports are no longer permitted. We urge Treasury to reaffirm its long-standing policy allowing parallel imports, and to reject the pleas of the would-be monopolists who seek an end to parallel imports.

AGMC represents the nation's price-competitive general merchandise retail industry. A primary sales strategy of the retail stores comprising this industry is vigorous price competition. AGMC's membership includes retailers that operate more than 20,000 discount, variety, dollar, junior department, family center, off-price, factory outlet, catalog showroom and other general merchandise stores. Its members range widely in size

*/ Executive Order 12291 requires that proponents of regulatory change demonstrate that their proposals will be cost-benefical. AGMC believes that the multinational enterprises in the Coalition to Preserve the Integrity of American Trademarks (COPIAT) cannot meet that burden. In fact, AGMC believes that the evidence in this record will establish that banning parallel imports would have a devastating effect on competition, the economy, consumers, and the efficiency of the nation's distribution system.

and include many of the nation's largest retail chains as well as companies active in one or more regions of the country and those with only a few locations, or even a single store. AGMC member company stores are located in all 50 states and account for over $50 billion in sales.

As the representative of the nation's price-competitive general merchandise industry, AGMC has a vital interest in maintaining all legitimate sources of supply for the American consumer. A change in long-standing Customs regulations which permit parallel imports would extinguish these sources of supply, on which the retailer and consumer have relied for decades.

The Association of General Merchandise Chains also subscribes to the comments filed in this inquiry by the Coalition for Competitive Imports.

While AGMC does not possess statistics detailing the market's the overall dimension, it does recognize that parallel imports constitute at retail a multi-billion dollar industry. The most recent industry census of general merchandise discounters, compiled by Discount Store News, estimates total sales at over $100 billion, a figure which includes $79.2 billion for full-line discounters (such as K mart and Target Stores), $14.4 billion by specialty discounters (such as Toy "R" Us), $8.6 billion by off-price discounters (such as Burlington Coat Factory) and $7.9 billion by catalog showrooms (such as Best Products and Service Merchandise).

In addition to these already impressive figures, price competition is also a standard feature in other stores not included in these totals, among them supermarkets, drug stores, some department stores and numerous segments of retailing.

The importance of discounting to the nation's economy and distribution efficiency is even more apparent when specific segments of discounting are examined. Discounters are a major presence in product lines where parallel imports are most often found. According to the Discount Store News study, full-line, specialty and datalog discounters together account for $10.3 billion in consumer electronics sales, $5.6 billion in health and beauty aids, $5 billion in sporting goods, $4.6 billion in jewelry (includes watches) and $3.6 billion in camera/photography.

AGMC does not possess comprehensive statistics on the extent of parallel import sales, or the precise savings to consumers, but can present a number of illustrative examples.

One retail company with sales over $1.5 billion estimates its 1984 sales of parallel import at $10 million in watches; at 90,000 units; this volume constitutes 14% of the company's total watch sales. In fragrance, the company estimates $2.6 million in volume, representing 235,000 units making up 95% of its fragrance sales. Comparable figures for 1983 are: for watches -- $5.3 million, 45,000 units, and 8% of category sales, and for fragrances -- $925,000, 84,000 units and 95% of sales.

Discount retailers bring consumers substantial bargains on genuine merchandise. For example, a leading catalog showroom company, Service Merchandise, sells a Seiko man's LCD digital watch at $39.97; to maintain the same profit margin, the company would have to sell the equivalent watch available through manufacturer-controlled channels at $47.90. A parallel imported Seiko lady's analogue quartz watch now sells for $79.90 at the catalog showroom, compared with $99.90 that would have to charged for the equivalent model through manufacturer-controlled distributors in order to maintain the same profit margin.

Another example provided by Service Merchandise is Halston 1.0 ounce Eau de Toilette Spray. The company sells the parallel import for $9.82, compared with the $13.35 which, to maintain the same gross margin, would have to be charged for the comparable product if available from controlled distributors.

Price-competitive retailers who refuse to adhere to artificially high manufacturer's "suggested" retail prices often find themselves attacked by full-price retailers, by the manufacturer or by both. A 1983 article from the trade publication Cosmetic World provides an example.

The article reports the difference between manufacturer's suggested retail prices and the prices at which Target Stores, a prominent discount store chain, advertised a number of men's colognes in its Father's Day Sales circulars.

Line	Suggested Retail	Offer	%Discount
Royal Copenhagen	$18.99	$12.99	31.6
Halston	19.99	12.99	35.0
Pierre Cardin	12.00	7.99	34.4
Polo	17.99	12.99	27.8
Chaps	11.50	7.99	30.5

The article reports estimates sales volume declines of 30% to 60% among (presumably higher-priced) retailers in Target markets, speculates that the cologne makers will want to join litigation against parallel imports, and pointedly notes that retailers "concerned" by parallel imports may want to join COPIAT.

If Customs acts to exclude parallel imports, the American retail industry -- apart from "authorized" distributors and dealers -- will be deprived of supplies of genuine merchandise. The natural effect of the price competition provided by the independent importers and retailers will be eliminated from the market.

American retailers and consumers would be deprived of the choice they have enjoyed for decades; namely, whether to pay list price for merchandise imported by a trademark holder or to enjoy a substantial discount on genuine merchandise which has been imported by an independent distributor.

Eliminating price competition -- which would be the direct and immediate effect of banning parallel imports -- eliminates the downward pressure from retailers on wholesale prices that can disrupt horizontal price-fixing cartels. Many retailers pursue a strategy of aggressive pricing, in which they accept a low markup per sale but compensate by doing a large volume of business. Individual price-competitive retailers successful with this mode of selling can pressure suppliers to lower wholesale prices and thereby further reduce retail prices. Rivals of these price-competitive retailers also independently seek reduced wholesale costs from the same manufacturer or manufacturers of competing brands in order to contend for retail sales. The overall impact is to dislodge manufacturers' interdependent pricing parallelism.

Although the arguments of COPIAT and the multinational firms which seek to ban parallel imports are couched in term of trademark rights, it is clear to AGMC that their efforts are motivated by their desire to control distribution and, thereby, the prices at which their goods are sold in this country. The complaints of "authorized" distributors about lost sales to price-competitors similarly make clear their interest in eliminating price competition. The courts have repeatedly ruled that trademark protection does not encompass the right to restrict the price of third party resellers. See Sunbeam Corp. v. Wentling 192 F.2d 7, 9 (3d Cir. 1951), holding:

> A patentee is given a monopoly by legal grant. But even a patentee, who can exclude everyone else from making his patented article, cannot control the price at which others may sell his articles to consumers. The protection given to the ownership of a trademark certainly should not be greater than that given to the holder of legal monopoly, the patentee.

Indeed, the Supreme Court has this very term put an end to disputes about the importance of price competition in the United States market place. See Monsanto Co. v. Spray-Rite Corp., 104 S. Ct. 1464 (1984), reaffirming the previously announced rule that all resale price maintenance programs are *per se* illegal.

A massive volume of testimony and economic data was presented to Congress in 1975 when it considered and repealed the legislation which permitted the states to adopt "fair trade" statutes. This evidence corroborates the hypothesis that vertical price fixing abets either express or tacit collusion at the horizontal level.

This material demonstrates the actual, harmful consequences of legalized vertical price fixing on consumer prices and on small business. A 1956 Department of Justice survey of products sold both in "fair trade" and in "free trade" jurisdictions disclosed that consumer prices for "fair traded" goods ranged from 19 to 27 percent higher in the "fair trade" states. A 1970 survey compared the prices of "fair trade" states during the week of June 26, 1970 with their "fair trade" prices and found that, for a majority, "free trade" prices ranged from 0.2 percent to 37.4 percent lower. Estimates of the total extra cost to the consumer as a result of resale price maintenance under the "fair trade" statues varied in amount but, as the House Committee on the Judiciary observed, "[w]hatever the exact figure, it is beyond dispute that resale price maintenance increases the cost to the consumer." For example, the Department of Justice estimated in 1975 that eliminating resale price maintenance by repealing "fair trade" statutes would save consumers approximately $2 billion per year, while the Congressional Research Service estimated the cost of fair trade to consumers in 1973 to have been between $874 million and $8.85 billion.

In many instances, parallel imports are the only source of supply for price-competitive retailers, since some manufacturers, especially those in highly concentrated or product-differentiated markets, refuse to supply price competitors. This refusal may come from the manufacturer's desire to shield its wholesale prices from the pressure from more efficient price-competitive retailers, or may come about as a result of pressure on the supplier from its less efficient, higher-priced customers.9/ In either case, however, eliminating parallel imports would completely do away with a sizable competitive force which now holds down prices and makes goods more widely available to consumers.

Parallel imports occur when manufacturers refuse to supply retailers directly, place excessive restrictions on the types of goods that will be supplied, or provide inadequate service. Parallel imports also arise when there are sizable differences between the prices at which goods are sold in the United States and elsewhere. When prices are set artificially high in the United States, parallel imports serve as a form of arbitrage. They thus perform the very important function of preventing a multinational company from segmenting the world market, so as to exploit the lucrative U.S. market by enforcing prices here significantly higher than those changed for comparable or identical products elsewhere in the world. If the competitive stimulus of parallel imports is removed, the United States could be turned into an island of above-competitive prices in an international sea of competitive prices.

9/ In a recent case, Seiko's exclusive New England distributor, Auto-Time, paid a $35,000 settlement and entered a consent decree in an antitrust action brought by the Connecticut Attorney General. Auto-Time agreed to refrain from attempting to fix the retail prices of Seiko products and from termination dealers who refuse to adhere to participate in retail-fixing schemes. State of Connecticut v. Auto-Time, reported in CCH Trade Regulation Reports, 1984-1 Trade Cases, pp 65,788.

A good example of a highly concentrated market subject to parallel imports is photographic equipment and supplies. Not only do a relatively few companies dominate the industry, but as shown by the record in _Bell & Howell_: _Mamiya Co._ v. _Masel Supply_, there are only five producers of medium-format cameras. This oligopolistic structure is reinforced by high entry barriers and relatively inelastic demand due to the unavailability of good substitutes.

Trade press reports in 1983 estimated that one-third of all foreign-made 35 mm. cameras sold in this country were parallel imports.

The president of the American Watch Association has been quoted by _Newsday_ as stating "There is no manufacturing done in the U.S." 8/ The same article notes that in 1982 the United States imported 122 million watches and movements, valued at $755 million, an estimated 32% of world production. The American Watch Association gives the major producing nations of American watch imports as

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8/ An editor for a trade publication _Jewelers Circular - Keystone_, cites data from the Federation of Swiss Watch Manufacturers as estimating U.S. watch produbtion in 1982 at 2 million units. Whatever the exact dimension of any U.S. production, it is clear that foreign producers dominate the U.S. market for watches.

Hong Kong (65 million units), Japan (11 million), Taiwan (8 million) and Switzerland (4 million).

In one sense, resolving the "problem" of parallel imports is clearly within the power of the manufacturer -- who chooses to manufacture the product overseas, and/or sell it there at prices significantly below those charged in the U.S. market. Nothing prevents manufacturers from carefully choosing their foreign and domestic distributors. The manufacturer generally designs or approves the labeling and advertising of its product.

AGMC notes that manufacturers can improve and clarify the packaging and labelling of its domestic and foreign production to make clear the geographic scope of its warranties.8/ In fact, that very approach was recently suggested by Judge Restani in Vivitar Corp. v. United States, No. 84-1-067 (Ct. Int'l Trade, Aug. 20, 1984) (Slip Op. at 33-34), and by the Second Circuit in Bell & Howell: Mamiya Co. v. Masel Supply Co. 719 F.2d 42,46 (2d Cir. 1983), vacating 548 F. Supp. 1063 (E.D. N.Y. 1982).

Interestingly, there is evidence that manufacturer-authorized distributors view as insufficient manufacturers' supposed efforts to "control" parallel imports. The record in this Treasury inquiry includes the results of a written survey taken this July at the

8/ As a matter of state law, a producer may not, however, be able to evade responsibility for defective products, whether they were manufactured in the United States or abroad.

annual convention of Pacific Northwest Jewelers. One survey question asked: "Do you think that the [trademark] owner companies are doing all they can to combat the grey market?" The jewelers' response was, by a 15-2 margin, in the negative. In the same survey, all jewelers responding replied in the negative to the question: "Do you have any information that you feel would help substantiate the presence of the grey market and can you show verifiable data to back it up". The majority of respondents, when asked "What effect does the grey market have on your personal business?", choose an answer other than "significant."

The February 1984 issue of Jewelers' Circular-Keystone, a trade publication, contained a lengthy article on parallel imports of watches. The article observed that, of an estimated $100 million in parallel imported watches, the lion's share are Seiko watches. After noting the unhappiness of authorized Seiko distributors with this "very tough" competition the trade press discount noted that:

> Yet, ironically, the same factory that provides these jewelers with their best sellers also stocks their cut-price competitors' shelves. The factory owner, the Hattori company, seems unwilling or unable to correct the situation.

After noting clamorous calls by Seiko-Time's president for the U.S. Customs to "clean up" the problem of unauthorized imports, the jewelers' trade publication further reported:

> Others in the industry say the job should be done by Hattori itself. According to John L. Davis, President of Longines-Wittnauer Watch Co., "A few years back, Hattori started over-producing watches without the slightest regard for supply and demand...the Japanese

> can clean up the problem any time they want...by tightening production and distribution..."

That perception is shared by many price-competitive retailers. An article "Is Influx of Gray Market Goods Hurting Catalogers' Photo Depts?" in the February 1983 issue of Catalog Showroom Business, a trade publication for the catalog showroom industry, interviewed merchants responsible for the photography sections of several medium-sized retail companies. According to the article:

> Most catalogers contacted by CSB seemed to blame the manufacturers -- rather than the gray market dealers themselves -- for the growth of this problem.
>
> "I have a real strong feeling that this gray market issues has been created by the manufacturers," said one midwestern cataloger. "They could change the prices in other countries if they wanted to."
>
> "The camera companies are starting to do something about gray market," said R&R's Roy. "But it all goes back to the Japanese firms. They have a certain number of cameras to sell and they don't care how they sell them. Gray market will only stop if they can be fair by charging everyone the same amount."

Many retailers who now carry parallel imports have also been, or still are, authorized distributors for those goods. For example, K mart has testified to the International Trade Commission that it is one of Duracell's largest accounts for alkaline batteries, but also wants the freedom of choice to purchase parallel imported Duracell batteries made by the company's Belgian subsidiary. Many retailers, speaking from their own experience, compare parallel importers favorably to manufacturer-controlled sales subsidiaries, in terms of competitive prices, but also in areas such as responsiveness to market conditions, breadth of selection and speed and quality of warranty service.

One major retail company notes that, by switching to two independent importers instead of Seiko U.S. and its "twelve very controlled and restrictive distributors," the company "is now able to offer consumer a broader assortment at a better value. It also makes our purchasing more efficent... the watches we carry are genuine Seikos which are serviced in a highly satisfactory manner under the terms of our warranty."

Far from "free riding", price-competitive retailers who purchase indirectly do not generally receive manufacturer-paid promotional allowances, unlike higher-priced authorized dealers. As a result, price competitors must undertake the expense of providing own advertising and promotion.

Many AGMC member have adopted, and widely publicize, customer satisfaction policies. As a result, shoppers who are dissatisfied with a purchase can generally take care of a complaint simply by visiting their store, and obtaining the appropriate remedy. Even without reliance on a manufacturer's or importer's warranty, such company policies can provide consumers with speedy repairs, replacements or refunds as appropriate.

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Where retailers do not or are not permitted to deal directly with authorized importers, and the trademark owner refuses to honor a world-wide warranty, importers and retailers provide service in several ways. Importers or retailer may provide a third-party warranty at least as good as the warranty provided by the manufacturer. Despite this added expense, parallel imports are still significantly less costly to consumers.

Ironically, although those who would most benefit from a ban on parallel imports are Japanese and European manufacturers in highly concentrated industries such as watches and cameras, both Japan and the Eupopean Economic Community permit parallel imports. See Takamatsu, Parallel Importation of Trademarked Goods: A Comparative Analysis, 57 Wash, L. Rev. 433 (1982). If American Customs regulations were changed to bar parallel imports, foreign manufacturers would be free to stifle independent American businesses in this country.

The United States would then not only be out of step with our major trading partners, but would give foreign manufacturers powers beyond those available to U.S. exporters in those countries.

Manufacturers and the distributors they own or control allege that parallel imports deceive or defraud consumers. The short answer to this baseless charge is that consumers decisively favor parallel imports at competitive prices over the same or comparable items through controlled, high-priced distributors.

Interviews with consumers around the country revealed that consumers were generally indifferent as to whether items like 35 mm. cameras, better watches, fragrances and automobile tires are imported by the trademark holders or by independent importers. In fact, that consideration was the least important of the many factors listed as possible influences on a purchasing decision.

At the same time, consumers strongly showed that price and value were the most important. By an overwhelming 2:1 margin, surveyed consumers clearly opted for the choice of buying parallel imports at 25% price savings.

In addition, a large number of individual consumers have gone to the time and trouble to express their views in this inquiry. Unlike those with an economic stake in the resolution of this issue, such as those jewelry shop owners who wish to be rid of the competition from parallel imports, these consumers understand that parallel imports offer them wider choices and better values.

State law also governs manufacturers duties to the goods they produce. Clearly, compliance with applicable state and Federal statues and regulations on packaging, labeling and warranties 8/ should be sufficient to prevent consumer confusion. Many reputable merchants already take great pains affirmatively to inform customers as to the source and terms of avaiable warranties. If Treasury wishes to explore the sufficiency of those efforts, or explore additional labeling requirements, AGMC suggests that it not take any further steps without additional study to develop workable proposals and then afford interested persons ample opportunity to comment on those proposals. Overlabeling a product not only detracts from the effectiveness of existing labels, but would also increase costs to consumers and distributors.

The trademarks on parallel imports correctly denote their source of origin and provide valuable information to purchasers. If would not only be illogical, but also harmful to consumers to obliterate trademarks when a product enters this country through an importer independent of the manufacturer.

AGMC appreciates this opportunity to share its views on the important issue of parallel imports.

8/ _See_ the Fair Packaging and Labeling Act, 15 U.S.C. 1451 _et seq._, and the Magnuson-Moss Warranty Act, 15 U.S. C. 2301 note.

TESTIMONY SUPPORTING S.2614
by
EVERETT PURDY
President, Jewelcor Jewelers & Distributors, Inc.

SUBCOMMITTEE ON INTERNATIONAL TRADE
COMMITTEE ON FINANCE
July 29, 1986
9:30A.M.

Dirkson Senate Office Building
Room 215

My name is Everett Purdy. I am president of Jewelcor Jewelers & Distributors, Inc., a chain of 22 catalog showrooms located in six states and headquartered in Pennsylvania. I thank the Committee for this opportunity to present our views in support of S.2614.

As low-margin retailers who provide high-quality merchandise to the consumer at the lowest prices possible, consistent with the principles of our free-enterprise system, we are very much in the forefront of the consumerist movement and very much concerned when events happen that will raise the prices we and the consumer must pay. It is for this reason that we support efforts to maintain parallel imports as a viable alternative to unconscionably high prices charged by so called, "authorized distributors."

Parallel imports, derisively called "gray market goods" by its opponents, are genuine and legally imported. The importers from whom we buy these products are independent American businessmen who buy the products overseas, bring them into the United States, pay all duties, and sell these products to us at a price that is substantially lower than the so-called "authorized United States distributors" who, as subsidiaries of foreign manufacturers, have established a two-tier system of pricing ... one for the United States and one, substantially lower, for the rest of the world.

If, in fact, these foreign manufacturers sold their products in the United States at world-wide prices, parallel imports would probably cease to exist. But instead of reducing their prices in the United States, these foreign manufacturers are trying to get the United States government to grant them a monopoly on the distribution of their products and, therefore, increase the prices to the customer to artificially high levels. They seek to control their products from manufacture to use by the consumer, obviously violating the spirit of our free enterprise system, a system that has made ours the strongest economy in the history of mankind. Further, they often attempt to restrict distribution to high margin retailers.

It has been estimated that parallel imports account for some 10 billion dollars a year at retail. Typically, parallel imports sell at retail for 20 to 30 percent less. The consumer, therefore, saves up to a staggering three billion dollars a year on these purchases. This money is then available to the consumer for other purchases, especially important at a time when we look to the consumer to fuel our economy.

We have all heard the arguments that these foreign manufacturers and their organization in the United States ... Copiat ... have advanced in an attempt to justify prices that are higher in the United States than in the rest of the world.

We have heard about the "free rider" theory. This theory holds that the higher price is justified by all of the ancillary services manufacturers and high-margin retailers provide.

It is claimed that we are riding on their coat-tails for free without providing access to these services. This is simply untrue, but in any case, could not justify these higher prices.

We have heard that these manufacturers are trying to protect the American people from shoddy merchandise. Does this mean that the products they intend for distribution outside the United States are shoddy? We have Seiko watches that are identical in every detail with one exception: The last digit of the eight-digit case number. The watch intended for distribution in the United States has the number nine as its last digit. The watch intended for distribution outside the United States has a zero as its last digit.

Both watches are made by Seiko in the same factory. Does the zero make a watch shoddy? I don't think so.

The third argument we hear has to do with the warranty. Seiko refuses to honor its one-year limited warranty on a watch it intended for sale outside the United States if that watch was purchased in the United States. We believe this is unfair. We believe that the American customer is entitled to fairer consideration. Every Seiko watch we sell is warranted for at least one year, some for two years.

Those opposed to parallel imports are advocating labeling or de-marking as an alternative to an outright ban on parallel imports. Such a maneuver would cause confusion in the consumer's mind and pave the way for counterfeiters. Without the name or identification, it would virtually have the same effect as banning parallel imports. Labeling or de-marking are not measures designed to help the consumer. They are measures that would confuse the consumer, that would be anti-competitive and that would increase consumer prices and ultimately eliminate the consumer's need for parallel imports.

This, then, is not a free rider or a shoddy merchandise or a warranty issue. It is a basic pocketbook issue. It is simply and entirely a struggle between those who believe in monopolistic, price-fixing practices and those of us who believe that the American consumer deserves the advantages of a competitive marketplace.

I urge your support for S.2614 which preserves the right of the American consumer to have a choice.

Senator DANFORTH. Mr. Gassin.

STATEMENT OF BERNARD A. GASSIN, PRESIDENT, G-K-G, INC., SKOKIE, IL, ACCOMPANIED BY EUGENE A. LUDWIG

Mr. GASSIN. I am Bernard Gassin, and I am president of G-K-G Inc., a distributor of Seiko watches in the States of Michigan, Illinois, Indiana, and Wisconsin.

Having spent a good part of my life building the Seiko trademark, I am here to oppose S. 2614, which would permit the gray market to destroy that brand and, with it, my business.

There are four things I want to emphasize today.

First, we built the Seiko brand over a period of about 16 years through very hard work. I cannot overstate how important Seiko's quality control and factory trained service center has been to building a trademark which the consumer respects and appreciates.

In sum, we built the trademark in accordance with U.S. law and we have an obligation to protect it.

Second, I want to emphasize that we sell legitimate Seiko watches to all types of stores. We do sell to discount chains, and virtually all of our retail customers regularly discount our product. The gray market is not a fair trade issue.

Third, I want you to know that the gray market is destroying the Seiko brand and with it my lifetime's work.

The gray market attacks only well-known branded products like Seiko watches. Gray marketers could choose to build a brand of their own. They could promote a fine product that are popular overseas but unknown here. And the gray marketer, he could buy private label a product similar to the one he gray markets, put his own trademark on it, and sell it on the basis of his own reputation.

The gray marketer does not do this because he wants a free ride. The gray marketer promotes himself, not the product.

Fourth, the gray market may deceive the consumer in several ways. In buying a gray market Seiko, the consumer simply does not always get the same product as the watch I distribute. He does not get the U.S. factory authorized service warranty. Often, the gray market watch itself is inferior. Typically, the origin of a gray market good is when some person overseas breaks his contract with a manufacturer and sells goods to a gray marketer, often because he has goods that did not sell well in his foreign market. These products may not only be outdated models or shopworn items, but also simply less desirable models than we offer in the United States.

It is a fallacy that gray market sells at lower prices in the authorized Seiko. Last fall I shopped a chain store in the Chicago area that sold gray market Seikos. I have with me the results of that purchase and compared it with the U.S. product that we distribute.

Here is one watch that Seiko manufactured 5 years ago. It is so bulky and obsolete that we would not sell it now at any price. It has a price tag of $110.

A second watch is similiar to that which we sell domestically. Our suggested price is $110. Gray market outlets suggested price was $135. A third watch sold for $250. I would estimate a fair retail price for it at $75 less.

Last week, one of our Seiko distributors shopped Rhode Island, and I have in front of me the results he found in Seiko products in authorized dealers' stores uniformly sold for less than the gray market product.

Moreover, in many cases, he found that supposed gray market discounts were discounted off of phony retail prices.

I hope that the members of this committee and your staff will take the time to examine these products.

In short, the sale of these inferior gray market goods are at no better prices than those available from authorized dealers, and with no grand promotion leads to greater profits for the gray marketer. It also leads to consumer harm and the destruction of our brand name.

Over a period of time, consumers stopped buying the trademark product. Then our retailers cannot afford to carry it, and the brand declines, and eventually the brand disappears.

I respectfully submit that Congress should not help the gray market to destroy 60 years of trademark law and ongoing administrative and court proceedings; rather, Congress should help us maintain the longevity of our trademark that we have worked so hard to establish.

Thank you.

Senator DANFORTH. Mr. Gassin, thank you very much.

[The prepared written statement of Mr. Gassin follows:]

BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL TRADE
COMMITTEE ON FINANCE
UNITED STATES SENATE

STATEMENT OF BERNARD GASSIN
IN OPPOSITION TO S. 2614
JULY 29, 1986

I am Bernard Gassin, and I am President of G-K-G Inc., a distributor of Seiko watches in the states of Michigan, Illinois, Indiana and Wisconsin. I also am President of the Seiko Distributors Association, an organization of regional distributors concerned with national sales and promotional strategies. As a distributor, we are responsible for selling watches to retail outlets which, in turn, sell them to consumers. Having spent the better part of my life helping to build the Seiko brand from a relative unknown to one of the most popular watches in the United States, I am here to oppose S. 2614, which would permit the gray market to destroy that brand and, with it, our business. Although what I have to say is applicable to the gray market issue generally, I will focus most of my attention on the business I know best, selling Seiko watches.

I have been selling watch products for nearly 40 years. In 1969, I was a regional distributor for Speidel and began as a backup to distribute Seiko watches in the four-state area. At that time, Seiko was largely unknown to both retailers and the American consumer. Indeed, in those years, many of my customers as well as consumers were somewhat suspicious that a Japanese watch could be as accurate and reliable as a Swiss product. Although I had my doubts that we would be able to create a market for these watches, we worked hard to promote Seiko and to sell it to our existing retail accounts. We were on the road every day of the week visiting jewelers and department stores to convince them to carry Seiko watches. We had trouble in many cases even getting in the door, and we also had trouble getting anyone to carry the Seiko brand. Because I was on the road so much during this period, I had to do all of my paperwork on the weekends. By the end of that first year we had convinced approximately 250 of our retail customers to begin carrying Seiko watches.

Today, we are distributing Seiko watches to more than 2,300 retail accounts in four states. Our customers include all types of stores: mom-and-pop stores, large jewelry chains such as Zales and Gordon Jewelry, department stores such as J.C. Penney's and Sears, and catalogue merchandise chains that have a substantial watch and jewelry business, such as Service Merchandise and Best Products.

How was this success achieved? In addition to hard work, it is the result of the very fine product that Seiko provides for sale in the United States. But this is not the whole story.

A very large part of the success of this brand involved convincing retailers and consumers that they could rely on the product and then providing them with the type of service that over the long run showed that our promises about the product were true. In short, a combination of product quality, honest and quality service, advertising and promotion built the goodwill for the Seiko trademark that has made Seiko a popular product and resulted over time in even better watches, better service and lower prices. In my experience, it is this combination of factors that builds any trademark.

Let me elaborate. As a Seiko distributor, we promote the brand by providing sales and marketing assistance to our retail customers. For example, an important aspect of brand marketing is inventory control, to assure the consumer a continuing supply of popular watch models. We buy back unsold, excess watches from retail customers who maintain a consistent sales plan. This allows these retail outlets to ensure that their customers do not have a selection of old, outdated watches but rather a selection of the current and popular watches that they desire. In order that they may continue to supply the public with popular watches, we also assure our retail customers a continuing source of supply of current watch models and, with our large inventory on hand, can turn most orders around in under 48 hours.

We also work hard to ensure the presentation of the Seiko product to consumers by knowledgeable and understanding salespersons. We use a sales training program to do this for our retail customers, which includes not only how to explain and sell Seiko watches, but also how to handle after-sales contacts and service. I personally have traveled to many different stores to train salespeople in the four-state area, and to show them a film that has been produced for this purpose called "You Make The Difference." I would estimate that in the last few years we have trained more than 1,500 salespersons in our retail outlets.

Brand advertising too is a key element of the Seiko marketing strategy. In this regard, we provide our retail outlets with in-store displays at no charge, and to the extent that they create their own displays, we share the cost. In addition, we encourage our retailers to advertise Seiko in print, and on radio and television. Each time one of the jewelry stores, department stores or catalogue showrooms to which we sell engages in this advertising, it pays only one half of the cost -- the other half is paid by Seiko and by us. Indeed, I would estimate that in the past five years Seiko and its dealers spent more than $100 million to advertise the product.

Of course, equally important is the Seiko quality control and service in this country. Seiko Time Corporation, Seiko's United States affiliate, supports the distributors, retailers and consumers by providing the necessary number of factory-trained repair personnel to service the product properly. Seiko Time provides a warranty, perhaps the best in the industry, that provides for warranty service on authorized products in the United States, in most cases at no cost to the consumer. And, Seiko takes pains to ensure that the product that is initially sold to the consumer has been carefully inspected and shipped so that as far as humanly possible the consumer "gets it right the first time."

Again, I should emphasize that these are the kinds of things that any company does to build its brand. Consumers buy the brand not because of a lot of "hype" but because over time they learn the image, in fact, reflects the real thing.

In sum, we have been able successfully to build the Seiko brand by selling to responsible retail outlets with a large watch and jewelry trade and by supporting them in the ways I have described in selling our watches. These support services take up about 75 percent of our gross profit. These stores, in turn, support the brand by building consumer confidence: they are responsible and knowledgeable and share with us in promotion and marketing of the brand.

I want to emphasize that the distribution system I am describing is <u>not</u> anti-discount. To the contrary, virtually <u>all</u> of our retail customers regularly discount our products. We encourage pricing that is competitive with other similar watch brands and, as I have mentioned, share the cost of our retailers' advertising, which promotes these discounts. Even so, these retailers share in brand-building promotion and service expenditures, even where such expenditures also significantly reduce their profit margins. However, these reduced margins are tolerable because by building the trademark through consumer demand and satisfaction, over the long haul they and I expect there will be enough business so that we can all survive. Let me now tell you how I view the gray market.

As plainly as I can put it, the gray market is based on deceiving consumers by taking advantage of our and our retail customers' brand-building investments. The gray market attacks only well-known, branded products like Seiko watches. You don't see a gray market in many fine products that are popular overseas but unknown here -- the reason is that in order to sell them the gray marketeers would not be able to rely on someone else's brand-building expenditures; they would have to make their own. This they don't want to do.

Where the brand has a high degree of positive consumer recognition, a person will buy that brand, relying on the trademark and the distribution system that built it. The consumer typically does this without asking a lot of questions. The greater the brand recognition, the easier it is for the gray marketeer to deceive the consumer into believing he or she is buying the real trademarked goods with all the attributes that come with buying a properly trademarked good.

The very fact that a consumer wants to buy a particular brand such as Seiko is almost always the result of a great deal of work and continuous expenditures by the trademark owner, the distributor and his retail customers. These costs the gray marketeer does not pay because the gray marketeer does not offer the service or engage in the promotional activities that we do. The gray market sellers just do not support and promote the brand. Many of them do no advertising at all; those that do simply advertise price -- this is not the kind of promotion that builds a brand. Nor do gray market sellers provide the extensive sales force training or inventory controls that we do. In fact, I understand it is not uncommon to have gray market back orders of eight months or more. As in the story of the Little Red Hen, gray marketeers are like the barnyard animals that want to eat the bread but would have no part in sowing the wheat, grinding the flour or baking it.

You should recognize that the gray marketeer, if he were willing to create his own goodwill, could buy in many cases a product very similar to the one he gray markets, put his own trademark on it and sell it on the basis of his own efforts. For example, Seiko has a division that sells high quality watch products to individual retailers and wholesalers that wish to put their own trademark on the good and sell it as their own. Many reputable retailers including noted national discount chains do just this. But the gray marketeer would not do this because to sell his own trademarked good he would have to pay himself for the promotion, service and other benefits that the consumer receives with a trademarked good that is properly distributed.

After all, when the consumer buys a gray market item like a Seiko watch he or she does not merely lose the warranty and other services that the trademark owner and his authorized distributors provide, but also frequently buys an inferior product. Typically, the origin of a gray market good is when some person outside the United States decides to break his contract with the manufacturer and sell goods to a gray marketeer. Frequently, the third party does this because he has goods that have not sold well in the local market. The very fact that the foreign third party wants to dump the goods after not being able to sell them means the goods tend to be old goods. These products may not only be outdated models or shopworn items, but the goods may simply be less desirable models that the United States distributors don't carry for a variety of reasons.

Thus, the gray market Seiko watch that the consumer unwittingly buys can be an old model, an inferior model, a less stylish model, in sum, a model that the gray marketeer can buy up and deceive the consumer into believing is the high quality, state-of-the-art product that we sell. Last fall, for example, I decided to shop in a noted chain store in the Chicago area that advertised gray market Seiko products at supposed discounted prices. I purchased one watch that Seiko manufactured five years ago -- it is so bulky and obsolete that we would not sell it now at any price. It had a price tag of $110. A second watch I purchased was similar to one that we sell domestically. Our suggested retail price on that watch is $110, the gray market outlet suggested price was $135. I purchased a third watch for $250; the style is not popular here. However, I would estimate a fair retail price for it at $75 less than that.

The story gets even worse for the consumer. All watches imported into this country must meet special internal marking requirements. Seiko carefully puts these markings on watches intended for our market in hygienic factory conditions. The same markings frequently are not put on watches intended by the factory to be sold elsewhere in the world. Therefore, for most gray market watches to be imported into the United States legally the factory seals must be broken, the watches opened and the required markings applied. Gray marketeers just cannot do this under factory-controlled conditions. It is nearly impossible to open watches and apply these markings outside the factory without doing some damage to the watch. Watches are delicate instruments and even the slightest amount of dust can shorten the life of a watch considerably. Moreover, we have found many gray market watches where the markings are corrosive materials or have been applied in such a way that the watch has been permanently damaged and will not function as intended.

The sale of these inferior gray market goods in the short run leads to great profits for the gray marketeer. Because the gray marketeer can sell a trademarked item like our Seiko watches without spending money on service and promotion, he is guaranteed a big profit. The consumer is unaware of what he or she is buying and the gray marketeer is off on his free ride.

But this does not last. The one thing I have learned in my 40 years of distributing merchandise is that the consumer has a great deal of intelligence and over time makes sensible decisions. Thus, the consumer that has bought a gray market good soon wakes up to the fact that the product does not meet his or her expectations. Instantly, the consumer takes out his or her justifiable frustration by writing letters of complaint, and Seiko has received literally thousands of letters complaining about gray market Seiko products. Worse, over time consumers simply stop buying the trademarked product, our retailers can't afford to carry it and the brand declines.

For the gray marketeer, this loss of goodwill in the trademark is unfortunate but unavoidable. In most cases the gray marketeer has already made a handsome killing. He has gained from the parasitic relationship that is the gray market. He moves on to another trademarked good.

Because of the gray market I am already seeing a decline in the goodwill of the Seiko trademark. If the gray market continues, brands will fall off and disappear. The permanent losers will be all those who have relied on the trademark: The trademark owner, the authorized distributor, our retailers and, most of all, the consumer.

The one hope we have of being able to control this problem is the law. The law encouraged Seiko, our company and our retail customers to invest many years and dollars in the Seiko brand. And, current trademark law gives the trademark owner and its authorized distributors rights to deal with problems like the gray market.

I respectfully submit that Congress, having encouraged us to create this valuable brand, should not now change the law and help gray marketeers steal it from all of us.

I appreciate the opportunity to be here today. Thank you.

Senator DANFORTH. Mr. Lewin, I am particularly happy to see you again.

STATEMENT OF NATHAN LEWIN, MILLER, CASSIDY, LARROCA & LEWIN, WASHINGTON, DC, ON BEHALF OF 47TH STREET PHOTO, INC.

Mr. LEWIN. Thank you, Mr. Chairman. My name is Nathan Lewin. I am an attorney and I represent 47th Street Photo, Inc., of New York City, a retail seller of parallel import products. I have represented 47th Street Photo in numerous lawsuits involving parallel importation, all of them successful except for the recent COPIAT decision in the District of Columbia Court of Appeals.

47th Street Photo is the largest retailer of parallel import photography and electronic equipment in the United States. But it may surprise you to know that it is also one of the largest national dealers of such equipment imported by so-called authorized distributors.

When a customer buys a Vivitar lens from 47th Street Photo he may get a parallel import or he may not. The products are identical.

Here, for example, you see a Nikon FM-2 camera, available from 47th Street Photo through an authorized dealer and an identical product available through a parallel import. The difference is simply price. The authorized camera with its warranty sells for $252. The identical camera with an equally extensive 47th Street Photo warranty sells for $234. And the price difference would have been substantially greater if not for the fact that over the past few years the authorized price has been driven down by the parallel import availability. The same is true for the two Canon Sprint cameras that are here on the table.

What this demonstrates is that the claim that authorized distributors do not trust parallel import dealers, that they are some way involved in some surreptitious activity, is simply untrue. Almost all of the major foreign manufacturers of consumer electronics and photographic equipment, including Vivitar, have selected 47th Street Photo as an authorized distributor, as an authorized dealer. Therefore, it carries parallel imports in order to provide for lower price, as well as authorized imported goods.

With regard to service and warranty, 47th Street Photo provides a warranty which is equivalent to—and we submit, better in actual implementation than—the manufacturer's warranty, and it extends for a period as long as the manufacturer's warranty on all these goods. The only difference is who is it who is providing that warranty. And the repeat business of 47th Street customers demonstrates that they are satisfied with the 47th Street Photo warranty.

Let me turn to what I think is the major point that has been raised here by the chairman and in various discussions, and that is the free rider argument.

We submit it is patently unsound for several reasons. First, besides paying for its own exchange and repair services, 47th Street, K-Mart, and a host of others who deal in parallel imports, have huge independent advertising and marketing budgets that actually create the demand for the product.

Twice a week, 47th Street Photo places full-page ads, costing over $7,000, in the New York Times. It is one of the largest advertisers every week in the New York Times. The trademark names of various products sold at 47th Street Photo are popularized through their appearance in these ads.

On Sundays, it places a two and one-half page ad that costs about $55,000 in the New York Times. It spends about $35,000 a month for Wall Street Journal ads, and $10,000 to $15,000 a month for radio.

In fact, it is our view that the American authorized distributors are free riding on 47th Street Photo's ads [laughter] as a result of this extensive advertising.

This advertising is paid for by a wholly American-owned business in the United States, not subsidized by foreign manufacturers. And that I think is a second point which is really essential in considering the chairman's question.

Even under this bill, an independent American distributor who pays for its own $500 expense would be able, under this bill, to protect that investment. All that this bill reaches are conglomerates, foreign manufacturers who are really paying in order to popularize the same name around the world. And that is the key distinction between the classic Supreme Court case of *Bourjois* v. *Katzel* and the situation that the parallel importers are trying to present in all these cases. Where we have one worldwide conglomerate, we think it is not entitled and it cannot claim that people in the United States are free riding when they are putting the same name on their product abroad as they are in the United States.

We support this legislation and ask that it be adopted.

Senator DANFORTH. Thank you, Mr. Lewin.

[The prepared written statement of Mr. Lewin follows:]

**TESTIMONY OF NATHAN LEWIN
BEFORE THE SUBCOMMITTEE ON INTERNATIONAL TRADE
SENATE FINANCE COMMITTEE, JULY 29, 1986,
ON S. 2614, THE PRICE COMPETITIVE PRODUCTS ACT OF 1986**

Mr. Chairman, my name is Nathan Lewin. I am an attorney and represent 47th Street Photo, Inc., of New York City, a retail seller of parallel import products. I have represented 47th Street in numerous lawsuits involving parallel importation -- all successful but for the recent COPIAT decision on appeal.

47th Street Photo is without doubt the largest retailer of parallel import photography and electronic equipment in the United States. It may surprise you to know, however, that 47th Street Photo is also one of the largest national dealers of such equipment imported by so-called "authorized" distributors. When a customer buys a Vivitar lens from us, for example, he may get a parallel import or he may not. The products are identical -- only the price may be different. For example, this Nikon camera, with the Nikon warranty, sells for $252. The identical camera, with an equally extensive 47th Street warranty, sells for $234. The same is true about these two Canon Sprint cameras, one parallel and one "authorized." These price differences, while still significant, are actually down from what used to regularly be 40-60% -- before parallel importation brought competition to the marketplace.

The fact that 47th Street sells identical foreign-made items imported through "authorized" as well as parallel channels destroys a number of arguments made by opponents of parallel importation.

First, it eliminates the claim that "authorized" distributors do not trust parallel import dealers to sell their goods. The fact is, no more than 30% of our total business has ever been parallel imports -- no more than 70% in cameras. Almost all of the major foreign manufacturers of consumer electronics and photographic equipment -- including Vivitar -- have selected 47th Street as an authorized United States dealer. 47th Street carries parallel imports as well, in order to give consumers the opportunity to purchase price-competitive goods, and to make available foreign manufactured items not sold here by the "authorized" distributors. 47th Street Photo has created a demand that authorized distributors have not been able to create, or satisfy.

Second, the servicing and warranty arguments that opponents make are smokescreens. If a parallel import does not include a manufacturer's warranty, 47th Street Photo provides one with the very same terms. It is estimated that less than 1% of sophisticated photography equipment fails due to defects. Nevertheless, 47th Street contracts with independent servicing companies to repair any defective merchandise that is returned. In fact, the only difference between the two Nikon or Canon cameras I showed you earlier is the wording -- not the terms -- of the warranty cards. One says Nikon, the other says 47th Street Photo.

Moreover, 47th Street Photo will take back any camera equipment and replace it, no questions asked, within 15 days of purchase. Few, if any "authorized" retailers match this guarantee. So no customer of 47th Street Photo is forced to wait a month or more for repairs. And 47th Street Photo pays the cost of its warranty and exchange services independently, while dealers who sell "authorized" products exclusively are usually subsidized in their repair costs by their multinational organizations. Customer satisfaction with 47th Street Photo is very high for the industry -- approximately 40% of our business is repeat customers. Thus the "consumer dissatisfaction" charge is a generalized myth.

Third, the "free rider" argument just doesn't hold water. Besides paying for its own exchange and repair services, 47th Street has a huge independent advertising and marketing budget, that actually creates demand for trademarked products. 47th Street Photo advertises several days a week in The New York Times. Twice a week 47th Street places full-page ads, costing about $7,200 each. On Sundays it places a two-and-one-half-page ad that costs about $55,000. Add to that the approximately $35,000 it spends per month for Wall Street Journal ads, and $10,000-15,000 per month for radio, as well as the cost of preparing frequent hundred-page catalogs. In fact, 47th Street Photo is among the top ten retail advertisers appearing in the Times, far ahead of any other camera or electronic equipment advertiser.

These advertisements are paid for by 47th Street Photo alone, not subsidized by foreign manufacturers. The trademark names are prominently displayed in all such ads. Who is free riding on whom? To claim that parallel import dealers such as

47th Street are taking a "free ride" on someone else's demand is a topsy turvy argument. In fact, parallel import dealers create a whole new market for high-priced trademarked merchandise: that of price-conscious middle-class shoppers who otherwise would not buy. By increasing demand, parallel importation ultimately benefits the same multinational organizations that own or control the U.S. trademark holders.

47th Street Photo -- like other parallel import dealers -- is a totally independent American company, creating jobs for American citizens. 47th Street alone currently employs approximately 300 people. United States companies that oppose parallel importing are, by definition, owned by or subject to common control with foreign manufacturers. Vivitar is a perfect example: although its corporate headquarters are in the United States, it does not manufacture cameras here -- almost all of its camera equipment is made by foreign workers in Korea, Japan, and China. Having abandoned this country for cheaper labor abroad, it then sells its goods overseas at lower prices than here. Yet Vivitar seeks to use American law to insulate its two-tiered pricing policies from competition. Vivitar can't have it both ways: manufacturing and sales in a foreign market, yet claiming to need protection as a "domestic" corporation.

In the lawsuit Vivitar brought in the United States Court of International Trade to try to block parallel importation -- a lawsuit it <u>lost</u> -- we tried to get Vivitar to tell us the facts of its international pricing policies, distribution schemes, foreign connections, and the like. But Vivitar refused. Instead, Vivitar claimed that the issue was "exclusively legal" and that no factual discovery was necessary. As I stated, Vivitar lost that legal issue. But the same refusal to provide hard factual information was also made by COPIAT in its lawsuit here, which it lost in the trial court but then won on appeal. These attempts to win without discovery are unfair, and also quite telling. The repeated refusal of U.S trademark holders on foreign-manufactured goods to reveal the facts of their pricing and distribution decisions in litigation strongly suggests that they have something to hide. I suggest to you that they are hiding blatant price discrimination against the American consumer.

America's economy is premised on free trade and competition. The theory is that American consumers ultimately benefit from energetic competition in the commercial arena. That is why three well-known consumer advocacy groups -- Consumers Union, Public Citizen, and Consumers for World Trade -- have <u>endorsed</u> the practice of parallel importation. Senator Chafee's Price Competitive Products legislation would merely guarantee competition to the international market.

In addition, the United States would remain in accord with the law in every other major country in the free world. As a legal memorandum written by my partner, Jamie S. Gorelick (attached) demonstrates, <u>all</u> our major trading partners permit parallel importation, and the United Nations has promulgated a principle condemning efforts to prohibit the practice. American manufacturers are therefore not offered protection from competition in foreign markets. Why should we protect foreign manufacturers here? The effort to bar parallel importation in the United States amounts to a plea for unilateral disarmament, a concept discredited in other contexts.

No one compels multinational trademark owners to stamp the same trademark on the products they sell in different countries. No one forces these multinational entities to sell the identical goods overseas at prices so much lower than those charged here that added transportation and import costs still permit a bargain. The multinational entities make these choices voluntarily. So they must live with them. The era of domestic trade protectionism is long past in the area of consumer goods. By settling the issue of parallel importation now, the Senate can save American consumers millions of dollars, with no loss in quality. 47th Street Photo and the American consumer strongly urge you to support Senator Chafee's bill.

MEMORANDUM

TO: The Coalition for Competitive Imports

FROM: Jamie S. Gorelick

DATE: April 17, 1986

The purpose of this Memorandum is to set forth the basis for our assertion before the courts, the Congress and the Executive Branch that all of our major trading partners affirmatively permit parallel importation, as a matter of both law and policy. Although this assertion has never been challenged in the cases we have litigated, we have heard in our legislative and administrative visits that our opponents have argued that only members of the European Economic Community permit parallel importation and, then, only within the borders of the Community. This Memorandum dispositively addresses that assertion and demonstrates that if this country were to prohibit or impede parallel importation it would provide foreign manufacturers with a benefit that other countries deny to U.S. manufacturers.

Japan

By both judicial decision and legislation, Japan prohibits an affiliated trademark owner from preventing the importation or sale in Japan of authentic trademarked products manufactured by its foreign affiliate. In a 1970 decision involving Parker pens (an American product), the Osaka District

Court ruled that the exclusive Japanese distributor and trademark owner of Parker products could not bar others from importing genuine Parker pens into Japan, because parallel importation encourages free competition and improves prices and services. N. MC. Co. v. Schulyro Trading Co. (Parker Pen Cases), 234 Hanrei Taimuzo 57 (Osaka Dist. Ct. Feb. 27, 1970) reported in English, 16 Japanese Ann. of Int'l L. 113, 131-132 (1972). The court specifically rejected the "territoriality" concept of trademarks, hodling that the Japanese trademark owner did not have the exclusive right to market the genuine trademark article in Japan. More recently, the Tokyo District Court rejected an attempt by the French owner of the Lacoste trademark and its Japanese licensee to prevent the sale in Japan of Lacoste shirts manufactured for Lacoste's American licensee, on the ground that the importation does not prejudice "the function of trademark," which is the identification of origin and guarantee of quality. BNA Antitrust & Trade Regulation Reporter, Vol. 48, p. 225 (1985).

In 1972, the Japanese government issued a regulation under the Customs Duties Act, prohibiting the exclusion of trademarked goods if the domestic owner also holds the foreign trademark and directly or indirectly supplies the parallel imports or if the domestic trademark owner and the foreign trademark owner should be considered to be the same entity by virtue of their special relationship. The Procedures for Application of Import Prohibitions of Goods Infringing

Intellectual Property Rights, Finc. Ref. No. 1443 of 1972. See Takamatsu, Parallel Importation of Trademarked Goods: A Comparative Analysis, 57 Wash. L. Rev. 433, 442-443 (1982) (hereinafter "Takamatsu"). Guidelines issued by the Fair Trade Commission of Japan also declare it to be an unfair business practice under Japan's Antimonopoly Act to hinder or impede in any way the parallel importation of goods. Id. at 443.

Canada

As recently as 1984, the Supreme Court of Canada reaffirmed Canada's commitment to free trade in Consumers Distributing Co., Ltd. v. Seiko Time Canada, Ltd., Docket No. 16970 (June 21, 1984). In that case, the Canadian owner of the Seiko trademark sought to exclude authentic Seiko watches imported independently. The Court held that as long as the watch itself was authentic, it need not be accompanied by the Canadian distributor's warranty, instructions, or service to be sold in Canada. The Court denied an injunction against a parallel importer who sold only the watch (Slip. Op. at 40):

> To grant such an injunction, a court must conclude that the seller of personal property identified by a registered trademark owned by a third party may not do so, if someone else is selling that property in some different mode, or with some different characteristic such as here, a one-year warranty to repair. . . . I found no such right in the law.

The Court specifically rejected the argument that the defendant was passing off, noting (Slip. Op. at 22) that it would be "foreign to our law" to "recogniz[e] a right to entail and control the sale of personal property, however legitimately acquired, where another person, in the position of the vendor, was also marketing the identical item." Slip Op. at 22. Accord, Wilkinson Sword (Canada), Ltd. v. Juda, 2 Can. Exch. 137 (1968).

Switzerland

In 1960, the Swiss Federal Supreme Court considered the question of parallel importation under Swiss laws. In Philips A.G. v. Radio Import GmbH, Judgment of Oct. 4, 1960, Fed. Sup. Ct., 86B6IV 119, 86 ATF 270, summarized in 52 Trade-Mark Rep. 152 (1962), the owner of the Philips trademark in Switzerland manufactured television sets for sale in Switzerland and elsewhere and it sold television sets in Switzerland that were manufactured by Philips of Germany, all bearing the same mark. Radio Import also bought sets made by Philips of Germany and sold them in Switzerland. When Philips sought to enjoin the importation, the Court held that Philips of Switzerland could not claim protection against the sale of sets manufactured by the Philips "combine" in Germany.

West Germany

The Federal Supreme Court of West Germany has similarly rejected barriers to parallel importation. In the Maja case, Judgment of Jan. 22, 1964, Fed. Sup. Ct. (W. Ger.), 41

Bundesgerichshot (BGH2) 84, summarized in English in 54 Trademark Rep. 452 (1964), a Spanish manufacturer that owned both the Spanish and German trademarks granted its German distributor an exclusive license. When Maja products were imported from Spain by a third party, the German distributor sued. The Court held that the trademark owner's control ended when it introduced the goods into commerce.

Similarly, in Cinzano & Co. GmbH v. Java Kaffegeschafte GmbH & Co., (W. Ger.), reprinted in English in Ladas, "Exclusive Territorial Licenses Under Parallel Patents." 3 Int'l Rev. Indus. Prop. & Copyright L. 335, 432 (1972), in which the German trademark was held by a subsidiary of the Italian manufacturer, parallel importation of the product from Spain and France was upheld, on the ground that the trademark identified the origin of the goods. The "territorial" concept of trademark protection was affirmatively rejected.

Austria

The Supreme Court of Austria has specifically adopted the exhaustion theory of trademark rights -- that control over trademark good is exhausted once the goods are introduced into commerce. The Court permitted the parallel importation of Agfa goods from Germany despite the fact that the German manufacturer's Austrian subsidiary held the Austrian trademark. Agfa-Gavaert GmbH v. Schark, Judgment of Nov. 30, 1970, Sup. Ct.

(Aus.), reprinted in English, 2 Int'l Rev. Indus. Prop. & Copyright L. 220, 223 (1971).

The Netherlands

The highest Dutch court, the Hoge Raad, has held that a company that holds German and Dutch trademarks could not enjoin the sale in the Netherlands of trademarked products independently imported from Germany. Judgment of Dec. 14, 1956, Hoge Raad dev. Hederlander (Neth.), 2 Bijblad Bij de Industriele Eigendom [B.I.E.] 46, summarized in Derenberg, Territorial Scope and Status of Trademarks and Good Will, 47 Va. L. Rev. 733, 736-38 (1961). Accord, Judgment of Apr. 1, 1969, Commercial Ct. (Neth.), reprinted in English in 1 Int'l Rev. Indus. Prop. & Copyright L. at 149.

United Kingdom

In Revlon Inc. v. Cripps & Lee, Ltd, Court of Appeals (Nov. 22, 1979) (EIPR D-11, January 1980). The Revlon Group, a U.S.-based manufacturer and distributor of toilet and cosmetic goods and the holder of the British trademark, was denied the right to exclude from the United Kingdom Revlon Flex products which were never marketed in the United Kingdom by Revlon and which Revlon had determined were unsuitable for that market. The court held that the parallel imports were not the subject of "passing off" or trademark infringement.

Revlon argued that the parallel importers were implicitly misrepresenting the source of the goods and their quality, because the parallel imports had been manufactured for sale abroad while the Revlon Flex name and goodwill were associated with Revlon products that had been sold in the U.K. The Court held, however, that the Revlon identification extended to the whole Revlon Group, regardless of where the goods were made:

> No purchaser knows or cares whether Revlon Flex is made in Wales by a Venezuelan company or in New York by Delaware corporation.

Kitchim, D., "The Revlon Case: Trademarks and Parallel Imports (UK)," March 1980 EIPR, 86, 88.

With respect to trademark, the Court held simply that trademark identifies the origin of the goods and that Revlon Flex had been the mark of the entire Revlon Group which exploited the mark worldwide. The British trademark owner was considered to have consented to the application of the mark to the parallel imports because of the power of the international entity to control the sale of its goods abroad. As one commentator noted,

> The decision appears to be of general application where a mark has been used by various members of an international group and has come to indicate to the public the 'group' rather than any particular domestic subsidiary.

Sweden

In Skandinavisk Henkel Aktieselskab & Parfymeri Trading Aktiebolag v. Charasz, NJA 1967 at 467-470 ("Polycolor"), discussed in Koritz, 9 Int'l law & Politics at 406-08, the Court refused to bar parallel imports where the foreign and domestic trademark owners were financially related.

The European Economic Community

Quite apart from these judicial decisions, it is the policy of the Common Market to prohibit any hindrance of parallel importation. The Common Market's policy on parallel importation parallels but does not supplant the laws of its constituent nations. Takamatsu, Parallel Importation of Trademarked Goods: A Comparative Analysis, 57 Wash. L. Rev. 433, 438 (1982). The decisions and policies discussed above rest on analyses of national trademark and unfair competition law; they do not rest on the Treaty of Rome, the agreement regulating trade within the European Economic Community. Cases among Common Market members under the Treaty of Rome are decided by the European Court of Justice, not the individual supreme courts and lower courts of the constituent nations. Thus, it is abundantly clear that the cases cited above state those nations' policies toward all trading partners, including the United States.

The Treaty of Rome prohibits restrictions on parallel importation unless the domestic and foreign trademark owners are completely independent. Thus, Article 85(1) of the Treaty prohibits agreements on practices "which have as their object or effect the prevention, restriction or distortion of competition within the common market." While Article 36 of the Treaty permits import restrictions to protect commercial property, they may not be used "as a means of arbitrary discrimination in a disguised restriction on trade between other states." Schlieder, "European Competition Policy," 50 Antitrust Law Journal, 647-671. Thus, while a trademark gives "the exclusive right to use that trademark, for the purpose of putting products protected by the trademark into circulation for the first time . . ." (Centraform B.V. v. Winthrop B.V., C.J. 16/74 [1974 Transfer Binder] Common Mkt. Rep. (CCH) ¶8247 (1947), these rights are "subject to the exhaustion-of-rights principle" (Schlieder at 672-73):

> The proprietor of the right cannot prevent the import of protected products from another member state if they have been marketed there by him or with his consent. Exercising property rights to keep out parallel imports infringes the rule on the free movement of goods.

Id. at 672-73. Most recently, the European Court of Justice held that the Swiss manufacturer of "Swatch" watches may not deny warranty coverage to purchasers of "Swatch" watches from parallel importers, because such a restriction would hinder parallel imports. E.T.A. Fabriques d'Ebauches v. DK Investment, No. 31/85, European Court of Justice, 12/10/85, reported in 50 BNA Antitrust & Trade Regulation Reporter 262 (1986). Citing its Lancome, Hasselblad and L'Oreal decisions, the Court said:

> A guarantee system under which the supplier of goods provides a guarantee only to the customers of its exclusive distributor places that distributor and retailers to which it sells at an advantage in relation to parallel importers and distributors and must therefore be considered to have the object of restricting competition. Id. at 263.

The United Nations

Finally, language in Principle D(4) of The Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices, adopted by the United Nations Conference on Trade and Development, indicates an international consensus that restrictions on parallel importation are offensive:

> Enterprises should refrain from the following acts or behaviour in a relevant market when, through an abuse or acquisition and abuse of a dominant position of market power, the limit access to markets or otherwise unduly restrain competition:
>
> * * *
>
> . . . (e) restrictions in the importation of goods which have been legitimately marked abroad with a trademark identical with or similar to the trademark protected as to identical or similar goods in the importing country where the trademarks in question are of the same origin, i.e., belong to the same owner or are used by enterprises between which there is economic, organizational, managerial or legal interdependence and where the purpose of such restrictions is to maintain artificially high prices;

Senator DANFORTH. Mr. Kersner.

STATEMENT OF STEVEN P. KERSNER, BROWNSTEIN, ZEIDMAN AND SCHOMER, WASHINGTON, DC, ON BEHALF OF ORIGINAL APPALACHIAN ARTWORKS, INC., COLECO INDUSTRIES, INC., MARTIN'S HEREND IMPORTS, INC., AND VIVITAR CORP.

Mr. KERSNER. Thank you, Mr. Chairman.

My name is Steven P. Kersner. I am a member of the law firm of Brownstein, Zeidman & Schomer. I am accompanied here today by Donald Stein, of our office, and also two cabbage Patch Kids: one gray market and one authorized.

We are pleased to present the views of several of our clients here today, all who are wholly owned U.S. companies and have been very active in gray market litigation over the past few years. All of these companies—they being Vivitar Corp., Original Appalachian Artworks, Coleco Industries, and Martin's Herend Imports—have been severely injured by gray market imports over the past few years and have been active in opposing gray market imports.

I would like to really just make two points because many of the points really have been covered earlier, you know.

The first is something that Senator Rudman alluded to earlier and Mr. Lewin only a few seconds ago. This is not—gray market is not a problem that is generated by foreign manufacturers to the detriment of U.S. consumers.

The four companies on which I am appearing for today are all wholly owned U.S. companies which are developing trademarks in intellectual property rights in the United States and gray market imports are entering and severely hurting those rights. And perhaps the best example to demonstrate the harm of gray market imports to the U.S. consumer and the U.S. intellectual property right owner is the situation with gray market Cabbage Patch Kids.

Cabbage Patch Kids dolls, when they were introduced a few years ago, rapidly became the most successful toy in the history of the industry. They became the most successful toy in the history of the industry because of the efforts of the original Appalachian Artworks of Cleveland, GA, and Coleco Industries of Hartford, CT. These two U.S. companies developed a product, marketed a product and created a demand for a product that has not been equaled in the history of the U.S. toy industry.

And then we come into the situation which, in fact, does exist as exemplified by this product of free riding. You have a product that has a tremendous demand in the United States, and numerous other companies began importing gray market Cabbage Patch Kids dolls as these dolls were being distributed in other markets around the world, and being imported and sold into the United States.

What is the harm? The harm is really twofold. First, it is to the U.S. consumers. When you buy a gray market Cabbage Patch Kids doll you buy a doll which is not going to give you the same results as the authorized doll. Why? Because no one in the United States is going to honor the adoption papers. [Laughter.]

Second, no one in the United States is going to send you your annual birthday card for your doll. You cannot imagine how many letters OAA and Coleco have received from irate parents and disappointed children because the doll they have purchased is in a name they cannot read because it might be French, it might be Japanese, as this doll is, or it might be Africanese, it might be any one of a number of different languages. And that they are not going to get a birthday card.

And, third, what does it do? It damages the goodwill of OAA and Xavier Roberts in creating this product, and Coleco in marketing this product. And the only reason why the gray marketing cabbage patch kids could exist is because these two U.S. companies have created a very successful product and you have gray marketeers coming in to free ride on the benefit of these two—on the efforts of these two U.S. companies.

I think this example in this one product easily exemplifies the problems with the gray market, the harm of the gray market, and why S. 2614 should not be reported out by this committee. Thank you, Mr. Chairman.

[The prepared written statement of Mr. Kersner follows:]

COMMITTEE ON FINANCE
SUBCOMMITTEE ON INTERNATIONAL TRADE
UNITED STATES SENATE

COMMENTS ON S. 2614

FILED ON BEHALF OF
VIVITAR CORPORATION
ORIGINAL APPALACHIAN ARTWORKS, INC.
COLECO INDUSTRIES, INC.
MARTIN'S HEREND IMPORTS, INC.

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July 29, 1986

Good morning. My name is Steven P. Kersner, and I am a member of the law firm of Brownstein Zeidman and Schomer. I am accompanied by Donald S. Stein of our firm. We are pleased to be able to present the views of our clients, Vivitar Corporation, of Santa Monica, California, Original Appalachian Artworks, Inc., of Cleveland, Georgia, Coleco Industries, Inc. of West Hartford, Connecticut, and Martin's Herend Imports, Inc., of McLean, Virginia, on S. 2614. All of these companies have been injured by gray market imports, and have taken active measures to prevent the importation of such goods.

This bill would amend Section 526 of the Tariff Act of 1930 to conform with the current Customs Service regulations, which are intended to administer and enforce the statutory exclusion of so-called "gray market" goods from entry into the United States. The Customs Service regulations presently in effect today severely restrict the scope of protection afforded by the statute, and are, on their face, contrary to the plain language of the statute. Without this proposed amendment to Section 526, the validity of the Customs Service regulations would remain extremely suspect.

The question we wish to address today, on behalf of our clients, all U.S. companies and owners of U.S. registered trademarks, is not the validity of the Customs Service regulations, but the wisdom of allowing gray market trademarked goods to enter the United States in derogation of the intellectual property rights of U.S. trademark owners.

It is our contention that the existence of the gray market does not benefit the U.S. economy, inasmuch as the sale of such goods (1) misleads and harms the consuming public, (2) harms intellectual property owners and their authorized distributors, and (3) allows gray marketeers to "free ride" on the goodwill associated with the mark.

While gray market goods may often be purchased by U.S. consumers at lower prices than similar merchandise purchased from authorized dealers, it must be emphasized that what is being purchased is more often than not <u>not</u> the same product as offered by the authorized distributor, but one that merely appears to be the same. This results in the public being deceived into believing they are purchasing something that they are not.

Because gray market goods are introduced into the U.S. market through channels of distribution beyond the scrutiny and control of U.S. trademark and copyright owners, opponents of the gray market argue that such merchandise may often be of a different, and invariably lower, quality than similar goods offered for sale by authorized United States' distributors, because they were manufactured for sale in markets outside of the United States, and have been built to different, i.e., non-U.S., standards and specifications. Those importing gray market goods have no stake in the reputation of the merchandise, unlike the trademark owner, and as a result they are often not shipped as carefully as authorized goods, nor inspected as carefully prior to release into commerce, thereby resulting into the introduction of damaged and defective goods into the marketplace.

Gray market goods may also have different (again, generally lesser) warranty and/or service guarantees, or none at all, something a purchaser is generally not aware of until he has a problem with the purchased merchandise. Also, where the gray market good differs from those intended for sale in the United States, replacement parts for repairs become very difficult to obtain. Consumers are also harmed by gray market goods because such goods generally are not marked in the manner required by U.S. law for consumer protection, and that labels, instructions, manuals and other accompanying documents are generally in a foreign language, or missing altogether. Further, purchasers of gray market goods usually are not eligible for advertised promotional programs, such as manufacturer's rebates, a fact of which they are often not aware of until after they have purchased a product and have tried to participate in the program.

The harm caused by gray market goods is not limited to consumers, but also extends to the trademark owner and authorized distributors. Gray market goods erode and/or jeopardize the goodwill associated with a trademarked product by introducing inferior quality and/or damaged goods, or goods without service and/or warranty guarantees, into the market. With respect to warranty and/or service guarantees, trademark owners or their authorized distributors must service or make good on warrantees for goods not introduced into the market under their supervision and which they did not sell but which are nevertheless associated with their name, or suffer a further dimunition in goodwill. Further, legitimate distribution systems set up by U.S. trademark and copyright owners, and carefully thought-out marketing strategies, are ruined by gray market imports.

Gray market sales reduce the market for authorized sales on almost a one-to-one basis, i.e., every gray market sale is one less sale a trademark owner or authorized distributor will make. Gray marketeers are also able to "free ride" on the efforts of the intellectual property owner, and do not incur the expenses associated with advertising and maintaining the goodwill associated with the product.

In sum, neither the U.S. economy nor U.S. consumers benefit from the gray market, inasmuch as the lower priced goods that are purchased are generally inferior in some way (e.g., quality, warranty protection, ineligibility for promotional rebates, etc.) to the authorized product. Further, these goods inflict direct harm upon the intellectual property owner and their authorized distributors. As such, we respectfully urge that S. 2614 not be enacted into law.

Senator DANFORTH. Thank you, Mr. Kersner.

I, as the opinion of one member of this committee, have to say that in my judgment the argument that is made by the opponents of the legislation, that some restriction on gray market products is necessary because people who buy dolls will not get cards, or watches are ugly, or old fashion, or even the price is wrong, or the warranty is wrong, is not a persuasive argument, to me.

I mean, I think that this is something that given a choice, most customers can decide, you know, well, I want the warranty, I don't want the warranty; I want the handsome watch, not the ugly watch. I can make my own price decision. I just do not think that that is a very good argument. I think really the biggest question, as far as I am concerned, is the free rider question. And I suppose the one element in resolving that is whether trademarks are designed to provide protection for manufacturers, or for sellers, or for a combination, and insofar as they are designed to protect sellers, what is the tradeoff between protecting sellers, on the one hand, and price to consumers, on the other hand? And, to me, that is the basic issue before us.

Do any of you have any view as to what is the purpose of trademarks? Are trademarks basically to protect manufacturers or are they to protect whoever happens to be selling the goods at the time?

Mr. KERSNER. Mr. Chairman, I think one of the witnesses earlier alluded to some of the legislative history to the Lanham Act, and in reading that, which I do not have before me right now, the legislative history says the purpose of the trademarks are essentially twofold: One, to protect consumers so they can be insured that the product they are getting is one that the trademark purports to represent. And that goes for manufacture to distribution.

Senator DANFORTH. Again, in this case, that is not so persuasive with me.

Mr. KERSNER. But it should be, Mr. Chairman, because the product——

Senator DANFORTH. Well, it is not.

Mr. KERSNER [continuing]. The product——

[Laughter.]

Mr. KERSNER. Well, maybe I will convince you if you give me a second. Because the product that the consumers are ultimately getting is not what the trademark owner wants them to get. So you have the consumers being deceived because when people do buy the gray market Cabbage Patch Kids dolls they don't know that their adoption papers aren't going to be on it, that the name is in a foreign language, and the birthday cards they are not going to get. It is simply a deception on the public and the whole concept of Cabbage Patch Kids dolls is distorted, and that creates the injury to the intellectual property right owner.

Mr. LEWIN. But the question is, whose fault is that, Mr. Chairman?

Senator DANFORTH. I think it is an irrelevant argument, to me, no matter whose fault it is. I think the question is, to what extend do trademarks—are trademarks designed to protect the person who is promoting as opposed to creating the good, and how is that balanced against the consumer choice and the favorable price that grows out of competition?

Mr. LEWIN. I think the legislative history of the Lanham Act, which has been quoted, does show that there may be a second purpose in terms of protecting the investment. But the point precisely is that that protects the investment of the independent American distributor.

Nobody has ever argued since the Supreme Court decided its case by Justice Holmes in *Bourjois* v. *Katzel* that an independent American distributor who makes that investment has a trademark protection.

The issue with regard to gray market or parallel imports is when you do not have the independent American distributor but when you have the foreign manufacturer, or the American who is making it and selling it abroad and then trying to bring it into the United States.

Cabbage patch kids could very easily have labeled those "French Cabbage Patch Kids." They were in control. That is the point that Senator Chafee was making before. They can require their licensee to put on it everything he wants that says it will come without American names, without American birth certificates, without American birthday cards.

And the point is, he has chosen to manufacture it abroad and to confuse the consumer in that way, and then complains and wants it kept out of the United States.

Mr. KELLEY. Mr. Chairman, if I could add to Mr. Lewin's statement.

I think we are finally at the absolute nut of it. The manufacturer has control. He can call it "Pepsico" instead of "Pepsi Cola" in Mexico if he wants to differentiate his product. If he has got red dye, or talcum, or whatever, he has the control over the differentiation.

When we talk about geographic price discrimination, this is what makes parallel imports economically possible. If I could just make one point—they talk about trademark encouragement, but actually we are talking about encouragement of production outside the United States. They made the manufacturing profit outside the United States. They want to have a second profit in the United States through increased prices to the consumer.

And one point that has not been made today. If you control the channels of distribution and can charge a higher than worldwide wholesale price here, you can avoid U.S. income taxes in the U.S. by controlling the channels of distribution.

So there are three benefits all to the foreign manufacturer and none to the U.S. economy.

Mr. LUDWIG. Mr. Chairman, I beg to differ with this gentleman.

Senator DANFORTH. Could you do it briefly?

Mr. LUDWIG. Yes, sir.

The purpose of trademark laws under our laws is twofold: to protect the goodwill that the trademark owner has created, and to eliminate consumer confusion. That is an obligation on the part of the trademark owner. That is protected by 60 years of trademark law in the courts and by statute. And what you gentlemen are proposing to do with S. 2614 is to dramatically change those laws.

I submit, Mr. Chairman, that that would radically alter those laws. It could take away the right of trademark owners to sue to protect their trademarks, something they are obligated to do.

Senator DANFORTH. Senator Chafee.

Senator CHAFEE. Mr. Chairman, I have a feeling that I am in never, never land here. The owners of the trademark are licensed to be produced abroad goods of apparently two qualities. One, an inferior quality that is apparently sold to unsuspecting people abroad, and another of a superior quality that is shipped into the United States. And indeed in the statement of Mr. Gassin, several times he refers to Seiko, "the very fine product that Seiko provides for sale in the United States." That is on the bottom of page 2. And he has similar language: "Of course, equally important is the Seiko quality control and service in this country."

So apparently what Seiko has determined they wish to do, and Cabbage Patch dolls, and others, is to manufacture one brand overseas that is considered inferior—or it does not receive birthday cards, or has no adoption papers—and another for the United States. And then they get disturbed when those goods come into the United States and are not differentiated, or that the consumer buys one, thinking he is getting the other.

If these manufacturers want to produce an inferior quality product, they have got to stand by the results that stem from that. And whether it is the Dial soap or it is the Cabbage Patch doll, they ought to fix up their goods abroad that they are prepared to suffer whatever will come from it if that good should turn up in the United States to be sold.

And indeed if it is an equally good product, then I like the term "parallel import." I forgot to add that to my lexicon here. Is that what the word is?

Mr. LEWIN. Parallel import. That is what it is called.

Senator CHAFEE. Parallel import. That is a good one.

It is so much more gentle than gray market. Mr. Lewin's company, for the people he represents, are prepared to import and stand by it. And so is K-Mart when they bring in their watches.

So I don't think it is the duty of either the U.S. Government or this Congress to go around and protect these companies that license their goods overseas and produce an inferior product, or an apparent inferior product.

Doesn't your Cabbage Patch doll that is sold in France have on it, that it is made for France? Is the description of the doll in French and the instructions in French?

Mr. KERSNER. It is in French and English.

A couple of points, Senator Chafee, because maybe I wasn't very clear when I gave my brief remarks at the outset.

We are not saying that the gray market doll is an inferior product, nor that you will not be able to get adoption papers or birthday cards. With this doll you can do so in Japan. You buy the doll in Japan, and there is a Japanese service center that will send you adoption papers, and will send you the birthday cards, just the same kind of service center that exists in the United States and that exists in France and in England and all over the world.

These two products are essentially identical in those respect. It is just a question if you buy a Japanese doll or a French doll, you cannot get those papers honored in the United States.

Senator CHAFEE. Now what is there about that doll that somebody can go way over in Japan and buy it, and bring it over to the United States, and sell it at a lower price?

Mr. KERSNER. I am so glad you asked that questicn, because, you know, it gets to the whole heart of the free riding.

In the United States, as you are probably well aware, you cannot introduce a toy or doll product without such extensive advertising. If you need a television show, you have to have, you know, run commercials around your television show. You have to promote the product through your Saturday morning cartoons, through your constant commercials; that it takes a tremendous amount of money and effort to develop a product.

Movies are made in the United States about Cabbage Patch dolls.

In France, you cannot advertise toys or dolls on television, no less have a television show about it.

The differential in the price between what one product will bear in one market—and it is the same as in Japan—and what one product will bear in another market, such as the United States market, is absolutely enormous.

Senator CHAFEE. All right.

Mr. KERSNER. And it enables you to go to France and buy the doll a lot cheaper.

Senator CHAFEE. Fine.

Mr. HOLTZMAN. Mr. Chairman, may I make a brief comment, please?

Senator CHAFEE. Brief. Yes.

Mr. HOLTZMAN. Yes, sir.

In regard to the free rider comment, I would like to tell you that the two Seiko watches roughly have a list price of $250. They cost, in Japan, approximately $15. When they are bought by a parallel importer overseas, he is probably paying about $75, which is about five times their cost.

So it is not a free ride. Seiko made a substantial profit in selling that merchandise, five times their cost. When it is sold in the United States, they might make eight times their cost. We don't have to have a charity ball for them.

Senator DANFORTH. Thank you very much for your testimony, gentlemen.

The next panel: John Hennen, senior assistant attorney general, assigned to the Washington State Liquor Control Board; Anver Jamal Rizvi, deputy manager, All Planet Exports, London, England; Peter Thompson, president and chief executive officer, Paddington Corp., on behalf of the Distilled Spirits Council of the United States, and the National Association of Beverage Importers.

I am going to leave now and will turn this over to Senator Chafee.

Senator CHAFEE. All right.

Why don't we start right ahead. Would you quickly be seated? We are under a time existency here.

Mr. Hennen, why don't you start?

STATEMENT OF JOHN G. HENNEN, SENIOR ASSISTANT ATTORNEY GENERAL, ASSIGNED TO THE WASHINGTON STATE LIQUOR CONTROL BOARD, OLYMPIA, WA

Mr. HENNEN. Thank you, Senator.

I would like to begin by saying that the Washington State Liquor Control Board is a control jurisdiction. They sell all the liquor in the State of Washington, and they strongly favor passage of this bill because it would allow the parallel market to continue.

The State of Washington became the first control State to enter the parallel market approximately 6 months ago. The reasons for that, I am not going to rehash the basic arguments proparallel or against parallel, but I am going to speak to the reasons the State of Washington entered the market and the experience that we have had in doing so.

Since there exists a substantial price discrimination in liquor between various countries, a parallel market has been created. The State of Washington has saved $1,726,000 in the last 6 months purchasing approximately 21 different brands of imported liquor. That is a saving over the price that the board would have had to pay for the same goods from the authorized importers. That translates into a $2.9 million savings for the consumer of the State of Washington.

The existence of price discrimination in the area of $50 a case for essentially identical products creates this market. It is only where there is a substantial difference from one country to another that the market can economically exist.

The State of Washington does not want to put any authorized importers out of business. The State of Washington has tried to deal with authorized importers, has dealt with them for over 50 years. And it appears that the parallel market is the only way that those importers will have a competitive incentive to lower their prices to reasonable levels.

The consumers of the State of Washington, and in fact the consumers of the United States, in general, deserve to be treated as equals in the world marketplace, and not to be used as unsuspecting sources of enormous profits.

I would be happy to answer any questions that the Senator may have.

Senator CHAFEE. Well, we will have each of the witnesses speak first.

[The prepared written statement of Mr. Hennen follows:]

TESTIMONY
of
THE WASHINGTON STATE LIQUOR CONTROL BOARD
before the
INTERNATIONAL TRADE SUBCOMMITTEE
of the
COMMITTEE ON FINANCE
of the
UNITED STATES SENATE

July 29, 1986

Mr. Chairman, distinguished members of the Committee; I am John G. Hennen, Senior Assistant Attorney General and chief legal counsel to the Washington State Liquor Control Board. On behalf of the Washington State Liquor Control Board, I am pleased to have the opportunity to present the Board's views concerning S.2614.

The Board has asked that I summarize its experience with purchases of imported liquors on the parallel market and the advantages those purchases have afforded to the citizens of the state of Washington, our customers.

In November 1985, the Board began placing orders on the parallel market which, to this date, have totalled 131,046 cases of liquor. These purchases have so far resulted in a saving to the State of $1,725,879.70. This saving at the wholesale purchasing level will translate into savings of approximately $2,900,000 in the retail prices paid by the consumers of the state of Washington. I wish to emphasize that we are talking about savings of that volume spread over an approximate six-month period realized by the consumers of one state of the Union. I also wish to emphasize that the Board has continued to purchase on the parallel market, and is in fact planning to expand its purchases in the future. The fate of S. 2614 is thus of considerable interest to the Board.

In order to put this matter into perspective, I will give a brief description of the liquor distribution system in Washington State and the manner in which our parallel market purchases compliment that system to the benefit of our consumers.

<u>Background</u>

Washington State is one of eighteen jurisdictions within the United States wherein the people, through a state agency, own and operate their own liquor distribution system. The Washington State

Liquor Control Board serves as both wholesaler and retailer of liquor.[1] The state of Washington is the sixth largest wholesale purchaser of liquor in the United States and presently operates 360 retail liquor outlets selling packaged goods at uniform prices throughout the entire state.

Historically alcoholic beverages have been considered good sources of tax revenue for all levels of government. Washington State has the dubious distinction of having the highest taxes on distilled spirits products in the nation.[2] This, in turn, has lead to the highest prices on distilled spirits products in the nation.

The magnitude of those taxes, and the other elements which make up the retail price of liquor in Washington State, are illustrated on the "bottle chart" which appears on the following page. That chart depicts an "average" 750 ML bottle of 80 proof distilled spirits. (See Page 3)

As you can see, state and federal taxes comprise 54.4 percent of the total cost. Freight and operating expenses constitute another 13.6 percent.

The portion of the chart identified as "Revenue for Distribution" makes up 10.2 percent. While this area is under the control of the Board, it cannot be changed without directly impacting revenue to state and local governments which depend heavily on this income.

The remaining area in which the Board is free to operate to reduce retail prices for the Washington consumer is the "supplier price" of liquor purchased. This constitutes 21.8 percent of the retail price charged.

In the past, the Board has attempted in good faith to work with foreign liquor manufacturers' "authorized" United States importers in order to obtain the best available prices for the state's consumers. For the most part, these efforts have been unavailing. The "authorized" distributors simply cited promotion and advertising costs and other "services" as making their selling prices "beyond their control" to lower.

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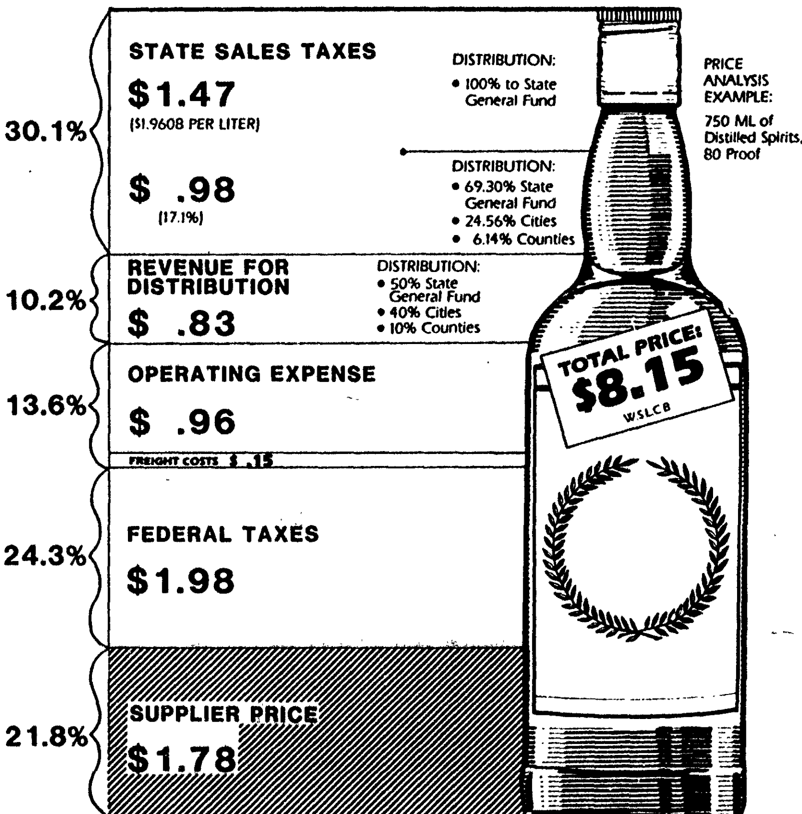
1 Distilled spirits and wine, as well as a very small percentage of some of the stronger malt liquors are sold in state outlets. In addition, wine and beer may be sold under license by private wholesalers and retailers.

2 In addition to the federal tax which, of course, is the same on all products throughout the United States, Washington has a $1.9608 per liter tax and a 17.1 percent retail sales tax on spirits (see RCW 82.08.150). On wine, there is a $.2167 per liter tax (see RCW 66.24.210) plus the state and local general retail sales taxes.

WHERE YOUR LIQUOR DOLLARS GO...



FEDERAL AND STATE TAXES AMOUNT TO $4.43 OR 54.36 PERCENT OF THE $8.15 TOTAL PRICE.

WASHINGTON STATE LIQUOR CONTROL BOARD

Washington State's Entry into the Parallel Market for Liquor

During the summer of 1985, the Liquor Control Board received information indicating that imported alcoholic beverages could be obtained at considerable savings by dealing on the world market rather than dealing exclusively through manufacturers "authorized" United States importers. The potential savings were substantial, being anywhere from 12 to 20 percent at retail. Since, if this information proved accurate, it could directly impact the pocket book of the consumers of the state of Washington, the Board ordered an extensive investigation into all aspects of the subject ranging from product availability, genuineness, reliability and safety, to the potential impact on state revenues of such purchases.

What the Board determined was that an unsuspecting American public was being used as a major revenue source by foreign liquor interests who were charging exorbitant prices for liquor products which were available elsewhere in the world marketplace for far less.

The Board learned that the parallel market in liquor outside the United States was approximately 15 years old and that the parallel trade in liquor was a common and accepted practice in such diverse places as Japan, South America and Africa as well as throughout Europe.

When it was pointed out to the "authorized" importers that better prices were available from European sources, and that the prices of identical products in the Canadian market were roughly half the price to Washington State, the "authorized" importers merely made allusions to the inability of Washington State to "understand how business operates" and that whether we understood it or not the "authorized" importers were the only firms having the ability and expertise to successfully bring a continuous supply of foreign products to the United States market.

After much research and investigation of the parallel market and after exhaustive staff meetings, the Board made the decision to purchase goods on the parallel market and to serve as its own importer for them. This decision was made October 10, 1985.

Washington State's Experience with the Parallel Market

Orders were placed November 15, 1985, and the announcement to the public and news media of parallel purchases was made on December 9, 1985. A copy of the press release distributed in conjunction with that announcement is attached hereto as Attachment 1. Washington State thus became the first "control" state to enter the parallel market for liquor. These initial orders were for 32,000 cases of distilled products and represented an initial savings of $498,000 over costs for the same goods through "authorized" United States importers.

In its first order the Board purchased six premium products on the parallel market, realizing a per bottle savings to the customer ranging from $1.75 to $2.55.

The public, and the news media, reacted very favorably to the Board's decision to obtain products on the parallel market. (See representative sampling of editorials, news articles, etc. attached as Attachment 2.)

When the parallel liquor products actually began appearing on Washington State shelves on February 1, 1986, representatives from several major "authorized" liquor importers met with the Board and stated their strong objections to the Board's obtaining these products from the parallel market. There were hints to the effect that the "authorized" importers now understood the Board's concerns with exorbitant prices for imported liquor products, and allusions were made to forthcoming proposals which would resolve those concerns. There were also outright threats to react by withdrawing products from sale within Washington, introduce a "primary source" law in the Washington State Legislature, and remove the state of Washington from liquor sales altogether by means of the initiative process.

Suffice it to say that none of the "authorized" U.S. importers have come forth to this date with concrete and permanent price reduction proposals for their products, no products have been withdrawn from the Washington market, and the proponents of "primary source" legislation were unable to even find a state legislator willing to introduce such a bill.[3] Additionally, though there was an initiative campaign launched to take the state out of the liquor business, it failed to receive even a fraction of the signatures necessary to get on the ballot.

The "authorized" United States importers claimed that parallel market goods were likely to be counterfeit or contaminated. The Board's investigation of those claims disclosed that All Planet Exports, Ltd., the Board's parallel supplier, had delivered over eight million bottles of liquor in the parallel trade over the past ten years throughout the world without a single instance of counterfeit or contaminated product.[4]

3 The State Legislature was in session at the time the Board began its purchases on the parallel market. The Board has received solid support for its parallel market purchases from many legislators whose comments are generally of the "Why did you wait so long?" type.

4 There was one instance where an attempt was made to sell a quantity of counterfeit Johnnie Walker Scotch to All Planet

The "authorized" United States importers had also warned the Board that sales would decline without their services (i.e., promotion, advertising, etc.). This has likewise proven inaccurate. The Board's initial sales figures for February 1986 indicated a 77 percent increase in the number of cases of direct import products sold. This, though saving the consumer a substantial amount of money per bottle, also translated into a 64 percent increase in dollars expended on direct import products.[5]

An analysis of the Board's computerized sales records indicates that consumers are "trading up" to higher quality brands and that the increases in sales of direct import products do not indicate an overall increase in consumption by the citizens of the state of Washington, and that the savings to the customer do not indicate a decrease in state revenue over projections made when the prices of these products were higher.

Problems Encountered with Obtaining Label Approvals from the Bureau of Alcohol, Tobacco and Firearms

All importers of liquor, be they "authorized" or parallel, must obtain label approvals from the United States Department of the Treasury, Bureau of Alcohol, Tobacco and Firearms (BATF), for each product which is to be imported into the United States.

Initially, the state of Washington applied for, and received, a number of label approvals for foreign produced liquor products. Since the products involved were already being imported into the United States by "authorized" importers, the required approvals were initially granted with a minimum of bureaucratic red tape. Personnel at BATF were cooperative and helpful in processing the Board's requests for label approvals.

In late December 1985, there was a sudden and noticeable change in the manner in which BATF dealt with the Board's label approval requests.

With no prior warning or explanation the Board was advised that previously given permanent label approvals for distilled gins and various liqueurs would be cancelled. The Board was also advised that it would not be able to obtain any further approvals for these products until it had provided BATF with copies of formulas and lists of ingredients for them. This new requirement

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Exports. The fact of counterfeiting was quickly detected and, with the assistance of Scotland Yard and John Walker and Sons, Ltd., the would be seller was arrested, prosecuted and imprisoned.

5 Some case sales jumped as much as 144 percent with dollars expended for those products increasing by 129 percent.

was in spite of the fact that BATF had previously tested and approved these products. The practical effect of this was to make parallel importation of these products impossible. The required documentation could only be obtained from the manufacturers of the products, which, as BATF well knew, would not furnish that information to the Board.

The Board soon learned that a tremendous amount of pressure was being exerted on BATF by existing import industry members in an effort to use United States Government machinery to terminate the parallel trade in gins and liqueurs. One liquor industry official[6] even claimed in a generally distributed "information" paper that his company had been successful in using BATF to "effectively eliminate further gray market imports of Bailey's and other imported liqueurs." (See Attachment 3.) Other liquor import industry officials have been reported to have made similar statements orally.

The Board reacted to this special interest pressure by a combination of Freedom of Information Act requests and correspondence with authorized importers and European manufacturers. As a result the Board learned that many existing "authorized" importers of distilled gins and liqueurs, when obtaining their original label approvals, had never been required by BATF to provide the documentation being demanded of the Board.

The Board subsequently called this apparent disparity in treatment to the attention of BATF (as well as strongly indicating that the Board was contemplating Federal Court review of BATF actions, if necessary), and that agency has now apparently retracted its earlier "formula and ingredients" requirements and has adopted a much more reasonable and neutral approach to issuance of label approvals.[7]

We now believe that this stage of intense industry pressure, having been ineffective, is drawing to a close. We look forward to working constructively with BATF in the future and presently have confidence that any new problems which may develop can be resolved short of litigation.

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6 Peter Thompson, President and Chief Executive Officer of The Paddington Corporation. The comments were made in a letter dated June 19, 1986, a copy of which is attached hereto as Attachment 3.

7 BATF now requires, for a product already being imported into the United States, that any additional (i.e. parallel) importer must provide a sample of the product, an analysis of the sample, and an attestation to the nature of the product. This effectively permits parallel importation whereas the previous requirements would effectively make it impossible.

Price Comparisons

The passage of S. 2614 would allow continuation of parallel trade. The disadvantage to the consumers of the state of Washington of a discontinuance of parallel trade may best be illustrated by a comparison of case costs for identical liquor products between (1) Washington's purchases from "authorized" United States importers, and (2) the prices charged to the Canadian Provinces Liquor Commissions, which are presently able to buy direct from the manufacturer. In comparing these prices, it is important to bear in mind that the Canadian direct purchase prices include a factor built in by the manufacturers for advertising, promotion and all other services necessary to support a market.

All prices on the following chart are in United States dollars and relate to the 750 ML size bottle.

	"Authorized" U.S. Importers' Price Per Case to Washington	Canadian Liquor Board Purchase Price Per Case	Price Differential Per Case (Washington vs. Canadian)
Johnnie Walker Black Label Scotch	$ 95.70	$ 41.61	$ 54.09
Cutty Sark Scotch	56.30	23.17	33.13
J&B Scotch	56.50	23.50	33.00
Drambuie	100.10	43.61	56.49

These cost differentials are exorbitant, unjustified and unjustifiable. While the "authorized" importers argue that these price differentials are due to promotional and advertising costs, their claims of higher costs of doing business in the United States than in Canada are beyond all realistic bounds. There is simply no conceivably legitimate reason why it should cost $54.09 more per case for John Walker and Sons to promote or do business in the United States than in Canada.[8]

8 Somerset Distillers Group, the "authorized" U.S. importer of Johnnie Walker Black Label, is under common ownership and

A chart showing savings per case on all of Washington's currently offered parallel liquor items is attached hereto as Attachment 4.

Supplier's Costs are Minimal in Dealing with Washington State

In most cases, the "authorized" U.S. importer is a wholly owned subsidiary, or otherwise has common ownership with, the manufacturer of the liquor in question. Also, in most cases, the United States importer does not actually take possession of or handle the goods but merely takes orders which are then shipped directly from the manufacturing facilities in Europe. The Board buys many, if not most, of its imported products in container lots.

Importers of liquor must deal in many different state jurisdictions and under many systems of liquor distribution. The Twenty-First Amendment to the United States Constitution allows each state to set up its own scheme of liquor regulation and merchandising, or, should it decide to do so, to prohibit sale of liquor altogether.

While promotion and sales expenses attributable to a particular state may be substantial in "open" or "license" states, where there are many wholesale buyers of liquor, those expenses are virtually nonexistent in "control" states.[9]

In the state of Washington, a supplier of liquor need only make one sales presentation to the Board located at the state capitol in Olympia. If the Board purchases the product, the supplier is guaranteed statewide availability for the product as each of the Board's 360 stores and agencies will either carry the product or have it available on order for customers who wish to purchase it.

Also, as a practical matter, sales to the state of Washington carry no risk of nonpayment as sales in open states often do.

Promotional activities undertaken in a control state are, by law and policy, minimal. Sales representatives need not conduct promotional activities in conjunction with wholesalers (since there are none) and are very limited (by provisions of state and federal law and Board policy) with regard to retail licensed premises. In Washington supplier representatives are prohibited from entering

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control with John Walker and Sons, Ltd., the producer of Johnnie Walker Scotch Whiskey.

9 "Open" or "license" states are those wherein the people have chosen to permit sale of liquor by privately-owned wholesalers and retailers. This is as opposed to "control" states where the state itself handles the liquor either at the wholesale or retail level (and usually at both levels).

state stores and agencies except for the purpose of making a purchase of liquor.

Conclusion

The Washington State Liquor Control Board respectfully urges the members of this subcommittee to recommend passage of S.2614. Without it, American consumers may once again be defenseless to being held hostage by those "authorized" United States importers of foreign products who use their status as "authorized" importers to artificially increase the price of those products.

As was the experience in Europe and in other places throughout the world, parallel trade is only a "problem" to those entities who, by their own unreasonable pricing policies, make it economically possible for parallel trade to exist. A number of products are impossible to obtain on the parallel market because they have a single worldwide price. An example of such a product is Bacardi Rum, the number one selling spirit product in the world.

In liquor, as in all other products, the people of the United States deserve to be treated as equals in the world marketplace rather than being used as an unsuspecting source of exorbitant profits for foreign interests or for corporations owned and controlled by foreign interests.

The decision of the United States Court of Appeals for the District of Columbia Circuit in COPIAT, though contrary to the better reasoned decisions of the Federal and Second Circuits in Vivitar and Olympus, has created uncertainty concerning the future of parallel trade. Where imported liquor products are concerned, the parallel trade is the only way the American consumer can receive the benefits of competition.

S.2614, in restoring the law to its former state as interpreted by the United States Customs Service, will reestablish the right of the American people to be free of those foreign interests who would use United States government agencies and United States law to pick the pocket of the American consumer.

[ATTACHMENT 1]

STATE OF WASHINGTON
WASHINGTON STATE LIQUOR CONTROL BOARD

12-21/cm
Contact: Carter Mitchell
Information Officer
(206) 753-6276

December 9, 1985

FOR IMMEDIATE RELEASE
LIQUOR BOARD JOINS PARALLEL MARKET

"After an extensive study, the Liquor Control Board has decided to take advantage of the parallel marketing practices found in Europe and act as its own importer for certain distilled products," announced Board Chairman L. H. Pedersen. The announcement, made at the Seattle Distribution Center, marked the beginning of a new era in the way in which the Liquor Control Board purchases imported products.

The Liquor Control Board serves as both wholesaler and retailer of distilled liquor products within Washington. U.S. importers have continuously refused to lower the costs of the products purchased by the Liquor Control Board despite the fact that importers' costs in doing business with the Board are lower than those locations where they must deal with private wholesalers and retailers.

"We give the importers a single, centralized distribution point, a single purchasing source, and no additional costs by being the end retailers," Pedersen explained. "The importers have continued to take between 20 and 25 percent of the cost of the product as their gross profit, despite the savings we represent to them." Pedersen also pointed out that importers have no worries of receiving their payments as the state processes the orders, makes payments promptly, and has no credit problems.

Most of these imported products are in the 750 ml size, which is the most popular size for Washington's consumers. The Liquor Control Board plans to continue purchasing other sizes of imported liquors from the traditional U.S. importers, but expects to purchase the majority of the 750 ml size bottles on the Continent.

(over)

Liquor Board Member Kazuo Watanabe, a specialist in foreign trade agreements, said the decision to purchase on the parallel market was not easy for the Liquor Control Board. "We took into consideration the fact we were breaking with tradition," Watanabe said. "Additionally, we considered the tremendous amount of criticism we would receive from the U.S. importers, but our consumers must come first!"

Watanabe said the procedure for purchasing on the parallel market was complicated because of the additional steps the Liquor Control Board must take in order to secure federal approval of labels, the minute details of arranging for ocean shipments and the planning which is required to order sufficient quantities in anticipation of demand thus allowing for sufficient time for shipment.

Liquor Board Member Robert Hannah, a former retail executive, said the practice of purchasing on the parallel market is common in many parts of the world. "What we are doing is bringing the best prices possible to our customers and still maintaining our profits which are vital to the operation of state and local governments. Other retailers have employed parallel marketing practices for years. In fact, the October 28, 1985 issue of Time magazine pointed out the effectiveness of parallel marketing in a discussion on lower costs for photograhic equipment and other products."

Consumers will find prices lower on some selected brands as the Liquor Control Board begins passing along their savings. "We expect to pass on some of these savings by February 1, 1986," explained Board Member Watanabe, who supervises the overall operations of the retail outlets statewide.

The Liquor Control Board's initial orders utilizing parallel marketing were for nearly 32,000 cases of liquor. The savings of the purchases via the parallel market were slightly more than $498,000 or approximately $15 on every case! The arrangements with Planet Exports, the parallel marketer involved with the acquisition, include adding a label indicating the product is imported by the Liquor Control Board.

In making their announcement, the Liquor Control Board pointed out that the products being imported from Europe are the same as those the Liquor Control Board has been selling in the past. "We had to have some new labels approved by the federal government's Bureau of Alcohol, Tobacco and Firearms," Watanabe explained. "However, other than the changes to the labels, and some minor proof differences, the products are the same as we have been selling. Our products have been certified as authentic and we are employing the same basic practices as any other importer."

"We have taken a major step in bringing more reasonable prices to our consumers," commented Board Member Hannah. "We have already had inquiries from other states as to how we entered this agreement and there is a great deal of interest from all corners of the country. Washington is the first state to bypass the traditional U.S. importers and make purchases on the parallel market."

[ATTACHMENT 2]

THE LIQUOR
Reporter
News for Food Stores, Restaurants, Taverns and Suppliers

The Mice That Roared!

The liquor board's L.H. "Pete" Pedersen and [illegible]

SEATTLE, Dec. 9—*NEWS FLASH*— The liquor control board of Washington State announced today a decision that might lead to the dismantling of a distilled spirits importing, distributing and marketing system that has developed over the half century since Prohibition was repealed.

Board spokesmen announced that Washington would become the first so-called "control state" to import directly from Europe, bypassing traditional importers and cutting local brokers out of commissions they receive for representing and promoting the brands.

Continued on page 1...

Vol. 5, No. 1 75 Cents January 1, 198[illegible]

Liquor board rocks the industry

Direct imports will save bucks, but cut off traditional suppliers.

By Robert Smith
Editor and publisher

Yes, they are powerful. They determine who is to obtain a liquor license and they have great latitude, so long as they do not obviously act with caprice.

Once a year, in a process never fully scrutinized, they determine which distilled spirits products will obtain a chance to test the waters of the Washington marketplace, and which ones will be removed from standard listings. It is a power that keeps liquor pedlers diplomatic and occasionally obsequious.

Washington only one of 50 states, and the New York ad agencies probably gave little thought that a state with half that city's population might undermine their source of revenue.

But that could be just one of the outcomes of an announcement December 9 that the Washington State Liquor Control Board intended to import distilled spirits directly from Europe, bypassing the traditional supply routes and the companies that established and nurtured the products in the state.

News representatives summoned to the press conference at the board's Seattle distribution center reflected little understanding of the scope of the announcement. The questions focused on how the consumer would be benefited. They had little appreciation for the fact that Washington's actions might shake the entire national market for distilled spirits and subtly change the politics of distilled spirits sales in Washington for years to come.

By bypassing its traditional suppliers and purchasing from Planet Exports, which may be the first of many "gray market" suppliers to sell to the board, the state will be able to save $10 to $20 per case on products such as Black & White Scotch, Glenfiddich Single Malt Scotch, Johnnie Walker Red and Black labels, Beefeater Gin,

BOB HARVEY, liquor board purchasing agent, with some of the products which will be directly imported.

Drambuie Scotch, Grand Marnier Orange Liqueur, Harvey's Bristol Cream Sherry, Kahlua Coffee Liqueur, Finlandia Vodka, and other products, including premium wines.

But that's just the beginning. Further investigation has shown the board it may be possible to bypass Planet Exports as well and purchase directly from the manufacturers for an even greater savings. (See box on page 3.)

One reason the savings can be enormous: Anwar Rizvi of Planet Exports told *The Liquor Reporter* some products are being imported as if the exchange rate were still $2.40 to the pound instead of the current $1.40.

The implications are enormous, and they touch everyone who sells alcoholic beverages in Washington. What follows is a summary of just some of the implications:

FOOD STORES that would like to get into distilled spirits sal-

Continued on pag- -

parallel market . . .

—continued from page 1

have been dealt another setback. For the first time in the Washington's history, the state's steep liquor prices have been rolled back. And not by the legislature, whose taxing policy accounts for the high prices, but by the liquor board that at times has been unfairly criticized for those prices.

In addition, food stores will see the liquor board importing some premium wine brands at very favorable prices, which will help restore the competitive position the liquor board lost after raising its wine markup two years ago. (The markup recently was lowered after sales slipped.)

RESTAURANTS that emphasize imported brands will experience lower costs; other restaurants may choose to get into the "premium pour" business as a way of trading up without spending as much as it formerly would have cost.

TAVERNS will see one more advantage accrue to the restaurant industry that they do not share in, decreasing their competitive position in the marketplace.

LOCAL BOTTLERS of distilled spirits will find their price advantage eroded sharply. For example, Potter Distilleries of British Columbia has fielded Copa de Oro, a coffee liqueur remarkably similar to Kahlua in flavor, color and body, but far less expensive. As the price differential reduces, Copa de Oro may lose ground because of consumer preference for an established label.

BORDER SALES will likely shift, affecting Post Falls, Idaho, and Portland liquor outlets.

SALES TAX revenues will be impacted by the lower prices.

LABELS may change on some products. For example, the board has approved a label for Dewar's White Label Scotch that emphasizes the word, *Dewar's*, instead of *White Label*.

AFFIRMATION, the practice of requiring that suppliers sell to the board at their lowest price anywhere in the nation, will make it difficult for traditional suppliers to compete with Planet Exports in Washington without sacrificing millions of dollars in the 17 remaining "control states" and in the "open states" with affirmation provisions.

CONTROL STATES elsewhere in the nation are already contacting Washington to determine whether they should take part. Washington, which is perhaps the nation's fifth-ranking buyer of distilled spirits, conceiveably could import for other control states, at least in the Northwest.

ADVERTISING support could erode for imported products, unless the gray market suppliers are willing to promote a brand. Messages from Planet Exports to Liquor Board Purchasing Agent Bob Harvey recommend that Harvey purchase both from Planet Exports and the traditional supplier, so that the traditional supplier has an incentive to come down in price and stay down. That leaves the question as to who would advertise and represent the brand in the marketplace, if one supplier is benefiting from the other's efforts.

BROKERS for imported brands will lose commissions; brand representation in Washington State and promotional activities in restaurants conceiveably could be affected.

NEW PRODUCTS introduced into the state may not receive the support essential to make them succeed.

The list could go on, but the fact is the liquor board has not yet learned the full effect of the action it took in December, and likely won't for some time.

However, when the implications are considered in terms of 18 control states and additional affirmation states, the impact on the national distilled spirits industry becomes impressive. With less than two percent of the United States population as their constituents, Washington's liquor board members may well be remembered in the industry as the mice that roared.

A Comparison of Liquor Prices

The schedule below shows, by product, what the Washington State Liquor Control Board's current supplier charges per case for certain products, the price Planet Exports charges, and the price paid by the Alberta (Canada) Liquor Control Board, which purchases directly from the distiller. (Canadian prices were converted to U.S. dollars.)

Description	Cur. Supplier	P. Experts	Alberta
Cutty Sark	$56.30	46.90	23.17
Dewars (White)	66.33	46.90	21.46
J. Walker Black	95.70	76.70	41.61
J. Walker Red	57.25	44.90	23.18
Tanqueray Gin	49.27	36.85	19.85
Bailey's	97.00	76.20*	54.82**
Grand Marnier	125.70	104.70*	79.34**

*Liter **Fifth

As of December 18, other parallel market suppliers were contacting the board, and the board was investigating the possibility of obtaining better prices, including purchasing directly from the manufacturer, as Alberta does.

66-541 O - 87 - 6

BETTER MANAGEMENT Seattle Times
10/17/85

A boost for consumers

THE oft-criticized state Liquor Control Board finally deserves some credit for striking a long-overdue blow for consumers with a new cost-cutting purchasing approach.

By ordering several liquors and liqueurs direct from European companies to eliminate the middleman, the board initially will lower prices on 22 items from 12 to 38 percent. Prices will drop when that first $1.9 million order arrives in February. Some reductions will be up to $2 a fifth. The board is studying doing the same thing on imported wines.

The only explanation given for not taking such a sound-management approach earlier was that the liquor industry here is tightly bound by tradition. Liquor representatives also are no slouches at lobbying. Expect more when the Legislature convenes next month.

There are 24 states with "primary source" laws — they have to buy from a designated importer. That importer usually is designated by the distiller. Often the importer is owned by the distiller, who then profits at two levels. Fortunately, Washington is not a "primary source" state.

The board, mistakenly blamed — rather than the Legislature — for the highest liquor taxes in the nation, is now becoming the first liquor-control state to become its own importer. It hopes to become competitive with Oregon, stemming the tax drain caused by the flow of liquor from there.

Bob Harvey, board purchasing agent, warned: "They (liquor importers and their representatives) said they will fight us on this, and we expect them to. It could make for a very lively legislative session." Also a very wet one.

Consumers should keep an eye on any legislator suggesting that it would be good for the state to return to its costlier purchasing practices.

The Olympian
Monday, January 27, 1986

Decision on liquor imports spurs protest

By The Associated Press

Booze prices in Washington are going down Saturday, thanks to a state Liquor Control Board decision to buy some imported liquor from independent foreign exporters.

The arrangement has drawn the ire of domestic wholesalers, especially Seagram's, which sent a pair of vice presidents and a lawyer to meet with the board last week in an attempt to reverse the decision.

Seagram's might pull all of its products out of the state, lawyer Morton Siegel and vice president Jacqueline McCurdy hinted. They also challenged the board's authority to take such action and warned that the panel could be risking massive financial liability by buying from the independents.

They got nowhere.

If domestic companies reduce their prices, said chairman L.H. Pedersen, the board could reverse itself and resume doing business with them. The panel expects to hear from the distributors next month.

The liquor board announced plans last month to begin importing through independent companies that offered lower prices. The gain for consumers, however, is a loss of profits for Seagram's and other large liquor importers that have been exclusive suppliers of top-line brands to the state.

Pederson says the new arrangement could cut the wholesale cost of Scotch whiskey and other items by 20 to 25 percent, resulting in retail price cuts of 10 to 15 percent effective Saturday.

For instance, a fifth of Johnny Walker Red Label that now costs $13.95 a fifth in state liquor stores will be knocked down to $12.20, Pedersen said.

Liquor giants assail direct-import plan

State board to deal with foreign firms

by Lyle Burt
Times Olympia bureau

OLYMPIA — The State Liquor Control Board's decision to begin buying some imported alcoholic beverages directly from foreign exporters, bypassing domestic wholesalers, has stirred up a hornet's nest in the liquor industry, particularly with Seagram's, one of the industry giants.

Last month, the liquor board announced that it would begin importing through independent producers who offer better prices across the board.

The move means lower prices for Washington consumers, but substantial cuts in profits for Seagram's and other large liquor-importer firms which have been exclusive suppliers to the state of top-line brands.

Board Chairman L.H. Pedersen said the state could save 20 to 25 percent on the wholesale cost of Scotch whisky and other items, resulting in cuts of 10 to 15 percent in retail prices which become effective Feb. 1.

For example, Johnny Walker Red Label scotch, now selling in state stores for $13.95 a fifth, will be available at $12.20 a fifth in a few days because of the purchasing change, Pedersen said.

A total of 32,000 cases of high-class Scotch and Irish whiskeys and some vodka, liqueurs and wines purchased from the independent Planet Exports of London are now en route under the new plan.

But Seagram's, spearheading the industry opposition, is not giving up without a fight.

Last week two vice presidents and one attorney from Seagram's hammered away at liquor board members here for more than an hour, trying to persuade them to reverse the decision, to no avail.

"The ball is in their park now," Pedersen said after the meeting. "We got their attention."

If the big domestic companies agree to reduce their prices, he said, the board could reverse itself and again do business with them. The board expects to hear from the distributors next month.

High liquor prices stem from excessive profit markups and a two-tiered pricing system used by the domestic firms, Pedersen said. Under that system, alcohol is sold in Europe at a cheaper price than that in the U.S. — so much cheaper that despite high liquor taxes on the continent, liquor sold in Europe is far less expensive than it is here.

Seagram's executives have pulled out all stops in their attempt to reverse the board's decision.

Seagram's might pull all of its products out of the state, attorney Morton Siegel and Vice President Jacqueline McCurdy hinted. They also challenged the board's authority to take such action, and ominously declared that the board would be risking massive financial liabilities by buying from the independent market.

"When you use the spot (independent) market you have no protection," Siegel said. Seagram's

Please see IMPORTS on B 3

IMPORTED LIQUOR SAVINGS

First bottle of each pair, present retail price, second bottle, price as of Feb. 1

Here is a sampling of the savings Washington consumers will see on Feb. 1, when the state Liquor Control Board begins to pass along its savings. The board has begun to import liquor through independent importers, bypassing the more expensive domestic importers.

Judy Stanley Seattle Times

Liquor board stirs wrath

IMPORTS

continued from B 1

protects its customers, he said, from mislabeling, poor-quality products that could endanger the health of consumers and counterfeit liquor. They also insisted the Legislature should decide the issue.

Peter Warren, president of Planet Exports, pooh-poohed the suggestion of "dangers" to the state posed by his company.

Alcoholic products are carefully checked at distilleries or wineries by experts before being accepted for shipment, he said, and they are shipped from one customs warehouse to another en route to the state as a protection against tampering, adulteration or theft.

"As for counterfeit liquor, we've been in the business since 1975 and have seen only a few cases of counterfeiting," Warren said.

Warren said Seagram's and other domestic importers have brought their problem on themselves with the big markups on their products. He said it costs only $3 a case to ship whiskey from England to Washington, $2 for storage and 87 cents interest on money invested. One domestic exporter, he said, "pays $23 a case for whiskey and charges Washington $57."

Carter Mitchell, liquor board spokesman, said some other states have indicated interest in taking similar action.

SECTION B
Sunday, January 26, 1986
The Seattle Times
Seattle Post-Intelligencer

PUGET SOUND BUSINESS JOURNAL
A SCRIPPS HOWARD BUSINESS PUBLICATION
WEEK OF JANUARY 27, 1986 • 75 CENTS

Special report:

HEALTH AND FITNESS

Pages 9 - 17

State import move stuns liquor industry

By Wendy Jalonen

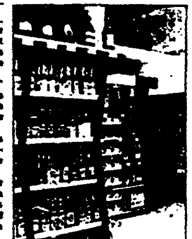
Last month's decision by the state to change the way it buys distilled spirits has sent Washington's liquor brokers reeling and has set a precedent that has drawn the attention of the country's other control states.

By turning to a European "gray market" to supply liquor to this state's liquor stores and restaurants, the state has cut by as much as 60 percent the business of some of the state's largest liquor wholesalers.

While the state, consumers and restaurants may revel in the new low liquor prices, national importers are threatening to take the state to court.

Even some of those least affected by the Dec. 9 decision question the state's wisdom in depending on the sometimes capricious gray market. And those most directly affected complain that the state made its decision without notifying them.

In short, this state's liquor brokers feel like



Gray market liquor

they've been slipped a Mickey.

"It's kind of a bombshell in the industry," says one manufacturer's representative, whose whole profit structure is now scrapped. "Right now everybody's stunned."

"It's probably going to have a devastating effect on Washington state," says another local broker, who overnight lost 60 percent of his volume.

Several liquor brokers, who are always at the mercy of the state Liquor Control Board, spoke on the condition that they not be named.

"A lot of people will lose money," says Robert Smith, editor and publisher of the Liquor Reporter. "It affects everybody in the liquor industry — either a little or a lot."

What the liquor board did in December was to conclude a short review of its liquor buying practices by deciding to bypass U.S. importers and their local brokers and buy directly from Europe. Many of those suppliers had spent much time and money nurturing and

continued on page 24

LIQUOR

continued from page 1

advertising their brands in Washington.

But the state will now buy from the gray market, European brokers with a surplus of certain brands who can sell for very little because they have little staff and no advertising expenses. The state's first order under the new system was placed last month with Planet Exports. The state buys $8.5 million to $10 million in liquor a year.

The decision effectively blasts a hole in the traditional system of distiller-importer-wholesaler-retailer with the state as wholesaler. The state liquor board was growing anxious to change the four-tiered chain because it wasn't getting the discounts from importers that it felt entitled to based on the low costs of doing business in the state. Prices to the Canadian liquor board are much lower, points out Bob Harvey, liquor purchasing agent for the state.

"Traditionally, there's no legal reason that we buy from the four-tiered system," says Harvey. "The importer, because of his pricing practices, has become a tremendous profit center in that chain without providing any services." With its sophisticated computer system, he says, the state seldom learns anything from the wholesalers that it doesn't already know."

As proof of the new system's effectiveness, Harvey points to cost savings of $500,000 on the state's initial order of $2 million worth of liquor. Cutty Sark, for example, can be had on the gray market for $40.90 a case, Harvey says, versus $56.30 previously. Grand Marnier goes for $104.70 a case from the European supplier, versus $124.70 before.

The costs savings will be shared with consumers or added to the state's revenue, Harvey says.

"They might get a hell of a deal on what they buy this first time," says one broker. But importers are expected to appeal to their manufacturers, and given the relative sizes of the two markets, manufacturers would likely cut off their gray market suppliers before cutting off the giant U.S. importers.

"It's not a never-ending supply," says another broker. If the state gets cut off, it will have to go back to the same people it just jilted.

The gray market is not even considered an alternative supply source by other brokers, points out a local retailer. No Dom Perignon was available locally during the holidays through regular channels, for example, only on the gray market. But "no one would touch it," he says, because of the unreliable reputation of the gray market.

Is the state burning its bridges in turning to the gray market?

"I don't think so," Harvey says, although he adds that it was a question with the board.

Most local liquor brokers don't have the financial resources to take the state to court. But a couple of those questioned indicated that the national importers they represent are talking with their attorneys. "There's liable to be some lawsuits," says one local broker.

A similar policy change in Alaska was stopped by injunction in December until a decision on its legality can be made, according to one broker.

"A lawsuit would end up questioning the patchwork of the whole system," says Corbin Houchins, a Seattle attorney for many members of the alcoholic beverage industry. "It would raise some fundamental questions."

Chief among those questions is how the same agency that acts as the largest merchant in the state can also regulate its own competitors. It's like IBM telling Burroughs what it can and can't sell, says Houchins.

State beer and wine retailers, for example, aren't allowed to buy on credit, while the state liquor stores do just that, he points out.

"It's free enterprise for the state; a socialist economy for the private sector," Houchins says.

Whatever the outcome of the state's change in liquor importing policy, some in the liquor community are already less than enchanted with how the decision was made. The handful of liquor brokers that talked with the Business Journal learned of the decision no earlier than Dec. 9, when a press conference announced the board's decision to the public.

The board apparently had been considering the change since July but, according to the Liquor Reporter, had never aired the issue at its regularly scheduled meetings.

The board wrote letters to the national importers in August, says the board's Harvey, notifying them that they were "charging too much." Copies of the letters were given to the importer's local representatives, Harvey says. "Any time in there brokers could have come to talk about it," he says.

The importers were "unanimous in their rejection of our contention of their pricing structure being too high," Harvey says. If importers had given Washington a price reduction, they would have had to do the same for other states with "affirmation" laws, which require that liquor sold in the state be sold at the lowest price anywhere.

After that turndown, the board started to look elsewhere for better prices.

"We don't work for brokers; we work for the citizens," Harvey says.

The board has supplied information on the purchasing change to other control states, Harvey says. The only other state to buy from the gray market, also called the parallel market, is California, and then only for wine.

But Washington might have set a precedent. Writes the Liquor Reporter: "Washington's actions might shake the entire national market for distilled spirits and subtly change the politics of distilled spirits sales in Washington for years to come."

Washington is perhaps the nation's fifth-ranking buyer of distilled spirits, says the trade paper.

Within the state, the board's actions could touch on everything from restaurants, which will experience lower costs, to taverns and food stores, which lose out on the new competitive boost. The state's sales tax revenues could fall some because of the lower prices, points out the Liquor Reporter, while sales in Idaho and Oregon border towns could shift back to Washington.

Local bottlers of distilled spirits, such as Potter Distilleries of British Columbia and Hood River Distillers in Oregon, will find their price advantage eroded. So far, only one wine is being imported from the gray market, but should more follow, this state's wine industry also could feel the pinch.

"This is by no means over," says one local broker. "We're just gearing up to see who's going to take the first shots." ◘

Group wants state out of liquor business

For the sixth time since 1972, an effort has been launched to take away the state's monopoly on hard liquor sales. The recent disenfranchisement of local liquor brokers and the current slump in the restaurant industry might give this effort better chances for success than prior attempts, all unsuccessful.

Taking advantage of what it perceives as growing anti-control sentiment, the newly formed Committee for Sensible Liquor Reform is hoping to gather 155,000 signatures by July to qualify for the next state election.

"The time is right," says Russ McCurdy, campaign coordinator for the group, which is composed, he says, of citizens, retailers, wholesalers and members of the hospitality industry.

What McCurdy's group proposes is that the same people who now sell and distribute beer and wine also be allowed to handle distilled spirits. Because liquor would be taxed as before, the tax revenue to the state would remain virtually unchanged, McCurdy says, while absolving the state of the costs of salaries and leases.

"It puts liquor on every corner," says Jack Gordon, head of the Restaurant Association of the state of Washington. Any of the 3,000 current holders of beer-and-wine licenses could pay $500 to get into the liquor business.

"There'd be an awful lot of liquor around," he says.

Gordon's association hasn't yet decided whether to support the proposal, pending legal opinions. The proposed system would have to result in lower liquor prices for the restaurant association to support it, he says.

Because of high federal taxes and the emphasis on controlling drunken driving, he says, restaurant liquor sales are down and the industry would look at any action that would reduce liquor prices.

Already behind the proposal are several of this state's liquor brokers, who in December found their business decimated by the liquor board's decision to import its liquor directly from Europe.

The real push behind the group's proposal, according to someone in the industry, comes from some grocery chains who have long desired to get into the liquor business under their own labels, such as is allowed in California.

[ATTACHMENT 3]

Paddington

Peter M. Thompson

June 19, 1986

Washington State Liquor
Control Board
Capital Plaza Bldg.
1025 East Union
Olympia, WA 98024

Gentlemen:

It has been some months since I forwarded you Paddington's point-of-view on the Gray Market. Since that time, there has been extensive coverage of this issue in the press and at NABCA.

I am writing today to provide you with an update on the Gray Market, and to assure you that The Paddington Corporation is continuing to pursue every legal means open to us to eliminate this needless risk to the health and safety of American consumers.

The steps we are taking are as follows:

1. Documenting the Source of Current Gray Market Goods

   We have confirmed that J&B scotch imported into Alaska came from Roumania, and that Washington State's gray market J&B came from Lebanon. I leave it to you to judge the morality of providing countries like these with hard currency and profits, while risking American jobs and, indeed, American consumer safety.

2. Bottle Sizes

   We have stopped shipment of the 750 ml. size to any country shown to be a supplier of gray marketeers. From now on those countries will be supplied with an 800 ml. bottle, which obviously could not be imported into the United States.

3. Legal Action

   We have filed suit against the gray market importer and against a key retailer in Alaska, on the grounds of trademark infringement. We firmly believe that the liberties being taken by the gray market importer with our trademark (removal of back label, stickering of

June 19, 1986

bottles) constitute grounds for a preliminary injunction. Our motion is to be heard on June 18, 1986.

At the present time, we are evaluating the feasibility of taking further legal action and, in this regard, are reviewing the implications of the recent decision of the United States Court of Appeals for the District of Columbia Circuit, which, on May 6, 1986, held that Section 526(a) of the Tariff Act of 1930 was intended to protect United States registrants of trademarks, that are identical to foreign trademarks, from gray market imports. The Court determined that regulations of the United States Customs Service that were inconsistent with the statute were invalid and that the statute's provisions should be enforced.

4. BATF Action

We are working with the BATF to ensure that BATF regulations are fully enforced on gray market goods. For example, we have been successful in convincing BATF to enforce the requirement for a manufacturer's certificate of composition to be filed for all cordials and liqueurs. This will effectively eliminate further gray market imports of Baileys and other imported liqueurs. We understand that one gray market importer has advised BATF that it would not import Baileys into the United States since it could not comply with BATF regulations.

5. Federal Lobbying

We are working with DISCUS to convince key legislators and federal agencies that existing trademark protection statutes are good for the consumer and the trademark owner, and should continue to be enforced. At the same time, gray market importers are working aggressively in Washington to have key trademark protection statutes repealed.

As you can see, we are taking concerted action on several fronts. However, we believe that this issue will not be resolved for several more months. Barring some major rewriting of the Trademark and Tariff Statutes, our expectation is that sometime in 1987, the United States Supreme Court will hear an appeal of the recent COPIAT decision, and will force Customs to enforce Section 526 of the Tariff Act--thus effectively cutting out gray market imports of products bearing trademarks registered to United States citizens or corporations.

In the meantime, we urge you to avoid the logistical problems and consumer risks of buying gray market spirits. Unconfirmed reports suggest that gray market importers have been unable to fill the orders placed by the State of Pennsylvania, and that Washington State continues

June 19, 1986

to have major problems clearing gray market goods. By continuing to buy from authorized U.S. importers, you can assure yourself continuity of supply, advertising and merchandising service and, above all, product integrity.

Sincerely,

Enclosure

(ATTACHMENT 4)

STATE OF WASHINGTON
LIQUOR CONTROL BOARD
PARALLEL MARKET SAVINGS

Case prices shown are on comparable FOB, tax and duty basis.

7-16-86

CODE	PRODUCT	CASES ORDERED	"AUTHORIZED" SUPPLIER	PLANET EXPORTS	SAVINGS PER/CASE	SAVINGS PER/ORDER
1222 F	Jameson Irish Whiskey	1,000	$ 93.50	$ 85.91	$ 7.59	$ 7,590.00
1233 F	Old Bushmills Irish Whiskey	1,450	65.10	53.10	12.00	17,400.00
1375 F	Black & White Scotch Whiskey	450	48.82	38.50	10.32	4,644.00
1398 F	Cutty Sark Scotch Whiskey	9,400	56.30	40.90	15.40	144,760.00
1403 F	Dewar's White Label Scotch	5,500	56.33	40.90	15.93	87,615.00
1418 F	Glenfiddich Single Malt	1,420	122.29	104.25	18.04	25,616.80
1421 F	The Glenlivet Single Malt	1,905	153.50	142.83	10.67	20,326.35
1476 F	J & B Rare Scotch Whiskey	9,565	56.50	44.35	12.15	116,214.75
1482 F	Johnnie Walker Black Label	3,400	95.70	76.70	19.00	64,600.00
1483 F	Johnnie Walker Red Label	12,570	57.25	44.50	12.75	160,267.50
1575 F	Teacher's Highland Cream	1,150	47.82	37.30	10.52	12,098.00
1755 F	Beefeater's Gin	9,305	49.30	37.30	12.00	111,660.00
1761 F	Bombay Gin	3,400	46.00	36.00	10.00	34,000.00
1792 F	Tanqueray Gin	14,200	49.27	39.55	9.72	138,024.00
2290 F	Absolut Vodka	4,100	76.55	62.09	14.46	59,286.00

Parallel Market Savings
Page 2
7-16-86

CODE	PRODUCT	CASES ORDERED	"AUTHORIZED" SUPPLIER	PLANET EXPORTS	SAVINGS PER/CASE	SAVINGS PER/ORDER
4664 F	Drambuie Scotch Liqueur	3,375	100.10	82.70	17.40	58,725.00
4704 F	Kahlua Coffee Liqueur	24,800	89.50	81.65	7.85	194,680.00
2291 F	Finlandia Vodka	600	76.55	39.05	8.86	5,316.00
9025 F	Moet & Chandon Brut Imperial	250	172.98	158.00	12.97	3,242.50
9650 A	Mumm Cordon Rouge Brut Champagne	50	162.00	158.00	4.00	200.00
* 4620 L*	Bailey's Irish Cream	14,010	*129.33	76.20	*53.13	291,408.00
4691 L*	Grand Marnier Orange Liqueur	8,006	*167.60	104.70	*62.90	168,126.00
6901 L*	Harvey's Bristol Cream	1,140	* 75.96	56.90	*19.06	79.80
	TOTALS	131,046				$1,725,879.70

* The products marked with an asterisk are being purchased in the liter size from All Planet Exports, Ltd. The product supplied and the prices charged by the "authorized" importer are the 750 ml size. The "savings" listed "per case" is figured on a per/liter basis for an equal volume of the product. This "per liter" price was figured in the following manner:

		"Authorized" importer price for 750 ml	750 ml price X 4/3 ("per liter" price)	All Planet Price	Savings per Liter
4620 L	Bailey's Irish Cream	$ 97.00	$129.33	$ 76.20	$53.13
4691 L	Grand Marnier Orange Liqueur	$125.70	$167.60	$104.70	$62.90
6901 L	Harvey's Bristol Cream	$ 56.97	$ 75.96	$ 56.90	$19.06

Senator CHAFEE. Mr. Rizvi.

STATEMENT OF ANVER JAMAL RIZVI, DEPUTY MANAGER, ALL PLANET EXPORTS, LTD., LONDON, ENGLAND

Mr. RIZVI. Senator Chafee, thank you very much for the opportunity of being here.

I represent Planet Exports and Exacto Establishment of Zurich. We are large exporters on the parallel market for liquor. We have exported about 8 million bottles so far to the United States and roughly 32 million bottles around the world. Not one bottle so far has been of the counterfeit variety or caused any health hazard.

The differences which have been are that the European product is labeled in a different way which shows a different size, or the alcohol is distinguished in a different method.

There has been no confusion caused in the American market which has been proved.

We have offered to give that free rider, which has been mentioned so many times, the opportunity of being able to advertise the product. We have written 14 letters, received 10 replies, which nine of them said, "No, you must not advertise our product in the United States." And one said, "Let's talk about it."

We feel that the products coming into the country are genuine, and there is no question of our supporting in any way a counterfeit product being exported from Europe.

The authorized importer charges something like $30 more here per case than he sells to your American cousins in Canada. There is no reason for it at all. The price differential which I have seen so far, when the dollar was much weaker, at 2.4 to a pound, now it is 1.5 or thereabouts, the 90-cent difference to every pound never seems to be offered to the American consumer in any form whatsoever.

I will be happy to answer any questions that you may have.

Senator CHAFEE. Thank you very much, Mr. Rizvi.

[The prepared written statement of Mr. Rizvi follows:]

TESTIMONY
of
Mr. ANVER J. RIZVI
before the
INTERNATIONAL TRADE SUBCOMMITTEE
of the
COMMITTEE ON FINANCE
of the
UNITED STATES SENATE

July 29th, 1986

Honorable Chairman and distinguished members of the Committee: I am Anver J. Rizvi, representing All Planet Exports Ltd, Planet Exports Ltd, and Exacto Etablissement of Zurich. Together, these companies form by far the largest exporters of parallel (Gray market) liquor in the world. I also believe that I am speaking to some degree on behalf of all American companies who buy alcohol on the parallel.

The companies I represent have asked me to summarize for you the existing scene of our trade and its effect on the American Economy, and the potential effects of S2614 from our viewpoint.

Our position is that we very strongly favour the passage of S2614, for the reasons laid out in the following testimony.

PARALLEL IN LIQUOR - BASIC PRINCIPLES

The area of parallel (Gray market) is a sea almost entirely populated with red herrings. At the bottom of the sea there is one whale of a truth and that truth is:

> PARALLEL ONLY EXISTS WHERE A MANUFACTURER OR HIS AGENT SELLS AT A MUCH HIGHER PRICE IN ONE COUNTRY THAN IN ANOTHER.

The price has to be much higher in the one country than in another: before a product can be imported on the parallel the following costs have to be paid:

A. The manufacturer and his profit
B. The foreign agent, his profit and the per case cost of advertising in his country. He always charges this even though the goods go for export. He also usually charges extra profit because he knows the goods are going to be parallelled.
C. The foreign distributor (wholesaler's) profit. He too charges extra profit because he knows the goods are to be parallelled.
D. Finance, storage, freight, documentation and distribution charges.

E. Extra labelling costs paid by the paralleller to bring the goods into compliance with the law of the country to which they are sent.

F. The paralleller's profit.

Note that the parallel importer has to pay the equivalent of ALL the United States importer's costs (A, B, C and D). But the paralleller has to charge for (E) and (F) in addition.

The United States importer has an additional advantage because he buys in far bigger quantities than the foreign importer supplying the paralleller.

Consequently, for parallel to be possible at all, the extra amount charged by the United States importer has to be greater than the paralleller's extra costs.

Under circumstances where an essentially unjustifiable extra amount is being charged the consumer, it is not surprising that the manufacturer's main defence is either to use law not intended for the purpose, or to introduce as many red herrings as possible:

RED HERRINGS - ARGUMENTS AGAINST PARALLEL

Here I will paraphrase some of the more common anti-parallel arguments used, and recount our review of such arguments:

1. IT IS CLAIMED THAT "parallelers are parasites living from the efforts of others and never support the product with advertising"

We grew bored with the frequent repetition of this argument and therefore, allocated a substantial proportion of our profit to advertising, and wrote to the manufacturers of the products we sell for permission to advertise.

FOURTEEN LETTERS WERE SENT, RECORDED DELIVERY

TEN REPLIES WERE RECEIVED.

NINE REPLIES SAID "NO"

ONE REPLY SAID "TELL US MORE"

Obviously, the complaints about failure to advertise were a red herring, designed only to convince the public into thinking parallel is bad. See Attachments 1, 2, 3, 4)

2. IT IS CLAIMED THAT "parallel represents a health hazard; for example, maybe someone somewhere is sticking hot needles into bottles, withdrawing and selling the whisky therein and putting "something else" back into the bottles."

Paddington Corporation used the "hot needles" argument.

We estimate 8 million bottles of well known brands of liquor have been imported on the parallel into the United States to date, and there has not been even one attempt to establish that one single bottle was a health hazard. Moreover, to the extent that there is any possibility at all of product tampering, the same possibility exists (in ports, warehouses or aboard ships etc) with product imported by "authorized" importers.

Therefore this argument has less than one eight-millionth of truth in it, if any at all.

3. IT IS CLAIMED THAT "parallel goods have previously been to Iron Curtain countries, fattening Communist pockets."

We do feel that those who live in glasshouses should not throw stones:

> It is true that the parent companies of some the United States importers do their best to sell large quantities of liquor to Iron Curtain countries. They are quite successful at this, making substantial profits for themselves and the Iron Curtain States in the process - a great deal of these goods are sold back to tourists to bring in foreign currency.
>
> Equally, United States importers pay substantial amounts of foreign currency for Iron Curtain products such as vodka, Yugoslavian wines, etc.

But it is true that some Iron Curtain countries have sold some of their purchases onto the parallel and made some hard currency profit thereby.

Our informed opinion is $20,000 have ended in Iron Curtain hands from a total of perhaps $100 million United States parallel liquor sales to this date, approximately .

That is 0.02% of sales and hardly a threat to Western Stability.

4. IT IS CLAIMED THAT "parallel imports have previously sat for long periods in places where they are not cared for and so come to the market in poor condition."

Due to the high "extra charge" by the United States importers, the cases sold on the parallel do not sit anywhere for very long.

Moreover, as no one has ever even attempted to show a single bottle to be in bad condition, this allegation also has less than one eight-millionth of truth, if any at all.

5. IT IS CLAIMED THAT "parallel imports may be forged or counterfeit"

Since no one has even attempted to prove one single bottle imported into the United States on the parallel is counterfeit this argument also has less than one eight-millionth of truth in it, if any at all.

We feel that arguments with less then one eight millionth of truth in them are classifiable as red herrings.

A BRIEF HISTORY OF LIQUOR PARALLEL
in the
UNITED STATES

The following short history of Parallel liquor importation into the United States tells its own story of a young parallel trade helping consumers while fending off a variety of attacks - based on anything but normal competitive trading - with the Lanham Act as the main weapon:

A. UNBELIEVABLE PROFIT MARGINS

In 1984, we were amazed to find that in the United States:

Wholesalers were taking 20 - 30% margins,—compared to 5% in Europe, where such businesses thrive nonetheless.

Dom Perignon was selling at $90 a bottle retail compared to $30 a bottle retail in Europe.

Well-known brands of Scotch, selling throughout the rest of the world at about $30 per case before tax (including ALL advertising, ALL importer and distributor profits) were sold by the United States distributors under the same conditions at $55 to $70.

We found liquor parallel almost non-existent, potential parallel importers in fear of the "big boys" - not daring to import parallel in case the "big boys" cut off other supplies.

B. THE FIRST MAJOR SALES

We approached Safeway in California; they and their specialist liquor branch 'Liquor Barn' bought from us some $3 million worth of champagne between September and December 1984.

The margins were such that we could fly three hundred tons of champagne to the United States, make a profit, and Liquor Barn could still put Dom Perignon on the shelves at $29.99

The "authorized" importer reacted to this price (as all competition does) and dropped his price to more reasonable levels. The $90 bottle of Dom Perignon disappeared but only in those markets where parallel was legal.

C. COUNTER ATTACK

A strong liquor lobby tried to get Senate Bill 589 passed in California. The Bill was a Primary Source law for wines and would have suppressed the parallel. With the media and many consumer oriented groups fighting against the bill, it was vetoed by the Governor and the consumers continued to benefit.

The possibility of closure of the California market prompted Planet to investigate importation of parallel liquor, rumoured at that time to be "impossible" in the United States.

D. PARALLEL OF SPIRITS COMMENCES

Our first trial sale was to G.L. International Trade in Alaska, a financially weak trader, but the only one with the courage to buck the 'big boys'. They sold their purchases to Oaken Keg in Alaska.

Shortly thereafter, Planet began to sell to the Control States where the people themselves make the profit.

E. COORDINATED LANHAM ACT LAWSUITS

In November 1985 Washington State became the first Control State to make a decision to purchase on the parallel.

Washington's action prompted a decision by the liquor giants to file, almost simultaneously, carbon copy lawsuits premised on the Lanham Act.

Our legal counsel indicated that the suits would almost certainly fail in the long run, but in the meantime, they would certainly be an expensive nuisance.

The real purpose behind the suits became obvious when, in one case GL itself knew nothing of the existence of a lawsuit until after Washington State Liquor Control Board had received a visit from the importer's lawyers, been given a copy of the GL suit and told "look what will happen to you if you continue." It was days later before GL received any notice of the suit.

Thus the Lanham Act was being (mis-)used to crush a small but gutsy importer and as a big stick held over the head of State Government officials.

Unfortunately for some, the little importer didn't crush, and the government officials didn't quail before that impertinence.

F. LAWSUITS - EFFECT OF THE EXISTING INTERPRETATION OF THE LANHAM ACT

Five lawsuits have been filed thus far and all use the Lanham Act as a foundation.

These lawsuits were not directed at the strong California parallel importers, who had been importing for some years without attack. Nor were they directed at the might of Washington State.

Instead, the foreign-controlled profits derived from "extra charges" to American consumers were now being used to squash other Americans - G.L. International, a company which could not afford to fight one lawsuit, let alone five:

BRAND	PLAINTIFF	FOREIGN OWNER
JOHNNIE WALKER RED	JOHN WALKER & SONS Ltd, & THE DISTILLERS SOMERSET GROUP INC	DISTILLERS CORP, LTD, ENGLAND
TANQUERAY GIN	CHARLES TANQUERAY & CO Ltd & THE DISTILLERS SOMERSET GROUP INC.	DISTILLERS CORP, LTD, ENGLAND
BAILEYS IRISH CREAM	PADDINGTON CORPORATION & R & A BAILEY & Co Ltd	INTERNATIONAL DISTILLERS & VINTNERS, UK.
KAHLUA	WALKER-HOME PETROLEUM d/b/a MAINDSTONE IMPORTERS INC	HIRAM WALKER, CANADA
PERRIER JOUET CHAMP. MUMM CHAMPAGNE CHIVAS REGAL SCOTCH THE GLENLIVET SCOTCH JAMESON IRISH WHISKY	CHAMPAGNE PERRIER-JOUET S.A, G.H. MUMM & Cie of New York INC, CHIVAS BROTHERS Ltd, GLEN GRANT DISTILLERIES Ltd IRISH DISTILLERS LTD, & JOSEPH SEAGRAM & SONS INC.	SEAGRAMS, CANADA

Lawyers in both the Somerset / John Walker case and the Paddington case applied for preliminary injunctions.

It is encouraging that both lost.

In the Paddington Case, the judge, in denying the injunction, wrote a 15 page opinion (copies of which are available) demolishing the red herrings used by the Plantiffs.

However, the Lanham Act as it exists leaves the door open for this type of suit - there is enough substance to make what appears to be a case, even if the case can not then be won. It provides enough of an excuse to squash the G.Ls of this world with legal fees, if not with legal right, thereby set a precedent, and thereby bring fear and consternation into the hearts of other potential parallel purchasers.

G. BATF CLAMPS DOWN

BATF (BUREAU OF LIQUOR TOBACCO AND FIREARMS) approval is required on the bottle label before any liquor can enter the United States. When the request is sent for approval, correctness of labelling is also reviewed.

At the beginning of parallel liquor importation, BATF was cooperative and helpful as a goverment agency should be. But not content with a concerted attempt to run GL out of money through legal fees, the "authorized" importers subjected BATF to considerable pressure to (mis-)enforce their regulations in such a way as to stop parallel imports.

BATF began repetitively cancelling our customers' label approvals following this with the imposition of severe and unusual restrictions on customers for parallel liquor - restrictions which appeared to be far more onerous than those the rest of the industry had to comply with. (Attachment 5.)

H. HISTORY YET TO BE WRITTEN

Our friends at Paddington have announced their next salvo - their corporate parent is deliberately introducing a bottle size in the rest of the world because that size is illegal in the United States.

This weapon too will come to little, and consumers who come to know of it may well avoid the brand altogether, but in the meantime, S2614 is a breath of fresh air and the fundamental recognition that competition still has a place in the U.S. market place and that the American Consumer too has some rights and needs a champion.

We will show in the following pages the degree to which foreign interests (and the current distribution system which they seek to maintain) have benefited at the expense of the consumer and the balance of payments:

FOREIGN OWNERSHIP OF PARALLELLED ALCOHOLS

There are thousands of different spirit brands on the United States market, some of which are imported. Of these, only a couple of dozen brands have sufficiently large price differentials between one country and another to be parallelled. Thus parallel liquor import applies to only a small portion of the industry and not the entirety.

The brands most in demand on the U.S. parallel market are brands where the U.S. importer is owned by a foreign manufacturer. (See Attachment 6.)

A foreign controlled importer can withdraw his brand from a particular distributor and therefore impose an economic death sentence on the distributor. Thus it does not matter whether the extra profit is made at the importer or the distributor level - the foreign manufacturer still controlls the disposition of the money.

THE MAGNITUDE OF THE "EXTRA CHARGE" AT WHOLESALE LEVEL

Attachment 7 shows some examples of "authorized importers" prices compared to those paid by the Canadian Provinces Liquor Commissions. The average difference in price is more than $30.00 per case. I will call this price difference an "extra charge" for the sake of convenience.

The following table shows the annual import of some brands into the U.S.A. by the Control States alone - (Control States form about 24.5% of the total market):

BRAND	ANNUAL IMPORT (Cases)
SCOTCH WHISKY	1,253,991
IRISH WHISKY	60,141
GIN	466,284
VODKA	217,881
RUM	98,311
BRANDY	469,647
CORDIALS	1,168,821
TOTAL	3,735,076

The annual "extra charge" to Control States is therefore:

3.7 million cases x $30 = **$111 million**

This estimate excludes champagnes and wines, and takes no account of higher priced brands where the "extra charge" is higher still.

Extrapolating from the 24.5% share of the United States market held by the Control States:

THE TOTAL ANNUAL "EXTRA CHARGE" AT WHOLESALE LEVEL IN THE ENTIRE UNITED STATES IS:

$111(m) x 4 = $444 million

This $444 million dollars annual "extra charge" can not be explained simply by the extra costs of advertising in the United States as opposed to Canada.

The figure translates into an "extra charge" to the consumer of about $577 million, since charges such as profit and some taxes are added as a percentage of the base cost.

Manufacturers do not reveal great detail in their balance sheets other than to attribute "substantial" profits to their U.S. operations. We suppose that a proportion of the "extra charge" goes abroad, worsening the Balance of Payments, and a proportion remains in the United States but under foreign control.

PROBABLE EFFECT OF THE "COPIAT" INTERPRETATION
of the
TARIFF ACT

I have mentioned that the present interpretation of the Tariff Act by the United States Customs Service allows existing parallel to occur.

One can also demonstrate the predicted effect if S2614 was not passed and the COPIAT interpretation was affirmed by the Supreme Court thus effectively eliminating parallel as we know it:

> STOLICHNAYA is a vodka produced in the Soviet Union. The U.S. trademark is owned by a completely seperate U.S. owned company and the The Tariff Act protects it from parallel import just as all brands would be protected if the COPIAT decision became law.
>
> STOLICHNAYA is imported into the United States at the rate of about 100,000 cases annually.
>
> STOLICHNAYA is available with ease in Europe at $18.00 per case, with European wholesaler profit and advertising margin included.
>
> It is sold to Control States in U.S. by the existing importer at $76.95.
>
> The difference is:
>
> 76.95
> 18.00
> $58.95

This difference is nearly double the normal case difference shown earlier for goods not completely protected by the Tariff Act.

Multiplying the difference by the number of cases imported annually, shows there is:

\$58.95 x 100,000 = \$5.8 million per year.

This is a simplistic view, but one can guage from these figures the adverse effect of not enacting S2614 and allowing the COPIAT decision to become law.

SUMMARY

The Lanham Act serves a laudable purpose. Its primary purpose is to prevent consumer confusion. This laudable goal should not be subverted by its use in a situation where the consumer is not being confused or mislead. This laudable goal should not be subverted to hurt the American Consumer by forcing the consumer to pay artificially inflated prices for identical goods, on which the foreign liquor multi-national has always already received a fair return.

Parallel gives the consumer his only weapon with which he can fight back against the manopolistic practices of foreign multi-nationals liquor conglomerates.

Senators: your Bill can harm nothing, except plans to reap unearned and undeserved rewards by those who are avaricious to a degree inconsistent with the ideals of free trade and competition. The American consumer deserves the benefits of competition.

The companies I represent are honest ethical and hard working companies (Attachment 8). They deserve the opporuntity to bring those benefits to the consumers. The swift enactment of S2614 will ensure this opportunity for all to benefit.

ATTACHMENT 1

13 GREENFORD GARDENS GREENFORD
MIDDLESEX UB6 9LY

AGENTS FOR LEICESTER BREWERY

Brand Manager for USA
David Dand,
R & A Bailey,
Western Industrial Estate,
Dublin 7,
Ireland

3rd March 1986,

Dear Sir,

It is our understanding that you must be aware that Baileys has been and is being sold in the United States market other than through Paddington your appointed United States representative.

We are writing to ask you for permission to advertise the Baileys product in any USA market where we might sell the product, thereby ensuring that the customary brand support is maintained. Alternatively, if you wish to have your advertising co-ordinated through a single United States advertising agency, we would be interested in discussing with you the possiblity of financial assistance in the brand advertisement which takes place in the USA markets where we might sell the product.

Please reply to this at your earliest convenience.

Yours Sincerely

P.D. Warren
Managing Director
Planet Exports Ltd

R. & A. Bailey & Co. Ltd. **ATTACHMENT 2**

Naas Road, Dublin 12. Telephone 561111. Telex 24601 GiblyEI

24th March, 1986.

P.D. Warren, Esq.,
Managing Director,
Planet Exports Limited
13, Greenford Gardens,
Greenford,
Middlesex UB6 9LY.

Dear Mr. Warren,

Thank you for your letter of 3rd March which in fact only just reached me after my return from a trip abroad.

Our position regarding marketing and promotion in the U.S. is that we carry out this activity through our exclusive importing agents, the Paddington Corporation.

With kind regards.

Yours sincerely

D.I.Dand

ATTACHMENT 3

Charles Tanqueray & Company Ltd.

ENGLISH GIN DISTILLERS

260/266 GOSWELL ROAD, LONDON, EC1V 7EB, ENGLAND

Tanqueray Gin

PJT/LAF

5th March, 1986

Planet Exports Ltd.
13, Greenford Gardens,
Greenford,
Middlesex. UB6 9LY.

For the Attention of Mr. P. L. Warren

Dear Sirs,

Thank you for your letter dated 3rd March, 1985. It is not our intention for Tanqueray to be sold in the United States market other than through our appointed distributor The Distillers Somerset Group Inc. All advertising of Tanqueray in this market is co-ordinated through a single advertising agency and therefore I regret we shall not consider your offer.

Yours faithfully,
CHARLES TANQUERAY & CO. LTD.

P. J. TANQUERAY

Director

THE QUEEN'S AWARD FOR EXPORT ACHIEVEMENT

ATTACHMENT 4

SOCIÉTÉ DES PRODUITS
Marnier-Lapostolle
91, BOULEVARD HAUSSMANN . 75008 PARIS
C.C.P. PARIS 510 73 TELEPH 266-43-11
TELEX 650086 F

PARIS le March 12th, 1986

Mr P.D. WARREN
Managing Director
PLANET EXPORTS LTD
13 Greenford Gardens
GREENFORD,
MIDDLESEX UB6 9LY
Etats-Unis

MC/MHS/EXP

Dear Sir,

We acknowledge receipt of your letter dated March 3rd, 1986.

As you probably know, Carillon Importers Ltd is the exclusive importing agent for the Marnier-Lapostolle products in the United States.

Grand Marnier, one of our products sold on the US market with great success, is marketed and advertised by both our importer and a very good advertising agency.

We thank you for your interest in our brand.

Sincerely yours,

MAXIME COURY
Managing Director

ATTACHMENT 5..PAGE 1

OFFICE OF THE ATTORNEY GENERAL

March 18, 1986

Mr. Norris L. Alford
Chief, Products Compliance Branch
Bureau of Alcohol, Tobacco and Firearms
1200 Pennsylvania Avenue N.W.
Washington, D.C. 20226

Re: Application of Washington State Liquor Control Board for Label Approval -- Kahlua Liqueur, Bombay Distilled Gin, Tanqueray Gin and Beefeater Gin (Use Up)

Dear Mr. Alford:

Your letter of February 25 to the Washington State Liquor Control Board (Board) has been referred to me for comment on the CFR provisions you cite in support of your requests that the Board furnish formula and ingredient information for products which have already been approved for import and sale within the United States. Based on the following analysis, I have advised the Board that the referenced CFR provisions do not authorize you to require such submissions. Consequently, the Board is now asking for a reconsideration of its label application for Kahlua (85-17) and approval on its applications for Bombay Distilled Gin (86-24), Tanqueray Gin (86-25) and Beefeater Gin [use up] (86-26).

This letter is written in support of those applications and further to provide your legal counsel with our thinking on the matter.

Your letter of February 25 cites 27 CFR 5.33(g) and 5.51(d) as being the source of your authority, and the reason, for requesting "producer statements" from the Board before you will give label approval for the Mexican Kahlua or the applications for Distilled Gins. I will discuss each provision separately.

Ken Eikenberry Attorney General
Temple of Justice Olympia Washington 98504-0521

ATTACHMENT 5..PAGE 2

Norris L. Alford - 2 - March 18, 1986

The first of these, Section 5.33(g), provides as follows:

> "5.33(g) Contents of bottles. A complete and accurate statement of the contents of the bottles to which labels are to be or have been affixed shall be submitted, on request, to the director or the regional regulatory administrator."

With regard to Section 5.33, we would submit that the contents of the Board's letter dated March 18, 1986, and the certificate of origin and customs documentation the Board has offered to produce would qualify as a "complete and accurate statement of the contents of the bottles" of Kahlua Liqueur and the Distilled Gins, and should be taken as adequate documentation for approval of our applications.

In researching this matter it was noted that BATF has, since at least 1980, been involved in a court battle with regard to ingredient labeling requirements on liquor. We understand that BATF has, at least twice in the course of this litigation, made policy based decisions that such ingredient requirements serve no useful purpose and has taken administrative action rescinding such requirements (TD-ATF-94 and TD-ATF-150). With the liquor industry, through the Distilled Spirits Council of the United States, having supported BATF's position against the necessity for ingredient labeling requirements, it seems hardly consistent that you would now take the position that duplicative ingredient information must be submitted for imported products which you have already analyzed and approved for import and sale in the United States.

The second stated basis for your producer statement request is Section 5.51(d), which provides as follows:

> "Subpart (f) - Requirements for withdrawal from customs' custody of bottled imported distilled spirits.
>
> 5.51 Label approval and release
>
> . . . (d) Statements of process. Forms 1649 covering labels for gin bearing the word "distilled" as part of the designation shall be accompanied by a statement prepared by the manufacturer, setting forth a step-by-step description of the manufacturing process."

With regard to Section 5.51(d), the "producer's statement" requirement is only mentioned in reference to release of goods from customs' custody, and purportedly requires the person obtaining release of those goods to present, along with the label approval, the manufacturer's statement of process.

ATTACHMENT 5, PAGE 3

Norris L. Alford - 3 - March 18, 1986

This provision is, by its plain wording, not a mandate for your agency to require a producer's statement at all. It speaks to customs release, not label approval.

In point of fact, Section 5.51(d) has never been enforced where goods purchased from Kobrand, the existing United States importer of Beefeater Gin, were involved.' (See Affidavit of Dwight Roscoe enclosed).

In any event, if §5.51(d) were to be construed to be authority for you to require "producer's statements", such a construction would, by commonly accepted principles of statutory construction, limit that authority to only those products which were "Distilled Gin."

In conclusion, there would appear to be no readily identifiable purpose to be served by requiring that the Washington State Liquor Control Board itself must provide a second copy of a formula and ingredients list which you already have. This, coupled with the practical effect of such a requirement being to keep genuine parallel market liquor out of the United States, would indicate that this requirement may have been promoted to you as part of a concerted scheme by certain liquor import industry members to suppress or eliminate competition in the liquor importation industry.

Since litigation on this issue is a distinct possibility, your agency may wish to reexamine whether requirements for such formula and/or ingredient information are supportable from either a legal or a policy standpoint.

If you, or your legal counsel, have any questions concerning the contents of this letter, please feel free to contact me at (206) 753-6283, at your convenience.

Very truly yours,

John G. Hennen
Assistant Attorney General

JGH:mf

ATTACHMENT 6

TABLE SHOWING DISTRIBUTION OF
WASHINGTON STATE ORDERS
TO ALL PLANET

BRAND	TOTAL CASES ORDERED: IMPORTER NOT FOREIGN OWNED	TOTAL CASES ORDERED: IMPORTER FOREIGN OWNED
ABSOLUT VODKA	4,100	
BAILEYS		14,010
BEEFEATER GIN	9,305	
BLACK & WHITE	450	
BOMBAY GIN	3,400	
CUTTY SARK	9,400	
DEWARS	5,500	
DRAMBUIE	3,375	
FINLANDIA	600	
GLENFIDDICH	1,420	
GRAND MARNIER	8,006	
HARVEYS BRISTOL CREAM	1140	
JAMESON		1,000
J & B		9,565
JOHNNIE WALKER BLACK LABEL		3,400
JOHNNIE WALKER RED LABEL		12,570
KAHLUA		24,800
MOET & CHANDON BRUT IMPERIALE		250
MUMM CORDON ROUGE BRUT		50
OLD BUSHMILLS		1,450
TANQUERAY GIN		14,200
TEACHERS	1,150	
THE GLENLIVET		1,905
	=====	=====
TOTAL	47,846	83,200

CASES ORDERED, IMPORTER US OWNED 47,846

CASES ORDERED, IMPORTER FOREIGN OWNED 83,200

ATTACHMENT 7

PRICE COMPARISON

CANADIAN LIQUOR BOARD PURCHASE PRICES IN US DOLLARS

versus

"AUTHORIZED" UNITED STATES IMPORTER PRICES

BRAND	U.S. IMPORTER CASE PRICE	CANADIAN LIQUOR CASE PRICE	"EXTRA CHARGE" PER CASE
TANQUERAY GIN	$49.27	$18.52	$30.75
BEEFEATER GIN	$49.30	$20.31	$28.99
DRAMBUIE	$100.10	$43.71	$56.39
COINTREAU	$156.55	$70.18	$86.37
GRAND MARNIER	$127.70	$55.80	$71.90
DEWARS WHITE LABEL SCOTCH	$56.33	$22.31	$34.02
J & B RARE	$56.50	$23.50	$33.00
JOHNNIE WALKER RED LABEL	$57.25	$23.50	$33.75

ATTACHMENT 8

STATE OF WASHINGTON

WASHINGTON STATE LIQUOR CONTROL BOARD

July 23, 1986

TO WHOM IT MAY CONCERN

Re: Experience of Washington State in Dealing With All Planet Exports, Ltd.

The Washington State Liquor Control Board has been doing business with All Planet Exports, Ltd., and Mr. Anver Rizvi, since November 1985, when the Board's first orders for parallel liquor products were placed.

To date the state of Washington has ordered 131,046 cases of parallel liquor from All Planet Exports, Ltd. The Board has been very pleased with the efficiency and quality of service received in connection with these orders.

Delivery of product has been timely and all financial dealings have been honored in a prompt, efficient and businesslike manner. Board Member Watanabe has personally visited the European facilities of All Planet Exports, Ltd. and was completely satisfied with the adequacy of those facilities.

Representatives of All Planet Exports, Ltd., especially Mr. Anver Rizvi, have always been available when needed or requested and have provided much valuable assistance in acquainting Washington personnel with the intricacies of dealing in the international market place and in working through any difficulties which have arisen as the new parallel purchasing system has come on line.

The Board's Purchasing Agent, Bob Harvey, considers All Planet Exports, Ltd. to be a first class supplier which, out of the hundreds of suppliers currently doing business with the Board, he would rate among the top five for consistent service, reliability of performance, and professionalism.

Sincerely,

L. H. Pedersen

L. H. PEDERSEN
Chairman

Senator CHAFEE. Mr. Thompson.

STATEMENT OF PETER M. THOMPSON, PRESIDENT AND CHIEF EXECUTIVE OFFICER, THE PADDINGTON CORP., FORT LEE, NJ, ON BEHALF OF THE DISTILLED SPIRITS COUNCIL OF THE UNITED STATES, INC., AND THE NATIONAL ASSOCIATION OF BEVERAGE IMPORTERS

Mr. THOMPSON. Good morning, Senator.

My name is Peter Thompson. I am president of the Paddington Corp. We are U.S. importers of J&B Scotch, and Baileys Irish Creme and various other brands.

Today, I am also pleased to appear on behalf of the National Association of Beverage Importers and the Distilled Spirits Council of the United States. These are trade associations which represent the vast majority of beverage alcohol producers and importers in this country.

Our industry fully supports COPIAT's position on the economic and trademark issues of gray marketing. However, my objective today is to demonstrate that gray imports of ingestible products, like beverage alcohol, raise a far more serious issue; namely, a threat to the health and safety of American consumers.

Wines and spirits are not consumer durables. Issues of product quality can be issues of life and death, as they were recently with adulterated Austrian and Italian wines.

The gray market increases the risk that such products will enter the U.S. food supply.

There are four essential facts that lead to that risk:

Fact one, gray marketers have no relationship with the original manufacturer, so they cannot know what is in a product or how it is made, or whether it is the same or not around the world.

Fact two, gray marketers buy from a distribution channel that is not supervised or controlled by themselves or anyone else.

Washington State J&B scotch came from a dealer in Lebanon, and Alaska's came from the Romanian Government. Next week, it may be excess inventory from countries like Zaire or Nigeria.

Fact three, these products were never intended for sale in the United States. They may or may not meet U.S. regulations for ingredients, additives or labeling. And I emphasize here that these are government regulations.

Many ingredients are legal overseas, but are not legal in the United States. We have already talked about red dye No. 2, which is legal, for example, in Canada, but not in the United States.

The gray market Baileys Irish Cream, which I have here and which is currently being imported into the States—this is Alaskan, but it is also being imported into Washington State—does not meet U.S. Government specifications. It includes an artificial ingredient at levels which would require it to be labeled "imitation." But yet it is being passed off by these importers as being the same as U.S. Baileys.

Fact four, with gray market goods, the consumer has absolutely no guarantee that the recommended storage or handling procedures for these products have been followed.

Wines and spirits can be seriously damaged by improper storage. Some products have to be sold fresh, much as Baileys, but they may be years old when they are bought in the gray market. And sometimes the gray marketer knowingly interferes with the manufacturer's efforts to insure product quality.

In Alaska and Washington State, gray marketers are currently soaking off the back label of gray market Baileys because it contains language which is illegal in this country. Unfortunately, the back label also contains a code which identifies the day and shift of manufacture, and which would be invaluable in the event any recall were ever necessary.

The fact is that the gray market importer can never be in a position to assume the American consumer that his product meets all U.S. regulations for ingredients, has been handled and stored in a way which will preserve its freshness, quality, and safety, or is even the real thing.

Now counterfeiting has not been an issue with beverage alcohol in the United States up until now, but it has been a major issue in other countries around the world. And history has shown conclusively that a flourishing gray market increases the incidence of counterfeiting because the economic incentive is there, and the sources of supply are unknown and unsupervised.

In summary, gentlemen, with gray market beverage alcohol products, there is absolutely no guarantee that "apart from price, the goods are identical" as the preamble to S. 2614 asserts.

Caveat Emptor may be an appropriate warning to the buyer of many products, but the Congress has enacted a comprehensive system of laws and regulations for food and beverage products to protect the public health and safety. Gray market imports seriously undermine these protections, and we urge this committee to do all in its power to stop them.

[The prepared written statement of Mr. Thompson follows:]

Statement

of

Peter M. Thompson

Chief Executive Officer

of

The Paddington Corporation

Fort Lee, New Jersey

Gray Market Imports Hearing

Before the

Subcommittee on International Trade

U.S. Senate Committee on Finance

July 29, 1986

TESTIMONY OF PETER M. THOMPSON
BEFORE SUBCOMMITTEE ON INTERNATIONAL TRADE
OF SENATE FINANCE COMMITTEE

My name is Peter M. Thompson. I am President and Chief Executive Officer of The Paddington Corporation. We are a New Jersey headquartered company with a sales force that is located throughout the United States. I am pleased to appear here today, not only on behalf of my company, but also on behalf of the National Association of Beverage Importers, Inc. and the Distilled Spirits Council of the United States, Inc. These two trade associations represent companies producing or importing the vast majority of beverage alcohol consumed in the United States.

We are in total accord with the views expressed by COPIAT about economic injury to U.S. businesses engaging in the authorized importation of a variety of products. But the paramount issue is health and safety. We are talking about beverages which are ingested by human beings. Neither the authorized importer nor the Congress can assure the public that beverage alcohol coming into the United States through gray market channels is suitable to drink. Beverage alcohol not intended for sale in the United States and counterfeit beverage alcohol pose an unacceptable risk to the public health and safety upon which you cannot put a price.

The gray market for beverage alcohol in the United States -- while relatively new -- has already shown the potential to undermine the U.S. regulatory structure, designed to ensure the public health.

Gray market alcoholic beverages are goods produced for sale in countries other than the U.S. and are purchased over-seas and imported into this country by someone other than the importer authorized by the producer. In my company's case, the products involved are J&B Scotch Whisky and Baileys Original Irish Cream Liqueur. With respect to each, Paddington is the sole authorized U.S. importer. However, other parties have found sources overseas from which to purchase J&B and Baileys for importation into the U.S.

Supplies may come from distributors in other countries, from duty free operators and ships chandlers, or from countries looking for hard currency. At the present time, some gray market wines and spirits come from Soviet Bloc and African nations. Bulgaria, Roumania, East Germany, Lebanon and Zaire are all known to have supplied gray market wines and liquors. Thus the proceeds from the sale of gray market goods often end in the hands of nations unfriendly to the United States.

The gray market has been advertised by its supporters as a boon to American consumers. Gray marketeers argue that price savings are the most important issue to buyers. They argue that except for price, gray market goods are identical to the authorized imports.

Such is not the case for beverage alcohol. Although everyone loves a bargain, the savings generated are clearly not worth the cost in terms of the threat to the public health and protection of the consumer.

In the case of ingestible products, such as beverage alcohol, the safety and health of consumers is the overriding concern. Americans demand and receive high safety and quality standards for such products. We are second to none in the standards we impose on food and beverage producers and distributors.

Over the last fifty years an elaborate system of regulation has evolved to ensure that the beverage alcohol consumed in the U.S. meets strict federal standards for safety and accountability. The growing "gray market" in beverage alcohol threatens the very foundations of that system, thereby endangering the public health.

Because beverage alcohol is ingested by humans, gray market imports raise many health and consumer concerns -- concerns involving: (1) the differing international health standards for approved ingredients and constituents; (2) product recalls and the ability to trace goods if they are contaminated; (3) the problem of counterfeit products, and (4) the problem of uncertain product quality. It is important to remember that gray market beverage alcohol is beverage alcohol <u>not intended for sale in the U.S. by the manufacturer</u>. These products may or may not meet the standards of the Bureau of Alcohol, Tobacco and Firearms (BATF) and the U.S. Food and Drug Administration (FDA) for public health and consumer protection.

<u>Gray Market Goods May Not Meet U.S. Health Standards for Approved Ingredients and Constituents.</u>

Because gray market beverage alcohol is intended for sale in a country other than the United States, oftentimes the bottle will contain ingredients or additives not approved by the FDA or the BATF. For example, for health reasons the FDA prohibits F.D.&C. Red Dye No. 2 in beverage alcohol, but other countries such as Canada permit its use. In addition, beverage alcohol products for non-U.S. consumption may contain ingredients, additives and constituents, the levels of which may exceed U.S. standards. For example, the Italian government permits higher levels of methanol in finished wine than does the United States.

From a practical standpoint, law enforcement is not the solution to this problem. In order to monitor effectively all imported products, it would be necessary for law enforcement authorities to inspect each shipment entering the United States or have the same on-site inspection program at foreign production facilities as exists for domestic production. This would be necessary because the gray marketeer acquires his supply from any available source, without knowing its origin, whether it is counterfeit, or whether it is in compliance with FDA and Department of Treasury standards.

The laws and regulations governing the production and labelling of beverage alcohol are unique. Expertise and sophistication, probably not possessed by the gray marketeer, are required to assure the public and law enforcement authorities that there is full compliance with such laws and regulations.

Even a sophisticated and experienced distributor of beverage alcohol -- the State of Washington -- ran afoul of the law by unintentionally misleading the public about one of my company's products. The Washington State Liquor Control Board bought goods on the gray market not intended for U.S. consumers. The goods contained amounts of artificial flavors which, although permitted in European countries, exceed the limits prescribed by U.S. law if the product is to be deemed "natural". Under the circumstances, Washington State should have labelled the goods "imitation" but, in fact, sold them without so informing the consumer.

On the other hand, the authorized U.S. beverage alcohol importer knows the producer, its products and the applicable regulations. He is the only one who can assure the public and the U.S. Government that there is compliance with the detailed FDA and BATF regulations.

Contaminated Gray Market Goods Are Difficult to Recall from Retail Shelves.

As in other segments of the food and drug industries, product recalls are not unknown to beverage alcohol. In 1985, the BATF ordered a recall of 45 brands of Austrian, five West German and eight Italian wines that were found to be contaminated with a poisonous chemical called diethylene glycol, commonly used in automobile anti-freeze. When ingested, this chemical can cause nausea, kidney disfunction or death.

Authorized United States importers of beverage alcohol products typically require the foreign producers to include product codes on bottles and cases of beverage alcohol destined for the United States. The codes provide information necessary to effect specific product recalls and to facilitate the proper handling of the product, including stock rotation and the removal of outdated products from wholesale and retail inventory.

Gray market goods may not display such product codes and, indeed even where such codes are set forth on bottle labels and cases, gray marketeers may unwittingly remove such information.

For example, because Washington State had to remove certain language prohibited by U.S. law from the back label of gray market Baileys, it did so by removing the entire back label. The result was that it also removed the important product code information. Without access to a product code, a general recall of both authorized and gray market product, whether or not contaminated, could be required. Gray marketeers may not have employees with the knowledge necessary to identify and remove goods that are subject to recall.

<u>The Gray Market Encourages Counterfeit Products</u>

The risks to consumer health represented by gray market goods are compounded by an increased risk of counterfeit products. Counterfeiting can include labels, bottles and caps, as well as the liquid itself. It is difficult even for a trained observer to detect the counterfeit product without actually drinking the liquid. Due to the emergence of the gray market in beverage alcohol outside the United States, counterfeiting has become a major source of concern worldwide.

The Roumanian Secret Service is believed to have manufactured more than 25,000 cases of counterfeit Scotch whisky in a plant outside Bucharest in order to obtain hard currency for that country. The <u>London Economist</u> reported on August 4, 1984, that a facility in Bulgaria had the capacity to produce and ship approximately 2.5 million bottles of counterfeit beverage alcohol each year.

Several years ago a number of leading brands of Scotch whisky were found to be counterfeited in Portugal. The contents consisted largely of Portuguese spirits mixed with small amounts of genuine Scotch whisky. Bottling and labeling were done in Portugal and the goods were intended for shipment outside that country. Counterfeit bottles of Scotch whisky were confiscated in Holland. The counterfeit Scotch whisky had been produced in Austria and put in counterfeit bottles from Germany.

The U.S. could become the next victim of counterfeiting if gray market becomes a larger factor here.

While counterfeits are not synonymous with gray market goods, there are many more opporunities for them to creep into the supply line when a gray market is allowed to flourish. This is made worse by the fact that gray marketeers have no relationship with the manufacturers and lack the knowledge and skill to police their sources adequately. They also may lack the incentive to police their sources if the demand upon them exceeds the available supply of gray goods. This results in their being susceptible to obtaining counterfeit merchandise to fill the void.

Even certificates of origin of the goods do not guarantee authenticity. They can, and have been, forged. Real certificates can even accompany counterfeit products. There is a known case of a genuine product being drained out of bottles, sold in bulk, and replaced with the counterfeit product, which still had all packaging, seals, and paperwork intact.

<u>Gray Marketeers Threaten Product Quality and Reliability</u>

Wines and many spirits products require special handling in transportation, storage and distribution. These products must not be subjected to extremes of heat and cold. They must not be allowed to sit on a dock in a U.S. or European port for an extended period of time in the summer or winter, nor should they be allowed to sit in a distributor's or retailer's warehouse, subject to extremes of heat or cold. Under extreme conditions, wine can turn to vinegar; cream-based products can separate and the dairy ingredients can curdle; cordials and liqueurs can suffer precipitation of constituents and crystallization of sugar.

In order to minimize the possibility of product spoilage to our Baileys, my company in conjunction with the producer, has undertaken the following:

1. Tested various methods of transporting the product to the U.S. and ultimately determined that refrigerated shipping containers must be used. Such containers are not used in shipments to other markets.

2. Added codes to cases and bottles to improve stock rotation in distributors' warehouses and to trace production lots of the product in the event a recall has to be implemented.

3. Included in each case a sheet containing handling instructions for the retailer to ensure product freshness for the consumer.

Baileys sold on the gray market is not produced fresh for the U.S. market and is not shipped in the mechanically refrigerated containers called for in the producer's specifications. It thus may be exposed to extremes of temperature. This risk is aggravated by the circuitous route which the product frequently takes to reach the United States. It may be shipped to a duty-free distributor, reshipped to Antwerp or Rotterdam and stored before being shipped to the United States. Gray market products do not include any product codes on cases to facilitate stock rotation.

That the gray marketeer does not adhere to the customary production and shipment standards should not be surprising, since he has no incentive to do so. He has made no investment in the creation of consumer demand for the product and therefore, has no financial stake in the well-being of the brand name.

The practical effect of this lack of standards is that, if the quality of the product deteriorates, to whom can the public look for redress? Certainly, one cannot expect the authorized importer, or the overseas manufacturer, to warrant a product over which it has had no control. In the end, it is the innocent consumer who is left unprotected.

Conclusion

The unique health concerns attendant to any ingestible product require that the public be fully protected and not exposed to any risk. Strict adherence to the comprehensive set of laws and regulations, designed to assure the public health and safety, is a pre-condition to responsible marketing. Congress should demand no less.

In the case of gray market goods, the axiom "caveat emptor" achieves its fullest meaning. When something goes wrong with gray market goods, who will help the consumer? Who is willing to risk public health and safety for the short-term cost saving argued by gray marketeers?

This Committee should do everything in its power to put a stop to gray market goods. At a minimum it must take steps to assure the public that ingestible products entering the United States are not gray or counterfeit goods. American consumers are entitled to the guarantee that the products they are ingesting comply with U.S. health and safety laws.

Senator CHAFEE. Well thank you, Mr. Thompson.

Mr. THOMPSON. Thank you.

Senator CHAFEE. I would like to ask Mr. Hennen, has Washington State experienced any health problems with the gray market?

Mr. HENNEN. No, Your Honor. Excuse me. I am an attorney. [Laughter.]

Mr. HENNEN. Senator, I would like to take strong issue with a couple of things that Mr. Thompson said. No. 1 is, he said the product does not meet U.S. Government standards. In fact, every single bottle that has been imported by the State of Washington has had Federal label approval. And any further importations will have appropriate labeling, the same as is required by Federal law.

We have not had any health problems with any of the parallel market products that we have imported.

I would also point out that Mr. Thompson does not refer to a series of lawsuits in Alaska in which this was an issue. And, in fact, the removal of the labels and health concerns, and storage, and so on, was an issue in those lawsuits.

There was recently a 15-page order issued by a Federal judge in Alaska essentially denying a preliminary injunction on that basis. So those issues are, I think the phrase used earlier was "red herrings."

In the State of Washington, our supplier on the parallel market, Planet Exports, has given every indication that they will stand behind their product. They have a long history of operating in this area. They can tell the difference in counterfeit goods. They are going to be here tomorrow. All of those issues are, in our view, red herrings, and they have proved to be so to this point.

Senator CHAFEE. Well, Mr. Thompson, the argument you make that if it is a parallel import, there are all kinds of health hazards, and it is frought with danger, leaves me a little confused.

Obviously, all the same problems could arise with a legitimate import, couldn't it? That is what you would call a legitimate import, that is, an importation in a nongray situation.

Why do you say suddenly that if your Irish Creme comes in, that is all right because you import it, and somehow it has been checked, but if a parallel importer brings in something, it is frought with suspicion? Can't he have his product inspected for safety just as Well,

Mr. Thompson. Senator, my company has had a working relationship with the original manufacturers of our products over many, many years. And as a bonafide long-term player in this industry, we have worked very closely to make sure that all the products that we import meet all of the laws and regulations of the Treasury Department, the Bureau of Alcohol, Tobacco and Firearms, and the FDA.

Frankly, as I said in my testimony, the gray market importer has no relationship with the original manufacturer, and he cannot know what is in the product he is importing.

Senator CHAFEE. Well, there must be a way. I cannot believe that the Bureau of Alcohol, Tobacco and Firearms isn't capable of inspecting just like they presumably inspected your shipments. They just don't take you at your word, do they?

Mr. THOMPSON. No; they do not, Senator.

But the fact is that enforcement is not a practical solution to this problem.

First, the paralleler does not buy from a single source. One week he may buy from Romania, the next week Bulgaria, the next week East Germany, and the next week Nigeria. So practically you would have to check every single shipment of gray market product coming into this country.

Second, many of these things are not detectable by chemical analysis. You have to know what you are looking for to find them. And I think that the case I showed you with the nature-identical vanillin which is in overseas Baileys is a case in point.

The State of Washington did not know that was there until we told them, and we told the BATF. The difference between natural and nature-identical vanillin is only identifiable by carbon dating, which is available in a very few labs around the country, and some of these difference are not detectable at all by chemical analysis.

Senator CHAFEE. Now wait a minute. You are saying the United States imposes requirements on imports——

Mr. THOMPSON. Yes, sir.

Senator CHAFEE [continuing]. That they cannot detect.

Mr. THOMPSON. No; that is not what I am saying, Senator. When we started importing Baileys in 1980, the BATF analyzed our products and told us that, with the levels of nature-identical vanillin that were in the product at the time, we would have to label the product "imitation." They detected that through the lab which they use, which I believe is Kruger Labs in Boston. There are a few labs which use carbon dating. The BATF did use this technique because they knew what they were looking for.

We subsequently changed the product, because we did not want it labeled "imitation." And we added more expensive natural vanilla for the U.S. product.

Senator CHAFEE. Well, it is my understanding that the way the Commerce Committee handled this in connection with the parallel import of automobiles, which has come before that committee, is to require that those goods be specifically inspected for safety. And it seems to me that the same requirement can be imposed here. And indeed the State of Washington seems quite content the way they proceeded.

Mr. THOMPSON. Senator, as I say, these sources of supply are unknown, so you would have to inspect every single shipment coming into the country.

And, second, you mentioned that the State of Washington has had no problems. I have to stress that the gray market in alcoholic beverages is a very, very new phenomenon. For spirit products, it really has only been occurring since September of last year.

Now, I would venture to say that no Senator has been killed by a bomb in this office building, Senator. But the fact is when I walked in the door here today there was an x-ray machine and a metal detector. That is not there because anyone was killed. It is because there is terrorism overseas or something else has happened somewhere, which has led you to believe that it might happen here. To be forewarned is to be forearmed.

Do you want to see a consumer in this country die from one of these ingredients? Do you want to see people being fed ingredients which this Government clearly believes are carcinogenic?

Senator CHAFEE. Well now wait a minute. Now let's slow this down a minute. What you are suggesting is that the people you are dealing with, Jameson's, for example, are distributing in the world market carcinogenic products, except in the United States. Now I am just not going to buy that argument, Mr. Thompson.

The suggestion that they are shipping these products all over the world—India or Nigeria or wherever it might be—and saying this is poisonous, and please don't ship that into the United States, they might not like that. I cannot believe that that is the way the Jameson name has gained the standing it has got in the world.

Mr. THOMPSON. I should emphasize that my supplier is R&A Baileys and not, in fact, Jameson.

But the fact is, Senator, that different governments have different standards for food products. And I am proud to say that the American Government's standards for food products are among the highest in the world. Other countries allow red dye No. 2. Even our neighbor, Canada, allows red dye No. 2 to be put in food products.

But the FDA believes that red dye No. 2 is carcinogenic.

Now our suppliers make their products to meet the standards of the market in which they are being sold. They do not make them to meet the standards of one world body or of the United States alone. And were they to do so, it might well cause them to be uncompetitive in local markets because some of these ingredients, which they are forced by Government regulation to put in products here, are more expensive. That is the fact. Around the world there are different standards less stringent than ours.

Senator CHAFEE. Well, I think we have got a manner of inspecting to make sure that those standards are observed with all the products that come into this country, and not just some products that have had a long-term relationship with the groups that you represent.

All right. I want to thank you all very much for coming here today. And I think this has been useful testimony. That concludes the hearing.

[Whereupon, at 11:16 a.m., the hearing was concluded.]

[By direction of the chairman the following communications were made a part of the hearing record:]

United States Senate
COMMITTEE ON FINANCE
WASHINGTON, DC 20510-6200

July 23, 1986

The Honorable James A. Baker, III
Secretary of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D. C. 20220

Dear Mr. Secretary:

The International Trade Subcommittee of the Senate Finance Committee is holding a hearing on July 29, 1986 on S. 2614, relating to the importation of "gray market goods." I am writing to invite the Treasury Department to appear at that hearing to present the Administration's perspective on this difficult and important issue.

The Subcommittee recognizes that the Treasury Department has recently issued a request for public comment on "gray market" policy options; and that, because the issue remains under review, the Department may not be able to present a definitive Administration position on the proposed legislation. Nevertheless, I believe the Subcommittee could benefit substantially from the Department's participation at the hearing.

Sincerely,

Jack Danforth

John C. Danforth

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

July 28, 1986

Dear Senator Danforth:

This is in response to your letter of July 23, 1986 inviting the Treasury Department to appear at a hearing on July 29, 1986 being held by the International Trade Subcommittee of the Senate Finance Committee relating to the importation of "grey market" goods.

This issue has been the subject of considerable controversy within the trade community and, as your letter notes, still is under review within the Administration. It has also been the subject of litigation, much of which is still ongoing.

An interagency working group under the auspices of the Economic Policy Council (EPC) has been reviewing the entire grey market goods issue and considering possible solutions. The EPC is in the process of formulating recommendations to the President for a unified Administration position. As you know, a part of this effort was the Treasury Department's publication on June 17, 1986 of a second notice in the Federal Register on this subject. This notice solicits comments on two alternative approaches to the grey market that have been suggested to address certain of the economic problems created by parallel imports. The alternatives are mandatory labeling and mandatory removal of trademark (i.e., demarking) of such imports. The Treasury Department, on behalf of the EPC, is seeking information on the economic soundness, possible methods of implementation, problems, costs, and relative effectiveness of the approaches. The Federal Register notice is part of an ongoing effort to determine what alternative action on the grey market issue, if any, would be in the best public interest.

Beyond the information contained in the Federal Register notice, there is little that the Treasury Department could contribute to any resolution of the grey market issue at this time.

Let me assure you that the Treasury Department shares your interest in having the grey market issue resolved. Nevertheless, we regret that for the reasons I have mentioned we must decline your invitation to testify at your hearing of July 29, 1986.

Sincerely,

J. Michael Hudson
Assistant Secretary
(Legislative Affairs)

The Honorable
John C. Danforth
United States Senate
Washington, D.C. 20510

STATEMENT ON S. 2614
BY SENATOR CHARLES McC. MATHIAS, JR.
TO THE SENATE FINANCE COMMITTEE
JULY 29, 1986

S. 2614 is the latest in a series of Congressional initiatives that demonstrates the increasingly important link between intellectual property and international trade.

The legislation would amend the Lanham Act to specify that the importation of "parallel imports" or "grey market goods" does not violate American trademark law. In doing so, the bill would settle a split in the circuits and resolve an issue that has been riddled with uncertainty. In fact, no one seems certain what to call the problem. Opponents of "grey marketed" goods contend that independent distributors are taking advantage of the trademark investment of the manufacturer. Proponents of "parallel imports" argue that the only distinction between their good and the authorized distributor's merchandise is price.

As Chairman of the Senate Subcommittee on Patents, Copyrights and Trademarks I am well aware that we must strike a balance between trademark proprietors and consumers. While we do not want to artificially raise prices, we must be careful to protect the legitmate economic expectations that trademarks foster. I look forward to reviewing today's testimony, and I applaud Senator Chafee and this committee for their initiative in this area.

COMMENTS OF

CONGRESSMAN BEN BLAZ

TO THE COMMITTEE ON FINANCE

UNITED STATES SENATE

JULY 28, 1986

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

I AM BEN BLAZ, THE DELEGATE TO CONGRESS FROM GUAM.

I URGE YOUR SUPPORT FOR SECTION 839 OF H.R. 4800, RELATING TO CERTAIN KNITWEAR FABRICATED IN GUAM. THE LANGUAGE OF THIS SECTION IS DESIGNED TO PRESERVE A SUBSTANTIAL PART OF THE EXISTING PRIVATE ENTERPRISE IN THE TERRITORY OF GUAM. THIS CONGRESS HAS LONG RECOGNIZED THAT IF THE TERRITORIES ARE TO PROSPER AND PAY THEIR OWN WAY THEN ALLOWANCE MUST BE MADE FOR THEIR LACK OF SIGNIFICANT NATURAL RESOURCES AND SMALL POPULATION. WE DO NOT HAVE LARGE DEPOSITS OF MINERAL ORE NOR DO WE HAVE LARGE POPULATIONS TO MAN THE ENGINES OF COMMERCE. WE ALSO DO NOT HAVE LARGE AMOUNTS OF LOCAL CAPITAL WITH WHICH TO BUILD UP OUR ECONOMY. WHAT WE DO HAVE ARE ONEROUS FEDERAL REGULATIONS AND LAWS WHICH WERE NOT DESIGNED WITH OUR BEST INTERESTS IN MIND AND WHICH FURTHER DISADVANTAGE US IN COMPETITION WITH OUR LOW-WAGE, POPULOUS FOREIGN NEIGHBORS. COMPANIES IN THE PHILLIPINES DO NOT HAVE TO COMPLY WITH THE FAIR LABORS STANDARDS ACT. COMPANIES IN HONG KONG DO NOT HAVE TO OBEY OSHA. CORPORATIONS IN SOUTH KOREA DO NOT HAVE TO ABIDE BY THE DICTATES OF THE CLEAN AIR ACT. IN GUAM, HOWEVER, WE DO.

THIS CONGRESS HAS LONG KNOWN THE ECONOMIC PREDICAMENT OF THE TERRITORIES AND HAS CONSISTENTLY ACTED TO STIMULATE THE DEVELOPMENT OF THEIR INDUSTRY AND TRADE. THE CURRENT STATEMENT OF THAT POLICY IS CONTAINED IN GENERAL HEADNOTE 3(a) TO THE TARIFF

SCHEDULES OF THE UNITED STATES. UNDER HEADNOTE 3(a) ARTICLES WHICH ARE MANUFACTURED IN THE TERRITORIES WITH NO MORE THAN A CERTAIN PERCENTAGE OF FOREIGN MATERIALS BY VALUE ARE NOT SUBJECT TO DUTY WHEN SHIPPED TO THE UNITED STATES. UNDER THIS POLICY A TEXTILE FIRM FROM NEW YORK CAME TO GUAM WITH THE FULL BLESSINGS OF THE CUSTOMS SERVICE AND SET UP A MODERN FACTORY AT A COST OF $1,500,000 TO MANUFACTURE SWEATERS. THIS FACTORY NOW EMPLOYS NEARLY THREE HUNDRED GUAMANIANS AT WAGES WELL ABOVE THE MINIMUM. AN ANNUAL PAYROLL OF OVER $1,800,000 AND TAXES IN EXCESS OF $75,000 MEAN A LOT TO A SMALL TERRITORY SUCH AS OURS. IT STANDS AS A MONUMENT TO OUR FAITH IN THE FAIRNESS OF THIS CONGRESS AND THE PROMISE OF FREE ENTERPRISE. IT WILL HELP US TO SHOULDER THE BURDEN OF THE CUTS IN FEDERAL SPENDING WHICH ARE THE LEGACY OF THE GRAMM-RUDMAN ACT--CUTS WHICH THE U.S. CITIZENS IN GUAM WILL FEEL AS WILL ALL OTHER AMERICANS.

UNFORTUNATELY, THE VERY INDUSTRY WHICH WE HAVE LABORED TO CREATE AND WHICH COULD HELP TO SEE US THROUGH THIS ERA OF BELT-TIGHTENING IS ONCE AGAIN THREATENED BY FEDERAL REGULATION. WE CANNOT SURVIVE IF PRIVATE INDUSTRY IS HAMSTRUNG AND FEDERAL SUPPORT IS REMOVED. IT IS THAT SIMPLE.

THE U.S. CITIZENS IN GUAM HAVE ALWAYS STRUGGLED IN THE FACE OF OVERWHELMING FEDERAL CONSTRAINTS TO CREATE PRIVATE INDUSTRIES. WHAT SHOCKS US IS THE EXTREME FERVOR WHICH NOW DRIVES CERTAIN GOVERNMENTAL AND PRIVATE GROUPS IN THEIR EFFORT TO CRUSH THE SMALL TEXTILE INDUSTRY IN GUAM. ON AUGUST 2, 1985 THE CUSTOMS

SERVICE PUBLISHED A NOTICE IN THE <u>FEDERAL REGISTER</u> OF A PROPOSED CHANGE IN DUTY PRACTICE. THIS PROPOSED DUTY PRACTICE COMBINED WITH THE REVISED COUNTRY OF ORIGIN RULES ALSO PUBLISHED BY CUSTOMS LAST YEAR WILL ELIMINATE ANY PRACTICAL BENEFIT TO GUAM AND THE OTHER INSULAR POSSESSIONS IN HEADNOTE 3(a). THE APPAREL INDUSTRY IN GUAM, U.S.A. WILL CEASE TO EXIST ON THE DAY DUTY IS IMPOSED ON THE APPAREL WHICH IT MANUFACTURES AND SHIPS TO THE UNITED STATES. THREE HUNDRED GUAMANIANS WILL LOSE THEIR JOBS. THIS IS EQUIVALENT TO THE LOSS OF 75,000 JOBS IN CALIFORNIA. THE EFFECT IN GUAM WILL, THOUGH, BE FAR WORSE THAN IN CALIFORNIA SINCE THERE ARE PRECIOUS FEW OTHER JOBS IN GUAM TO ABSORB THE UNEMPLOYED.

THE LOSS OF BUSINESS, WAGES AND REVENUE IS ONLY PART OF THE IMPACT OF THE EVISCERATION OF HEADNOTE 3(a). THE STRATEGIC AND SYMBOLIC IMPORTANCE OF GUAM IN THE TROUBLED WESTERN PACIFIC CANNOT BE FORGOTTEN. WE IN GUAM WANT TO REMAIN A BEACON OF DEMOCRACY AND A MODEL OF U.S. ENTERPRISE IN THE PACIFIC. WITHOUT THE PROMISE OF A VIABLE PRIVATE INDUSTRY AND A SENSE THAT GUAM IS INDEED A PART OF THE UNITED STATES IN BOTH WEALTH AS WELL AS RESPONSIBILITY THEN GUAM CANNOT FULFILL IT LEADERSHIP ROLE. WITHOUT SECTION 839 AND THE CONTINUATION OF THE INCENTIVES IN HEADNOTE 3(a) THE WELL OF PRIVATE INVESTMENT WILL DRY UP AND THE PROMISE OF A PROSPEROUS, EXEMPLARY AMERICAN TERRITORY OF GUAM WILL CEASE. THIS NATION'S TENUOUS PRESENCE WILL BE FURTHER WEAKENED IN THE PACIFIC WHERE THE FUTURE OF THE WORLD LIES.

I ASK FOR YOUR SUPPORT FOR SECTION 839 OF H.R. 4800 TO PRESERVE THE EXISTING INDUSTRY AND INVESTMENT IN THE TERRITORY OF GUAM TODAY AND THE PROMISE OF A SELF-SUSTAINING COMMONWEALTH OF GUAM TOMORROW. THANK YOU.

BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL TRADE
COMMITTEE ON FINANCE
UNITED STATES SENATE

STATEMENT OF THE
AMERICAN WATCH ASSOCIATION
IN OPPOSITION TO S. 2614
AUGUST 14, 1986

This statement is submitted on behalf of the American Watch Association ("AWA") in opposition to S. 2614, which would radically amend Section 526 of the Tariff Act and Section 42 of the Lanham Trademark Act, as they apply to gray market goods. The AWA is a trade association of 33 companies organized and doing business within the United States that are engaged in the importation, assembly and manufacture of watches, watch movements and watch products for sale in the United States and world markets. AWA members include the firms that market such well-known brands as Advance, Armitron, Baume & Mercier, Bulova, Cartier, Casio, Citizen, Concord, Ebel, Hamilton, Helbros, Innovative Time, Jaz, Jules Jurgensen, Juvenia, Lasalle, Longines, Lorus, Marcel, Movado, Omega, Piaget, Pulsar, Rado, Raymond Weil, Rolex, Ronda, Seiko, Swatch, Universal Geneve, Wittnauer and many others.

The AWA is strongly committed to the protection of intellectual property rights. AWA members worked hard to pass the Trademark Counterfeiting Act of 1984 and, since its passage, have used it to prosecute counterfeiters. Similarly, while working for full enforcement of federal trademark laws against the gray market, AWA members again have taken steps to protect their trademarks by bringing actions under the law against gray marketeers. In keeping with this commitment, we unequivocally oppose S. 2614 which, in effect, would repeal the laws protecting trademark owners and consumers against gray market goods, as they have applied for over 60 years.

As statements already have been submitted by the Coalition To Preserve The Integrity Of American Trademarks and other trademark interests setting forth the economic, legal and factual bases for opposition to this bill, we will not repeat them here. We would, however, like to emphasize the following points:

1. The gray market is a significant problem for trademark owners and authorized distributors and retailers in the watch industry. In 1983, for example, watch companies, on average, each lost approximately $6.5 million in sales to the gray market. See Collado Associates, Inc., The Economic Impact Of Diversion, at 36 (September 1984). Similarly, watch industry experts estimate that the gray market siphons off between $80 and $100 million from jewelry and department stores each year. See Modern Jeweler, at 44 (October 1983); Jewelers Circular Keystone, at 186 (February 1984). In fact, retail jewelers each have been estimated to lose, on average, 16.4 percent of sales revenue to gray market watches. See The Economic Impact of Diversion, supra at 44.

2. The gray market is a result of the ability of gray marketeers to free-ride on the substantial promotional, marketing and service investments of U.S. trademark owners and authorized distributors. Together, AWA member companies have spent hundreds of millions of dollars in developing and maintaining the markets for their watch products, including product promotion and advertising, inventory maintenance and control, sales force training and factory-authorized service and repair. Authorized distributors and retailers participate in these investments. Gray marketeers do not bear any of these costs, and instead reap the benefits of our members' substantial investments while denying to trademark owners and their authorized distributors a fair return on those investments. This type of misappropriation, be it through counterfeiting or gray marketing, is precisely the type of activity that our trademark laws are intended to prevent.

3. Consumers do not get a bargain with gray market watches. First, as demonstrated at the July 29 hearing on this bill and by the written statements noted above, gray market watches routinely do not sell for less and, in fact, may sell at higher prices than their legitimate counterparts. Second, consumers buying gray market watches are not aware at the time of purchase that they may be buying old and discontinued models or ones never intended for the American market. Third, watches must be marked internally in order to be legally imported into the United States. In the case of authorized products intended for United States consumption, these markings are applied at the factory under sterile conditions. Because watches entering the United States through the gray market are not intended for consumption here, they do not have the required markings and therefore must be opened and marked by gray marketeers prior to importation, which involves the breaking of factory seals in non-sterile environments and, in many cases, the use of corrosive materials to mark the watches. This greatly increases the risk of defective performance and water damage -- the files of

AWA members are replete with consumer complaints in this regard. Fourth, gray market watches are not entitled to factory authorized warranty service in the United States which, again according to numerous consumer complaint letters, is not known to consumers until it is too late. This kind of consumer deception leads to consumer ill will toward the trademark owner whom the consumer ultimately holds responsible for the quality and service of goods bearing his trademark, irrespective of whether such goods were authorized for sale in the United States. This is precisely the type of consumer confusion and deception that the trademark laws are intended to avoid.

In sum, the gray market is a raw deal for United States trademark owners and their authorized distributors and retailers who have created brand markets, and for American consumers who buy products bearing their trademarks on the basis of these brands. The trademark law has provided protections against the free-riding and deception of the gray market throughout much of this century. S. 2614, which would radically alter this sustained body of law, is entirely ill-conceived and should be rejected.

SUPPLEMENTAL STATEMENT OF CABOT CORPORATION

REGARDING S.1292 AND S.1356

ON THE COUNTERVAILABILITY OF NATURAL RESOURCE SUBSIDIES

BEFORE THE SENATE FINANCE COMMITTEE

JULY 10, 1986

Cabot Corporation is the leading producer of carbon black in the United States, and also produces specialty metallic alloys and other chemicals, and explores for petroleum and natural gas. As a major exporter, the interests of Cabot in free and fair international trade are great. In the past few years, however, Cabot has faced competition in the United States market from foreign producers who benefit from the availability of their natural resource inputs at prices set by their governments at levels far below those on the world market. This Committee is considering two bills, S.1292 and section 502 of S.1356, that would explicitly define such practices as subsidies if certain conditions are met. The Administration has claimed that such legislation would violate the asserted "principle" that generally available benefits are not countervailable, and that the International Trade Administration's proposed preferentiality appendix removes the need for the bill by providing a method under which such practices can be countervailed if they are not generally available in fact. Neither of these objections is valid.*

I. THE PURPOSE OF THE COUNTERVAILING DUTY LAW

In addressing these arguments, it is well to keep in mind the Congressional purpose and economic justification underlying the countervailing duty law. This Committee stated in its report upon the Trade Agreements Act of 1979 that "[s]ubsidies and dumping are two of the most pernicious practices that distort international trade to the disadvantage of the United States." S. Rep. No. 249, 96th Cong., 1st

* A longer version of this submission is on file with the Committee, presenting more fully Cabot's comments on the objections to these bills raised by the Administration.

Sess. 37 (1979). The purpose of the countervailing duty law, then, is to remove the distortions subsidies produce in the international economy by offsetting them, and so to allow United States industries to compete on the basis of quality and efficiency, rather than subsidization.

The courts have confirmed that the purpose of the countervailing duty law is to rectify the unfair advantages in international competition that subsidies provide. As the Court of International Trade has stated, "[t]he only purpose of the countervailing duty law is to extract the subsidies contained in the merchandise entering the commerce of the United States in order to protect domestic industry from their effect. In this domestic purpose, its effectiveness is clearly intended to be complete and without exception." Continental Steel Corp. v. United States, 9 CIT ___, 614 F. Supp. 548, 553 (1985), appeal docketed, No. 85-2805 (CAFC September 24, 1985). Other cases in which the courts have interpreted the countervailing duty law have stressed as well that the purpose of the law is to offset the advantage subsidies give foreign producers over United States industries, i.e., the advantage subsidies confer in international competition. See also ASG Industries, Inc. v. United States, 467 F. Supp. 1200 (Cust. Ct. 1979); Zenith Radio Corp. v. United States, 437 U.S. 443, 455 (1978); ASG Industries, Inc. v. United States, 610 F.2d 770, 776 (C.C.P.A. 1979); Bethlehem Steel Corp. v. United States, 7 CIT ___, 590 F. Supp. 1237, 1241 (1984).

The same purpose underlies the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade, the so-called "Subsidies Code," to which the United

States is a party. The Code recognizes that, while domestic subsidies can be a legitimate means of implementing domestic policies, they can also have a negative impact upon world trade by distorting normal trade flows. See Article 11(2). For this reason, domestic subsidies are potentially countervailable under the Code. As in United States law, the focus of the Subsidies Code is upon the impact of subsidies on international trade.

The statement of this Committee and the decisions of the courts show that the purpose of the countervailing duty law is to protect United States producers from the ability of foreign producers to sell their products abroad at artificially low prices. The countervailing duty law reflects a commitment to the principle that international trade should be governed by market forces, rather than by the intervention of governments through the bestowal of subsidies. Subsidization artificially alters the competitive advantage one country has in the production of a product over another by changing their relative efficiencies independently of market forces, so moving trade flows in a way different from what they would be in a free market.

The provision of goods or services at preferential rates in particular alters the operation of market forces by relieving the recipient of some of the normal costs of producing an article. The recipient can then charge less for its products than would otherwise be possible, so enabling it to sell goods in which it does not have a competitive advantage. The amount of the artificial advantage created by the provision of goods or services at controlled prices is equal to the difference between what it would have cost the producer to produce the article under normal conditions, i.e., where the free market, rather than a government or other third party, determined the costs of inputs, and what it actually cost the producer. Obviously, unless the full amount of the artificial advantage bestowed by the subsidy is offset, the subsidy will still result in a distortion of trade, to the detriment of United States producers. It is also clear that whether or not producers of other products in the exporting country have access to the input at the same price is irrelevant. The provision of inputs at preferential prices is countervailable, not because one company in a foreign country may be preferred over another, non-competing company, but because the sale of the input at a controlled price provides the purchaser an advantage over its international competitors.

II. THE GENERAL AVAILABILITY TEST IS NOT REQUIRED BY THE INTERNATIONAL OBLIGATIONS OF THE UNITED STATES, AND IS CONTRARY TO THE PURPOSE OF THE COUNTERVAILING DUTY LAW.

The first objection voiced by the Administration against the enactment of a provision making explicit the countervailability of natural resource inputs sold at prices below world market levels, when those prices are not available to producers outside the country in question, is that it violates the "general availability" test. See Statement of Michael B. Smith before the Senate Finance Committee, June 26 1986, at 1-2 ("Smith Statement"); Statement of Gilbert B. Kaplan before the Senate Finance Committee, June 26, 1986, at 3 ("Kaplan Statement"). Under the general availability test, the sale of goods or services by a government to firms in a country at controlled prices is not a subsidy if the price is "generally available," i.e., available to more than a very limited number of firms, regardless of how far below the free market price the controlled price is, or what advantage that price gives foreign producers in international competition. See Carbon Black from Mexico, 51 Fed. Reg. 13,269, 13,272-73 (1986). It is claimed that the general availability test is required by the international obligations of the United States and by United States law. See Smith Statement at 1-3; Kaplan Statement at 3. A review of these claims shows that such a restriction in countervailing subsidies is not required by the Subsidies Code or United States law, and is contrary to the purpose of the countervailing duty law.

A. The General Availability Test and International Law

The Administration has claimed that there is a "broad international consensus" requiring adherence to the general availability test, and that this test is recognized in the GATT Subsidies Code. Smith Statement at 2. The "authority" for this proposition Article 11(3) of the Subsidies Code, which states that development goals may be met "inter alia, by means of subsidies granted with the aim of giving an advantage to certain enterprises." The article then lists some examples of domestic subsidies, and notes that "the above forms of subsidies are normally granted either regionally or by sector." Nothing in this language supports the position that the Subsidies Code forbids the countervailing of generally available subsidies. In the first place, the article itself notes that the subsidies described are merely examples, and do not constitute a comprehensive list of subsidies. Likewise, the article only "notes" that domestic subsidies are normally granted on a sectoral or regional basis. Indeed, the very use of the word "normally" indicates that the parties were not precluding the countervailing of subsidies that were given on a general basis.

This common-sense interpretation of "subsidy," rather than the restrictive definition proposed by the Adminstration, is obviously more consistent with the fundamental purpose of the Subsidies Code, which is to ameliorate the effect subsidies have upon international trade. It is for this reason that the entire orientation of the Code is towards the distortive effects domestic subsidies can have upon international trade and the injury subsidies can inflict upon industries in the importing country. *See* Article 11(2). Far from requiring the use of a general availability test, the Subsidies Code appears to allow the countervailing of generally available subsidies. This is consistent with the focus of the Code upon the international effects of subsidies. *See* Testimony of Rep. Sam M. Gibbons before the Trade Subcommittee of the Senate Finance Committee 3 (June 26, 1986); Testimony of Prof. Gary C. Hufbauer before the Trade Subcommittee of the Senate Finance Committee 1 (June 26, 1986). The Code also plainly leaves to individual nations the decision, on a case-by-case basis, of whether specific practices constitute subsidies. The position that the GATT Subsidies Code requires the application of the general availability test distorts the language of the Code, and ignores its fundamental purpose, which is to minimize the impact subsidies have upon international trade.

B. The General Availability Test and United States Law

The second defense of the general availability test raised by the Administration is that it is required under United States law. See Smith Statement at 2; Kaplan Statement at 3. This defense is unsupported by the language of the law, its underlying purpose, or its legislative history, and flies in the face of repeated judicial rejection of the test.

The ITA has based its use of the general availability test upon the language of 19 U.S.C. § 1677(5)(B), which describes as domestic subsidies those provided to a specific enterprise or industry, or a group of enterprises or industries. According to the ITA, the use of the word "specific" means "limited," so that if a benefit is generally available, it is not countervailable. See Certain Steel Products from Belgium, 47 Fed. Reg. 39,305, 39,328 (1982). The Court of International Trade has directly and explicitly rejected this interpretation of the statutory langauge. See Bethlehem Steel Corp. v. United States, 590 F. Supp. 1237 (1984); Cabot Corp. v. United States, 9 CIT___, 620 F. Supp. 722, appeal dismissed, # 86-729 (Fed. Cir. April 9, 1986), rehearing denied. The court in Cabot held that the language of § 1677(5) is on its face not exclusive, and that it is the effect of a benefit, rather than its nominal availability, that determines whether it is countervailable or not. 620 F. Supp. at 729-30. The court found further that the ITA had overlooked a vital distinction, that between generally available goods that provided specific benefits and general benefits. General benefits are benefits such as national defense and education that are not bestowed upon specific individuals, but rather benefit society as a whole. Such benefits are not countervailable. Generally available benefits, on the other hand, are benefits that may be obtainable by anyone, but when obtained, result in the bestowal of a measurable benefit upon an identifiable recipient. If the benefit bestowed by a generally available benefit provides the recipient with a competitive advantage in international commerce, it is countervailable. Id. at 731.

The court explained that this analysis of the countervailing duty law removed any fear that roads and bridges would be countervailable. At the same time, it also addressed the equally great absurdity inherent in the general availability test, namely, that the more widely a government bestowed a subsidy, the less likely it is that, under the general availability test, the subsidy would be found countervailable by the ITA. 620 F. Supp. at 731-32. The court concluded that "the generally available benefits rule as developed and applied by the ITA is not an acceptable legal standard for determining the countervailability of benefits . . . ." Id. at 732. Instead, the court held that the determination of whether a benefit constitutes a subsidy must be based upon whether the benefit is measurable, is supplied to an identifiable recipient, and bestows a competitive advantage upon that recipient. See id. at 732-33.

The decisions of the Court of International Trade in Bethlehem and Cabot directly rebut the claims that the general availability test is required by United States law. To the contrary, the courts have held that the test violates the fundamental purpose of the countervailing duty law. This conclusion is in full accord with that reached by Senator

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Baucus of this Committee, who has stated that "I have looked at the GATT, the subsidies code, and our own CVD law from every possible angle, and I cannot find this 'general availability' test anywhere." 132 Cong. Rec. S1621 (February 26, 1986). It is also in accord with the discussion above of the purpose of the United States countervailing duty law. There is simply no support for the statement that United States law requires the use of the general availability test, while there is a great deal of support for the position that the test is contrary to both the language and the purpose of the countervailing duty law of this country.

III. THE ITA'S PROPOSED PREFERENTIALITY APPENDIX DOES NOT PROVIDE AN ADEQUATE ALTERNATIVE TO THE LEGISLATION PROPOSED.

Mr. Kaplan stated that the ITA was reevaluating its application of the general availability test, and would henceforth focus on the actual use of a program, rather than its nominal availability, so that the agency's policy would obviate the need for the bills under discussion now. This position assumes of course that the general availability test is still valid in principle. It was shown above that the general availability test is contrary to law, so that even as "revised" by the ITA, the test still violates the purpose of the countervailing duty law.

Mr. Kaplan also expressed the view that the ITA's development of a standard methodology for determining whether goods or services had been provided at preferential prices would solve most of the problems that are the subject of this bill. See Kaplan Statement at 6. A review of the agency's proposed methodology reveals severe deficiencies in it. Cabot's complete critique of the proposed methodology, as submitted to the

Department of Commerce, is attached for informational purposes of the Committee to the full version of this submission, which as noted above is on file with the Committee. The agency's methodology is only proposed at this point and will, hopefully, be modified by the agency after full deliberation of all views submitted. Nonetheless, because the ITA has claimed that its methodology will address most of the issues sought to be resolved by this bill, Cabot wishes to emphasize that at least the preliminary methodology adopted by the agency -- the methodology that is supposed to cure all problems -- will leave domestic industries requesting relief from natural resource pricing practices with no relief at all.

IV. CONCLUSION.

Present U.S. law and present U.S. international commitments do not require the Commerce Department to refuse to countervail so-called "generally available" benefits. S. 1292 and section 502 of S. 1356 are two efforts to deal with one particularly acute problem area of existing agency administration -- failure to countervail two-tiered pricing systems of our trading partners for natural resources. Cabot strongly supports the statutory modifications proposed in these two bills.

Respectfully submitted,

Cabot Corporation

Eugene L. Stewart

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STATEMENT OF
CAL CIRCUIT ABCO, INC.
BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL TRADE
COMMITTEE ON FINANCE
UNITED STATES SENATE
ON
S.2614
THE PRICE COMPETITIVE PRODUCTS ACT OF 1986

I. Description of Cal Abco

Cal Circuit Abco, Inc. (Cal Abco) was incorporated in January of 1983. It now has over 40 offices across North America and more than 220 employees. At its Los Angeles headquarters located in Woodland Hills, Cal Abco operates an 86,000 square foot facility, including a 17,000 square foot warehouse, that houses 12 million semiconductor chips valued at millions of dollars. In fiscal year 1985, Cal Abco realized gross sales of $72 million.

In the past three years, Cal Abco has become a leading supplier of genuine Japanese semiconductors which Cal Abco purchases overseas and imports into this country for sale to its customers. Cal Abco competes in the sale of semiconductors with various companies in the U.S., including distributors "authorized" by the Japanese manufacturers. The "authorized" U.S. distributor is always a wholly owned subsidiary of the Japanese manufacturer. Cal Abco is a parallel importer and has not been franchised or authorized by any of the Japanese manufacturers.

Cal Abco's customers are primarily original equipment manufacturers (OEMs) who are engaged in the manufacture of sophisticated electronic and electro-mechanical products in a variety of technical fields. These customers and their employees are highly sophisticated in the field of electronics; they invariably design their products incorporating specific types and often specific brands of semiconductors. Thus, when buyers from OEMs contact Cal Abco they are fully aware of which products they want to purchase and they are interested primarily in price, availability and speed of delivery. Cal Abco trains its sales personnel to emphasize to customers the fact that Cal Abco is not an "authorized" or "franchised" distributor. This freely disclosed information is, and has always been, a major selling point for Cal Abco since it underscores the fact that Cal Abco is not tied to "franchised" dealer inventories, or to dealer prices.

Cal Abco's success has attracted the attention of its competitors, and the United States subsidiary of Nippon Electric Company ("NEC"). NEC has sued Cal Abco under the Lanham Act to enjoin its activities in the gray market. Although Cal Abco is aggressively defending this lawsuit, litigation against parallel importers has created confusion in the marketplace and may impede or even prevent Cal Abco's sales. The barrage of lawsuits recently filed against parallel importers has created legal uncertainty which Congress should resolve by unambiguously endorsing parallel imports. Cal Abco supports S.2614 and strongly urges its passage.

II. How Cal Abco Operates (Economics of Semiconductor Industry)

The Japanese Ministry of International Trade and Industry ("MITI") has long had as its goal for Japan world leadership in high technology industries. Because of the pervasive importance of semiconductors to the "high technology" industry, MITI has been promoting the semiconductor industry since the mid-1970s. In order to accomplish growth in the semiconductor industry in as short a time as possible, MITI organized Japan's 11 major electronic firms into industrial groups to divide up research and development (R&D) and production of semiconductors and effectively exempted these firms from Japan's antimonopoly laws. Now, virtually all Japanese semiconductors are manufactured by the six major and five "second-rank" electronics companies. These electronics firms also dominate Japan's end-product markets for semiconductors such as computers and consumer electronics.

Most of the semiconductors consumed by each end-product firm are not internally produced but are procured from other Japanese semiconductor producers. Under this arrangement, each firm specializes in the development and production of a comparatively narrow mix of product types. Although most firms maintain a strong presence in the high volume standard memory devices (i.e. RAMs and EPROMs) they are considerably more specialized outside this area. Thus, no single firm offers a full line of semiconductor products to fill all user requirements. MITI apparently perceived several advantages to this arrangement. First, the participating firms avoid the costs of duplicating R&D efforts. In addition, they reap substantial gains from the economies of scale that result when each specialized component is produced by only one firm.

MITI views semiconductors as a commodity and does not intend that the manufacturing firms make a profit on the semiconductors themselves, but rather that they produce the semiconductors as a foundation for their "high-technology" divisions. In order to make the high technology industries more competitive internationally, the semiconductor manufacturers sell semiconductors among themselves at very low prices (in most cases, lower than their respective costs of production). This policy creates a very low market price for the chips in Japan.

The objective of this scheme was to make Japan more competitive with respect to high technology products which incorporate semiconductors into their design. MITI's policy has succeeded. Japanese electronic imports now pervade the American economy, and the American manufacturers of similar high technology products have serious difficulty competing.

The Japanese firms also export their chips to the U.S. The chips are distributed primarily through U.S. subsidiaries of the Japanese firms and through "authorized" distributors. The domestic subsidiaries and "authorized" distributors sell them at a price somewhat above the Japanese firm's marginal cost of production, but apparently not at prices high enough to recoup fixed costs. Under U.S. Antidumping laws, this constitutes the making of sales at "less than fair market value" and has been held to be illegal.

Somewhat surprisingly, even though the Japanese have been found guilty of "dumping" semiconductors, the price for Japanese semiconductors in the U.S. is significantly higher than the price for the same semiconductors sold in Japan. This price differential accounts for the existence of a gray market in semiconductor chips. By way of example, a typical 64K DRAM (a high volume memory chip and a basic building block of the electronics industry) might sell for $.40 in Japan. During the same time period, the United States subsidiaries of the Japanese semiconductor manufacturers might sell their 64K DRAMs in this country for $.70. Cal Abco would purchase the chips in Japan at the wholesale price, bring them into this country and sell them for $.50 apiece.

III. The Domestic Subsidiaries' Explanations For the Existence of the Gray Market Are Flawed

The foreign manufacturers of goods which appear in the gray market distribute their goods in this country through their wholly owned domestic subsidiaries which are often called "authorized" distributors. These "authorized" distributors frequently claim that the lower price charged for gray market goods is a result of the gray marketers' "free ride" on the "independent goodwill" that they have generated in the U.S. This "goodwill", they argue, is attributable to the advertising of the goods, the warranty, and other services provided by the authorized U.S. distributor. The authorized U.S. distributors generally claim that the U.S. price of their goods is higher than the foreign price because they must recoup the costs of generating this goodwill in the U.S. It is further asserted that, by underselling the authorized distributor, parallel importers are enjoying a "free ride" on the increased demand they have created. Accordingly, gray market opponents claim that their investment in "goodwill" should be protected through the erection of legal barriers against the parallel importers. In fact, there are several fatal flaws in the domestic subsidiaries' "goodwill" arguments.

First, the foreign manufacturer of a particular good also creates demand, or goodwill, in its own country of origin, through the use of advertising and other promotional efforts. Presumably, the foreign manufacturer sets the retail price of the goods sold in the country of origin to reflect the cost of this goodwill. Thus, costs associated with the creation of that foreign goodwill are recouped every time the goods are sold in the country of origin. If the goods are sold in the country of origin to a parallel importer who exports them to the U.S., the foreign manufacturer still recoups the cost of its goodwill. In the case of a foreign manufacturer with a wholly owned U.S. distributor (the case to which S.2614 applies), the payment for goodwill ultimately reaches the same parent company - the parallel importer simply makes his payment in the country of origin rather than through the U.S. subsidiary.

Second, American consumers' demand for the foreign goods depends substantially upon their reputation in the country of origin. Because of this dependence upon foreign goodwill, the domestic subsidiaries have not generally created "independent goodwill" for their products. Thus, domestic subsidiaries seldom change the name of a popular foreign product once it is sold into this country. By keeping the foreign name, the domestic subsidiary does not create a demand in the U.S. for the product from scratch, but depends upon the international demand already in place.

The "authorized" distributors of Japanese semiconductors have not created "independent goodwill" for their product in the U.S. American OEMs that buy from Cal Abco prefer Japanese chips because of their reputation for reliability, which was first established in Japan. However, the OEMs' purchasing decisions seldom involve deciding among two or more Japanese semiconductor manufacturers. Instead, when OEMs order semiconductors, they are concerned with the application for the chip, and such attributes as access speed, processing speed and capacity. They are generally not concerned about which firm manufactures the chip.

With respect to the high volume "commodity" memory chips (64K DRAMS, 256K DRAMS, and EPROMS) the products of the major Japanese firms are interchangeable. The OEMs often are not concerned about which Japanese firm manufactures such memory chips because they are identical and are equally reliable. Furthermore, each <u>specialized chip</u> is usually manufactured by only one Japanese firm, and the OEMs have no choice but to purchase from the one Japanese firm which makes the chip they require. For example, an OEM can purchase a 64K DRAM from any one of the major Japanese firms, but since the 64K DRAMs manufactured by each of these firms are interchangeable, the OEM will purchase whatever is available and least expensive. On the other hand, if an OEM needs a particular Japanese "Standard TTL" chip, it can buy that chip only from Hitachi (a prominent Japanese chip manufacturer). Conversely, most kinds of "2K x 8 NMOS SRAMs" are only manufactured by Toshiba (another prominent Japanese manufacturer). For this reason, it would be ludicrous for Hitachi's U.S. subsidiary and authorized distributor to claim that Hitachi chips are "better" than Toshiba's chips. Thus, "goodwill" becomes largely irrelevant in the semiconductor market. Furthermore, while Cal Abco is prepared to offer technical assistance to its customers, OEM's are invariably highly sophisticated, extremely knowledgeable engineering and technology-related entities which purchase integrated circuits from Cal Abco because it offers superior prices, superior delivery, or superior availability.

The "free rider" argument is specious for other reasons. Many parallel importers advertise at their own expense. Such advertising, even by parallel importers, enhances the demand for the product advertised. Cal Abco is no exception. Cal Abco distributes a cross reference guide which advertises its own services but also advertises the high quality of Japanese semiconductors. See Exhibit 1, page 1, Cal Abco Japanese Integrated Circuit Guide. Thus, a foreign manufacturer's claim that gray marketer's goodwill consists only of advertising low prices is simply not true with respect to Cal Abco.

Nor does the provision of warranty service support the "free rider" argument. Even though the warranties may be the same in the U.S. and abroad for a particular good, domestic distributors frequently refuse to honor the international warranty on a gray market good. In such cases, the parallel importer usually provides its own warranties which are equal to or better than the warranties provided by the manufacturer. Since the foreign manufacturer and the parallel importer can provide the same service and warranties as the domestic distributor, but at substantially less cost, it is clear that the price differential is not based upon any increased cost associated with service and warranties provided by domestic subsidiaries of foreign manufacturers.

Again, Cal Abco's policies are illustrative. Today's sophisticated manufacturing techniques have enabled semiconductors to have ~~a~~ long life and a miniscule failure rate. In the exceedingly rare instance that a semiconductor fails to perform, an OEM wants a prompt replacement or refund. Computer chips are so inexpensive (often less than $1.00 apiece) and so readily replaced that, in the rare instance of failure, "repair" of the chip is neither feasible nor desirable. Cal Abco, as well as all of the authorized U.S. distributors of Japanese semiconductors provides such replacement or refunds. No warranty beyond this is either needed or requested.

There are, thus, no services, warranties, or other benefits which distinguish authorized distributors of Japanese semiconductors from Cal Abco. Cal Abco's lower prices are not the result of any "free ride", but are simply due to Cal Abco's ability to buy chips at lower prices in Japan. A prohibition on Cal Abco's activity would simply sanction price discrimination against the United States.

IV. Solutions Proposed by Foreign Manufacturers

The companies opposed to S.2614 have proposed two other "solutions" to the gray market problem: demarking and labelling. "Demarking" consists of requiring the parallel importer to remove the trademark from the "unauthorized" good before they are sold to the public. "Labelling" consists of requiring the parallel importer to place upon the goods a label warning that 1) the goods may not be covered by manufacturer's warranties and 2) the goods are sold without the authorization of the manufacturer. Ironically, both of these solutions are uniquely within the capability of the foreign manufacturer. The foreign manufacturer controls the manufacturing and packaging process at the factory. It is simpler and less expensive for any changes to the goods (removing the mark) or to the packaging (placing a label) to be done at the factory level rather than to require the parallel importer to make these changes once the goods are in its warehouse.

The labelling and demarking proposals have two troubling aspects. First, the proposals are based upon the supposition that U.S. laws can and should be used to enforce foreign manufacturer's differential pricing schemes. Both of these proposals are inconsistent with S.2614 because eliminating the threat of the use of U.S. laws for this end is the central theme of this legislation. Clearly, if the foreign manufacturers can take these steps themselves, there is no legitimate basis for requiring parallel importers to implement them instead.

In any case, neither demarking nor labelling would be at all useful in the semiconductor gray market. OEMs purchase the semiconductors in very large quantities. It would be ludicrous to attempt to remove the mark from or to label each chip. Furthermore, neither demarking nor labelling would be of any benefit to the OEMs that purchase chips from Cal Abco. The OEM employees who are responsible for semiconductor purchasing decisions usually do not see the actual chips and their decisions to purchase would therefore be unaffected by a label or by the removal of the trademark from each chip.

Demarking is not a sensible policy for other reasons. The expense would be enormous, especially in relationship to the relatively low prices of the chips themselves. In addition, demarking would serve no useful purpose. The OEMs generally are not concerned about which of the Japanese firms manufacture the chips they use as inputs. The high volume memory chips manufactured by the major semiconductor firms are usually interchangeable. The low-volume more specialized chips are usually manufactured by only one firm, and the OEMs do not have a choice of manufacturer.

Cal Abco already has voluntarily instituted a policy of informing all of its customers that it is not an authorized distributor and that the manufacturers' warranties may not apply. This policy achieves the objective of assuring that the customer has accurate information without the needless expense which would be created by a labelling or demarking requirement.

V. Cal Abco's Position on S.2614

Cal Abco is in no sense a secret, "fly-by-night," or unreliable supplier. Its presence and role in the market are well-known in the industry. In fact, NEC itself purchased semiconductors from Cal Abco during the semiconductor shortage in late 1984. Cal Abco's customers include the largest computer manufacturers in the world (including IBM). Cal Abco, therefore, resents the unsupported allegations by COPIAT at the subcommittee hearing on July 29 that the gray market is characterized by fraud and shoddy merchandise, and is somehow a "channel" for counterfeit goods. Such assertions are totally without basis in fact, at least with respect to Cal Abco.

Cal Abco strongly supports S.2614. The current uncertainty in the law has created opportunities for the U.S. subsidiaries of foreign corporations to harass parallel importers with a constant barrage of litigation asserting a variety of legal arguments that parallel imports should be prohibited. Given the division between the Circuit Courts of Appeals concerning the construction of the Tariff Act of 1934, it is imperative that Congress act to resolve the legal confusion. Compare COPIAT v. U.S., No. 84-390, slip op. (D.C. Cir. May 6, 1986), with Vivitar Corp. v. U.S., 761 F.2d 1552 (Fed. Cir. 1985), cert. denied 106 S. Ct. 791 (1986), and Olympus Corp. v. U.S. No. 85-6282, slip op. (2d Cir. June 9, 1986). Such action is appropriate because the attack on parallel imports really raises an issue of national economic policy. The issue, simply stated, is whether the U.S. government should exert its authority to help foreign manufacturers practice price discrimination against American consumers.

The opponents of parallel imports have it in their power to stop the gray market; all they have to do is to cease the practice of price discrimination against U.S. customers and the incentive for parallel imports would disappear. Nothing would be more unseemly than for the taxpayers' dollars to be expended in an enforcement effort designed to support such price discrimination. S.2614 guarantees that such an absurd outcome will not occur.

STATEMENT OF DAVID LADD

Hearings on S. 2614
before the
Subcommittee On International Trade
Committee On Finance
of the
United States Senate
July 29, 1986

I am a partner in the Washington law firm of Wiley & Rein, where I specialize in the law of intellectual property. Having served both as Commissioner of Patents (and Trademarks) and as Register of Copyrights, I have an abiding interest in our country's intellectual property policies. In this statement on behalf of the Coalition to Preserve the Integrity of American Trademarks (COPIAT), I appreciate the opportunity to voice my opposition to Senate Bill 2614, the misnamed "Price Competitive Products Act of 1986."

Contrary to its title, this bill does not focus on products, as such, but on trademarks, a form of private property that serves critical economic functions and provides important consumer benefits. The bill would not lower trade barriers, but rather would change the nature of the trademark property that is the subject of trade. In my view, S. 2614 is bad trademark policy because:

- S. 2614 is contrary to fundamental principles of trademark law and would injure both American consumers who rely on trademarks and American businesses that own trademarks;

- S. 2614 would undercut the authority of the Customs Service to reduce importation of counterfeit goods; and

- S. 2614 is contrary to the growing national resolve to strengthen, not weaken, international and domestic protection for intellectual property, including trademarks.[1]

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[1] "All nations share a responsibility to recognize and protect intellectual property rights. The forms of protection that should be recognized include patents, copyrights, trademarks [and others]. . . ." Administration Statement on the Protection of U.S. Intellectual Property Rights Abroad, Office of the United States Trade Rep. at 2 (April 7, 1986) [hereinafter, "U.S.T.R. Statement"].

Introduction and Background

S. 2614 has the same seductive appeal as any attack on intellectual property. Superficially, it appears to secure lower prices with little cost -- the proverbial "free lunch". But the same could be said for abolishing copyrights so that consumers could get any movie or computer program for the copying cost. In truth, the trademark rights attacked by S. 2614 play a vital role in assuring that the demands of American consumers are met by our free market economy.

The bill seeks to legalize the gray market, in which "goods manufactured abroad bearing legitimate foreign trademarks that are identical to American trademarks" are imported without the consent of the U.S. trademark owner.[2] As I will explain below, the gray market simply is a means of stealing the value of the market reputation (goodwill) added to a product by the U.S. trademark.

The gray market is most likely to arise where major expenditures for brand advertising, warranties, customer service, product information, and quality assurance are needed to satisfy U.S. consumer demand and to meet competition from other brands.[3] In our free market economy, such expenditures will not be made unless they can be recouped in the selling price of the product. By allowing the U.S. trademark owner to control distribution, the trademark system permits recovery of such costs, and hence, assures that consumer demand is fully served. The U.S. trademark owner, whether the manufacturer or exclusive distributor,[4] bears the

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[2] COPIAT v. United States, 790 F.2d 903, 904 (D.C. Cir. 1986). See U.S. Firms' Views on Customs' Protections, GAO/NSIAD-86-96 at 12 n.9 (May 1986). Gray-market goods, to which a foreign trademark has been legitimately affixed, thus differ from "counterfeit goods," to which the trademark has been illegally affixed without authorization of a trademark owner in any market. Annual Report on National Trade Estimates, Office of the United States Trade Rep. 226 (1985).

[3] The problem of gray-market imports has grown severe. "Large scale import competition has been fairly recent, starting for most products in 1980 or even more recently." Working Group on Intellectual Property of the Cabinet Council, Policy Options on Grey Market Goods (Parallel Imports), 3 Inside U.S. Trade 9 (April 26, 1985).

[4] There can be little doubt that an exclusive U.S. distributor contributes value or that it may own the U.S. trademark. See Premier Dental Prods. Co. v. Darby Dental Supply Co., No. 85-1468, slip. op. at 10 (3d Cir. June 24, 1986).

(footnote continued)

costs and is assured the benefits of market development.

An exclusive distributor is close to his territorial market, and knows best how to develop it by pleasing local tastes and meeting local customers' expectations. He also knows best, because he is in the market, how much to spend on customer service, training, and advertising, and where and how to spend it. The value of a trademarked good is, then, not merely the physical product, but the product plus the goodwill embodied in the trademark, earned by the trademark owner's promotions, sponsorship and service in his market.

The gray marketeer, even when he sells an identical physical product, steals the benefit of the trademark owner's market reputation and goodwill and injures the trademark owner's reputation as the exclusive domestic source of the product.[5] In so doing, the gray marketeer impairs the trade-

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Goodwill exists

> [i]f the public believes that the exclusive distributor is responsible for the product, so that the trade-mark has come, 'by public understanding, to indicate that the goods bearing the trademark come from plaintiff although not made by it,' A. Bourjois & Co. v. Katzel Co., 260 U.S. 689, 692 (1923), or if the distributor has obtained 'a valuable reputation for himself and his wares by his care in selection of his precautions as to transit and storage, or because his local character is such that the article acquires a value by his testimony to its genuineness.' Callman [Unfair Competition, Trademarks and Monopolies § 17.16 (4th ed., 1981)].

Id.

[5]

> The value of the mark to Premier [the exclusive U.S. distributor] is largely determined by its connotation of a single source who stands behind the product. . . . The continued availability of IMPREGUM through sources . . . not associated with Premier must inevitably injure Premier's reputation as the exclusive domestic source of IMPREGUM. . . . This is true whether or not the service and financial guaranties

(footnote continued)

mark owner's incentives to serve consumer demand.

The exclusive U.S. source of trademarked goods often may be related in some way -- as owner, parent, affiliate, subsidiary, licensee, or licensor -- to a foreign operation that manufactures goods bearing the trademark symbol. Such a relationship does not alter the economic realities of the American market, or the fact that the gray marketeer is stealing from the U.S. trademark owner. Yet S. 2614 unfairly singles out U.S. trademark owners that are related to foreign manufacturers and seeks to deprive only them of protection that is available to all other U.S. trademark owners.

The trademark owner's right to exclude gray-market goods from importation into the United States is established independently in two statutes -- section 526 of the Tariff Act of 1930,[6] and section 42 of the Lanham Act, the federal trademark statute.[7] Both provisions clearly prohibit all gray market imports of foreign-made goods bearing a domestically owned U.S. trademark.[8] Nevertheless, in 1972 the Customs Service promulgated regulations[9] that permit importation of unauthorized gray-market imports when the U.S. and foreign trademark are owned or controlled by related entities. Those regulations, issued without coherent explanation, are the latest in a long history of "changing views of the role of Customs in enforcing [sections 526 and 42],"[10] which have not "been supported by anything more than poorly articulated and vacillating reasoning."[11]

(footnote continued from previous page)

> are comparable to those offered by Premier. We find this proposition the inevitable corollary of Bourjois.

Id. at 20-21 (emphasis added).

[6] 19 U.S.C. § 1526 (1982).

[7] 15 U.S.C. § 1124 (1982).

[8] "The statutory language [of § 526] is broad and unambiguous. It declares illegal the unauthorized importation of any merchandise of foreign manufacture bearing a domestically-owned trademark." Premier Dental Prods., slip op. at 17 (emphasis in original).

[9] 19 C.F.R. § 133.21 (1985).

[10] Vivitar Corp. v. United States, 761 F.2d 1552, 1565 (Fed. Cir. 1985), cert. denied, 106 S. Ct. 791 (1986).

[11] COPIAT, 790 F.2d at 916. The best explanation for the (footnote continued)

All three federal courts of appeals to consider the issue have held that these Customs regulations, on which S. 2614 is based, do not fully implement the rights granted by the Customs Act and Lanham Act and do not limit enforcement of section 526 in private actions by a related U.S. trademark owner.[12] The courts of appeals have split only over whether the regulations can nonetheless be sustained as an exercise of Customs' discretion to allocate its enforcement resources -- a rationale Customs has never asserted.[13] The most recent opinion, which declined to invalidate the regulations, directly criticized them as "unsound both as antitrust policy and as trademark law." Olympus Corp. v. United States, 230 U.S.P.Q. 123, 126 (2d Cir. 1986).

On June 17, 1986, the Customs Service stated that it is considering modifying its regulations to provide protection to all U.S. trademark owners that is much closer to the terms of section 526 and section 42.[14] As discussed below, giving full effect to sections 526 and 42 would better implement

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current regulations is that they are based on an outmoded antitrust theory -- that exclusive territorial distributorships are anticompetitive. See id. This theory was authoritatively repudiated in 1977. See Continental T.V., Inc. v. G.T.E. Sylvania, Inc. 433 U.S. 36 (1977). See generally, U.S. Department of Justice Vertical Restraints Guidelines (January 23, 1985) (recognizing that exclusive territorial licensing may promote competition and declaring that vertical restraints in intellectual property licenses are particularly unlikely to raise antitrust concerns).

[12] Olympus Corp. v. United States, 230 U.S.P.Q. 123 (2d Cir. 1986); COPIAT, 790 F.2d 903 (D.C. Cir.) (striking down Customs regulations); Vivitar, 761 F.2d 1552 (Fed. Cir.); see Premier Dental Prods., slip op. at 17 (3d Cir.) (Section 526 declares "illegal the unauthorized importation of any merchandise of foreign manufacture bearing a domestically-owned trademark"). By making the present Customs regulations binding on the courts in private actions to exclude unauthorized imports, S. 2614 thus would overturn decisions by three separate federal appellate courts.

[13] The COPIAT decision struck down the regulations, holding that under SEC v. Chenery Corp., 332 U.S. 194, 196 (1947), the courts must evaluate only the rationales offered by the agency. Vivitar and Olympus ruled otherwise. The issue does not appear in Premier Dental Prods.

[14] The proposed modifications are discussed at pages 18-19, infra.

U.S. trademark policy and assist in stemming the rising tide of counterfeit goods.

1. S. 2614 Is Contrary to Fundamental Principles of Trademark Law and Will Injure both the American Consumers Who Rely on Trademarks and the American Businesses that Own Them.

The pernicious effects of S. 2614 arise because the bill runs counter to and will vitiate the fundamental functions and benefits of trademarks. "Trademarks perform a vital role both for companies putting goods and services on the market and for the consumers who make up that market."[15] Trademarks benefit the public, directly by providing necessary information, and indirectly by inducing trademark owners to respond to the demands of the market -- in plain language, to give the customer what he wants.

At the most basic level, trademarks are merely symbols that are adopted by the source of a product to distinguish the product from competing goods. The essential function of a trademark is to connect, in the minds of the public, the goods bearing the mark with the owner of the mark. When this linkage occurs, the mark becomes uniquely associated with the reputation of the goods and thus, with the reputation of their source, the trademark owner.

This reputation is also known as the "goodwill" of the business.[16] As Justice Holmes stated, a trademark is inextricably linked to "good will" and "stakes the reputation of the [trademark owner] upon the character of the goods." A. Bourjois & Co. v. Katzel, 260 U.S. 689, 692 (1923).

As with all intellectual property, trademark law provides to the creator the exclusive right to use his property. Here, that property is the trademark symbol and all of the associated goodwill. A trademark is not government bounty or largesse; it protects what the creator has contributed, by sweat and coin, to the economy and to consumer benefit.

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[15] Global Competition, The New Reality, Report of the President's Commission on Industrial Competitiveness, vol. II at 311 (January, 1985).

[16] Premier Dental Prods., slip. op. at 7. "'Goodwill' is the advantage obtained from use of a trademark. This includes public confidence in the quality of the product and in the warranties made on behalf of the product, and the 'name recognition' of the product by the public that differentiates the product from others." Id.

The link between the trademark and the business goodwill of the trademark owner is indispensable to our free market economy. The free market functions only when information concerning available products flows to consumers. In our complex society, ordinary consumers simply cannot personally investigate, or even know, the source of all of the goods they purchase. Thus they must rely on the business reputation or "goodwill" of the source and on the information transmitted by the source.

The costs to consumers of accumulating this information and learning of this reputation are commonly known by economists as "search costs." Trademarks dramatically reduce search costs and permit information to flow in an orderly, efficient and comprehensible manner. The trademark announces that a product is on the market and permits the consumer to associate with the product his own experience and what he has heard from others.

The trademark carries more than just information relating to the physical characteristics of the product. The trademark carries with it an entire package of assurances, concerning, for example, warranty, repair and replacement policies of the trademark owner. The trademark also may carry independent "image" value that is, itself, important to the consumer.[17] The value of trademarks to consumers is demonstrated by the willingness of consumers to pay more for products bearing recognized trademarks in preference to apparently similar "generic" products.

At the same time, the trademark provides the trademark owner an essential incentive to adhere to a consistent level of quality, service and image and to communicate information relating to the trademarked goods. Quality, service, image and product information are all costly to provide. A rational trademark owner will not incur such costs at the optimal level unless he alone will capture the full benefit accruing from those expenditures. If any third party is permitted to divert or to destroy part of that value, the market will be distorted and the trademark owner will lack the incentive to act in the most efficient manner. If this occurs, both the public and the trademark owner lose.

The costs incurred by a trademark owner of establishing a product in a particular market -- acquiring goods of suitable quality, providing service and warranties, informing the public, establishing a distribution network, and market-

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[17] Some trademarks, such as "Levis" on jeans or the IZOD "alligator," have such appeal and such magnetism for consumers that they become an important element of a product's value.

ing -- are uniquely linked to that market. The benefits of those expenditures must also derive from that market if they are to provide the incentive needed to produce the results that the consumer desires.

Trademark law long ago recognized the differing marketing and goodwill needs of different economies. To accommodate those differences, it was established early on that trademarks are territorial -- that is, they are limited by national boundaries. The sound logic of the territorality principle is discussed in Part 1.A., infra.

I hope this brief explanation makes clear that S. 2614 violates the basic tenets of trademark law and policy. By interfering with the vital link between U.S. trademarks and the goodwill that those trademarks represent, S. 2614 is certain to harm consumers and U.S. trademark owners. Specifically, S. 2614 must be rejected because it would:

- violate the fundamental principle that trademarks are territorial, by confusing U.S. trademarks with identical symbols that may have very different meanings in foreign markets;

- destroy the incentive to build trademark goodwill by authorizing the misappropriation of the value of the trademark by persons other than the trademark owner;

- compel the U.S. trademark owner to stake his reputation on goods he never intended to be judged by American expectatons;

- inherently tend to deceive U.S. consumers by misleading them into believing that they are purchasing the value that the U.S. mark represents;

- destroy the value of the U.S. mark through the dissatisfaction of deceived customers;

- hobble U.S. trademark owners seeking to compete on the differing terms required by varying world markets; and

- cause an unwarranted intrusion into the disposition of private property.

These disadvantages need not be suffered to achieve any legitimate benefit, since present law already permits unbranded goods, which do not require the recoupment of trademark costs, to be imported freely.

A. S. 2614 Violates the Territoriality Principle of Trademark Law.

Deciding what goodwill to associate with a trademark is a fundamental competitive decision that a trademark owner must make. The correct decision must reflect consumer demand and other market characteristics that vary dramatically from country to country. For example, the U.S. market may demand a sophisticated and highly reliable product with an up-scale image supported by a skilled and informed dealer network. In contrast, a less developed market may call for a bare-bones product distributed through high volume outlets offering little support or service.

Such differing markets may require very different strategies. Hence, the same trademark symbol often has a very different meaning in various markets.

For this reason, a fundamental principle of trademark law is that trademarks are territorial. Simply stated, the same symbol is a different trademark in each country where goods bearing the symbol are sold. When the owner of a U.S. trademark places an identical symbol on goods intended to be sold abroad, those goods are not marked with the U.S. trademark, but with a foreign mark. A foreign purchaser of those goods has no right to the goodwill associated with the mark in the United States. If those goods later are imported with the U.S. trademark owner's consent, then the symbol is adopted and becomes the U.S. trademark. But if the U.S. trademark owner does not consent to the importation, the foreign mark merely masquerades as the U.S. mark and infringes the rights of the U.S. trademark owner.

The Supreme Court recognized the fundamental principle of territoriality more than sixty years ago in Katzel. The Court held that importing French cosmetic powder in the original French containers that bore the genuine trademark of the French manufacturer infringed an identical U.S. trademark that had been purchased by a U.S. distributor. The problem was not that the French packaging misidentified the powder or that the French manufacturer had breached any contract. Instead, the problem was that, after importation, the genuine French trademark appeared to be the U.S. trademark and, hence, involuntarily associated the American trademark owner's U.S. goodwill with the unauthorized import. Justice Holmes summarized the key holding as follows:

> It is said that the trade mark here is that of the [French manufacturer] 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 stakes the reputation of the plaintiff upon the character of the goods.[18]

This unanimous holding rested solely on the nature of the trademark property right; it had no reference to issues of trade policy or trade legislation. By effectively reversing the well settled territoriality principle, S. 2614 would have several inevitable and unhappy consequences.

B. S. 2614 Would Destroy the Incentive To Create Trademark Goodwill.

S. 2614 affirmatively endorses misappropriation. In simple terms, S. 2614 would allow gray marketeers, who purchase a product abroad for a price that does not reflect the value of the U.S. trademark, to sell that product in the United States for a price that includes the value of the U.S. trademark. This trademark value, for which the gray marketeer has not paid, rightfully belongs to the trademark owner, who created it, not to the gray marketeer who seeks a free ride. If this free riding is permitted, the U.S. trademark owner will not respond to the demands of U.S. consumers but will provide the lowest common denominator of value and service desired by consumers worldwide.

The economists who will submit statements to the subcommittee will, no doubt, fully develop these vital points. But the wisdom of the ages teaches that it is unwise and unfair to allow one to reap where he has not sown.

The fundamental flaw in S. 2614 may result from an implicit assumption that, where the foreign manufacturer and the U.S. trademark owner are related, the value of the U.S. trademark is recouped upon the foreign sale of the product. Not so. The overseas sales price of a product bearing a foreign trademark does not include the costs incurred by the U.S. trademark owner for the benefit of the U.S market.

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[18] 260 U.S. at 692 (citations omitted); see D. Wilson, Impact of Gray Market on Licensing, Les Nouvelles 91 (June 1986).

These U.S. costs can be recovered by the U.S. trademark owner only in the U.S. price. Thus, the premise of S. 2614 is false whenever a product is sold in many markets, regardless of any relationship between entities.

C. By Allowing the Importation of Marked Goods on Which the U.S. Trademark Owner Has Not Agreed To Stake His Reputation, S. 2614 Will Cause Consumer Deception.

The unauthorized imports that S. 2614 would sanction are inherently misleading to American consumers. The goods carry a mark that appears the same as the U.S. mark and are commonly passed off, by gray marketeers, as the authentic U.S. product. Thus the American consumer will naturally, but erroneously, assume that the symbol carries with it the assurances that are associated with the U.S. trademark. In fact, the American consumer who purchases a gray-market good often finds to his dismay that:

- the product physically differs from the U.S. product (e.g., it is a perfume formulated to foreign taste or a model designed to foreign specifications inappropriate for U.S. conditions) and is not consistent with the reasonable expectations based on the U.S. trademark;

- labeling and instructions are in a foreign language or are nonexistent;

- the product was not given necessary care in transit or was not reinspected after delivery to assure the quality associated with the U.S. trademark; or

- there is no U.S. warranty or service and necessary parts may be unavailable.

Of course the U.S. purchaser may get lucky. The gray product may be precisely equivalent to the legitimate U.S. product, and the U.S. trademark owner may not detect the goods as gray or may, to preserve goodwill, elect to incur the unreimbursed cost of warranty and repair.[19] But none of this is assured by the trademark. The consumer believes he has purchased an insurance policy, but the policy is void. A void policy is no bargain.

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[19] This, of course, will directly and unfairly burden the trademark owner. See Part 1.D., infra.

D. S. 2614 Will Unfairly Damage U.S. Trademark Owners by Fostering Consumer Dissatisfaction.

The deception authorized by S. 2614 would directly harm U.S. trademark owners as well as consumers. A consumer who is disappointed by a gray good is likely to blame the U.S. trademark owner. This frustration will immediately and unfairly reduce the trademark owner's goodwill.

If the U.S. trademark owner seeks to repair his injured goodwill -- by providing service, warranty, or replacement -- he must bear additional, direct costs. These costs, which would be defrayed by the U.S. sales price, are not returned to the trademark owner by gray-market sales. As a result, the trademark owner may find it necessary to raise his price for authorized goods, costing him further sales, alienating consumers and aggravating the gray market problem. Forcing the U.S. trademark owner to choose among injury to goodwill, lost sales and unreimbursed costs is both contrary to the fundamental theory of trademarks and unfair.

E. S. 2614 Will Hobble U.S. Trademark Owners in Their Efforts To Compete Effectively Abroad.

Allowing free unauthorized importation of trademarked goods will hobble U.S. trademark owners in competing effectively abroad. For example, to penetrate a new foreign market, an introductory low price may be required. If the introductory price results in expanded market share and higher volume, with resulting efficiencies of scale in production, everyone, including American consumers, may benefit. However, this market penetration effort may be defeated if goods priced at introductory levels for sale in foreign markets simply are diverted back to the United States. Moreover, American trademark owners are unlikely to offer foreign promotions that serve only, or primarily, to undercut U.S. sales.

Similarly, effective foreign competition may require product lines that include bare-boned goods unacceptable to U.S. consumers. If those goods cannot be excluded from the United States, the trademark owner will have to decide (1) not to compete in that country at all, (2) to compete ineffectively by offering only a goods and service package suited for the U.S. market, or (3) to reduce the U.S. goods and service package to the least common denominator worldwide. None of these options serves our national interest.

F. S. 2614 Reflects an Unwarranted Intrusion into the Disposition of Private Property.

Trademarks are property. They play a vital role in the functioning of free markets. S. 2614 is an attempt to tinker with the free market by impairing the ability of U.S. trademark owners to control their property. Its intent is to transfer from those who have created value -- the trademark owners -- to those who wish to poach on others' success. Such crude government intervention in the market, or the subversion of property rights, will crush the incentive essential to the functioning of a free market.

S. 2614 tries to provide a free lunch, offering the benefits of U.S. trademarks while avoiding the costs. Over the short run, such a strategy may benefit a few lucky consumers, but over the long run this strategy, like other attempts to interfere with free market prices, will injure all involved, consumers and trademark owners alike.

G. S. 2614 Is Not Needed To Secure for Consumers the Benefits of Lower Priced, Unbranded Products.

The harm to consumers and trademark owners caused by S. 2614 will not be offset by any benefits. The law as it is written today does not force consumers to pay for undesired goodwill or quality assurances. Instead, it is intended to ensure that consumers will receive the quality assurances they expect. The market can be expected to respond to a demand for a lower priced "unbranded" product without trademark assurances if such demand exists. For example, certain simple pocket calculators, quartz watches and pocket radios now are sold without the benefit of a known U.S. trademark. Gray marketeers, of course, are not enthusiastic about the prospect of importing unmarked or demarked goods since their very purpose is to appropriate for themselves part of the goodwill incorporated in the trademark itself.

2. S. 2614 Would Undercut the Authority of the Customs Service To Reduce Importation of Counterfeit Goods.

S. 2614 would deprive Customs and trademark owners of statutory authority for effective and administratively efficient measures to attack the serious and growing problem of counterfeit imports.[20]

The border is the logical place to stop counterfeit imports. Unfortunately, counterfeit goods do not advertise themselves as such, and they cannot be readily spotted and interdicted. But it is as simple as looking to know whether or not a trademarked shipment has been authorized in writing by the American trademark owner.

Customs already does this for the limited number of U.S. trademark owners who, despite not using their marks abroad, seek the protection of section 526 of the Customs Act and section 42 of the Lanham Act. The procedure is simple: the Customs inspector merely checks the trademarks on a shipment against a registered list of protected marks. If the trademark appears, the shipment is impounded unless proof of the American trademark owner's consent to importation is supplied.

According to the June 17, 1986 Federal Register notice, Customs is evaluating possible rule changes that would expand the list of protected U.S. trademarks to include those that the American owner or affiliates use abroad. Such a change would, among other things, provide a substantial further deterrent to counterfeit imports bearing such trademarks. Every federal appellate court to discuss the issue recognizes that existing law would permit such expanded protection.[21] Yet S. 2614 would strip Customs of this authority.

Under S. 2614 goods bearing the trademark symbol of an American trademark owner who competes abroad could be freely imported unless the Customs inspector -- who is likely to know little about the business of the trademark owner -- happens to detect that they are counterfeit goods. It is no criticism of Customs personnel to say that the great majority of such counterfeits will not be detected. As the 1984 report of the Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce concluded:

> Despite the best efforts of its competent and dedicated personnel, the U.S. Customs service has neither the people nor the resources to stop the flood of counterfeit products.[22]

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[20] See note 2, supra (defining "counterfeit goods").

[21] See cases cited in note 12, supra.

[22] House Subcommittee on Oversight and Investigations, Committee on Energy and Commerce, 98th Cong., 2d sess., Report:
(footnote continued)

This is not a trivial concern. The seriousness of the problem of counterfeit imports is well known and extensively documented.[23] For example, a report of the U.S. International Trade Commission estimates that this country loses almost $8 billion and 131,000 jobs annually due to counterfeit goods.[24] Counterfeit goods have become so pervasive that they have been detected among parts to be used in the United States Space Shuttle and the U.S. Army's Chapparall and Lance missile systems.[25]

And the consequences of product counterfeiting are not merely economic. As noted in a report of the Subcommittee on Oversight and Investigations of the House Committee On Energy and Commerce:

> The health and safety of consumers in the United States . . . is being seriously threatened by counterfeit drugs, medicines, medical devices and other medical equipment.[26]

The seriousness of the counterfeiting problem -- and the importance of suppressing it -- is not really disputed. Indeed, Senator Chafee, who cosponsors S. 2614, made many of these same points in his remarks in support of the Trademark Counterfeiting Act of 1984.[27]

> I am delighted that the Senate is considering and will shortly adopt this bill. It is critically needed, because it will provide a new measure of deter-

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"Stealing American Intellectual Property: Imitation is Not Flattery," (Comm. Print 98-V 1984) at 5 [hereinafter, "Stealing American Intellectual Property"].

[23] See, e.g., World Intellectual Property Organization, Committee of Experts on the Protection Against Counterfeiting, 1st Sess. (May 5-7, 1986); Recommendations of the Task Force on Intellectual Property to the Advisory Committee for Trade Negotiations at 2 (October, 1985).

[24] The Effects of Foreign Product Counterfeiting on U.S. Industry (ITC Pub. No. 1479, 1984).

[25] Stealing American Intellectual Property, supra note 22, at 40.

[26] Id. at 38.

[27] S. 875, 98th Cong., 2d sess. (1984).

> ence against the sale in the United States of what are termed counterfeit goods.
>
> The influx of such goods has become an epidemic. Manufactured abroad, these look-alike products attempt to duplicate the genuine U.S. product, in part by using the U.S. trademark. This is not merely a blatantly unfair trade practice. These products can also be a threat to the safety and health of the user, when they do not perform to the standard expected of the real article. And they destroy the markets of U.S. companies and the jobs of U.S. workers.[28]

It may be that other adequate means someday will be found to deal with the problem of counterfeit imports. Certainly, the rule changes being considered by Customs are not a complete solution. But until adequate measures have been adopted and proven effective, Congress should not move in the opposite direction by stripping Customs of its existing authority to deal with the problem.

3. S. 2614 Is Contrary to the Growing National Resolve of Strengthening, not Weakening, Protection for Intellectual Property.

Precisely to achieve many of the benefits that S. 2614 would impair, a groundswell of support has arisen for efforts to strengthen protection for U.S. intellectual property. For example, the April 3, 1986 U.S.T.R. Statement,[29] noted (at 1) that protection of intellectual property "is critically important to the United States, our trading partners and the world economy" and that lack of adequate protection is "a serious and growing problem." Accordingly, the Statement announced (at 4) the "strategy to pursue vigorously the strengthening of intellectual property protection." As part of that strategy, the U.S.T.R. Statement (at 1-2) committed the Executive to "[s]trengthening existing . . . national

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[28] 130 Cong. Rec. S8805 col. 3 (June 28, 1984); *see id.* at S8805 col. 1 (Senator Thurmond); *id.* at S8806 col. 1 (Senator Lautenberg); *id.* at S8805 col. 2 (Senator Mathias).

[29] *See* note 1, *supra*.

standards for protection and enforcement" and "ensuring that U.S. laws provide a high standard of protection."[10]

The U.S.T.R. Statement[11] declares the intention, _inter alia_:

- to introduce intellectual property into the agenda of General Agreement on Tariffs and Trade ("GATT");

- to "work to resolve the persistent problems of counterfeiting by seeking the early adoption of a GATT Anti-Counterfeiting Code;"

- to "work for increased protection under the Paris Convention [for patents and trademarks] and vigorously pursue U.S. accession to the Berne Convention" (which provides higher standards for copyright protection than the Universal Copyright Convention, to which the United States now adheres);

- to employ bilateral negotiations, including "vigorous use of the full array of U.S. trade and other laws to encourage other nations to provide timely, adequate and effective protection for intellectual property rights;" and

- to promote "enactment of the Administration's 'Intellectual Property Rights Improvement Act of 1986' to strengthen and expand the protection of U.S. intellectual property rights."

These goals are being achieved. For example, despite some daunting opposition abroad, intellectual property issues probably will be brought into the new round of GATT negotiations; American adherence to the Berne Convention has been formally proposed; the U.S. Trade Representative has commenced a section 301 action against Korea to curb the theft

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[10] In remarks on July 17, 1986, President Reagan declared, "there is a great deal of common ground between the administration and thoughtful members of Congress -- we support, for example, . . . stronger protection for intellectual property rights. . . ." White House Press Release, Briefing on Trade Issues at 4 (July 17, 1986).

[11] U.S.T.R. Statement, _supra_ note 1, at 5.

of U.S. intellectual property there; bilateral conferences on intellectual property have been held with India, Taiwan, Korea, Singapore, Malaysia, Mexico, Indonesia, Thailand and the twenty-two countries that are beneficiaries under the Caribbean Basin Initiative.

The Congress also has joined in the effort to strengthen the protection of intellectual property. In both the Caribbean Basic Economic Recovery Act and the Trade and Tariff Act of 1984,[32] the Congress adopted legislation conditioning trade and tariff benefits to foreign countries upon their protection of U.S. intellectual property.

The imperative of fully protecting intellectual property rights is emphatically supported in the Report of the President's Commission on Industrial Competitiveness[33] and in studies from the private sector.[34]

Within the general, strong, and growing resolve and movement to enhance intellectual property rights, the U.S. Trade Representative and the Customs Service have called into question the adequacy of the very regulations that S. 2614 would enact into law.

On October 5, 1982, William E. Brock, then U.S. Trade Representative, wrote to Commissioner of Customs William von Raab proposing that those regulations, insofar as they limit the trademark owner's power to exclude gray goods, be rescinded and that section 526 be enforced <u>as written in the statute</u> in order to "restore some equity that has been lost as a result of changes in the laws of other countries." On November 3, 1982, the Acting Commissioner of Customs responded, informing Mr. Brock that Customs was "considering changing our enforcement practices as you have suggested,"

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[32] Caribbean Basin Economic Recovery Act, Pub. L. No. 98-67, 97 Stat. 369 (1983); Trade and Tariff Act of 1984, Pub. L. No. 98-573, 98 Stat. 2948 (1984).

[33] <u>See</u> note 15, <u>supra</u>. See especially Vol. II, Appendix D, Preserving America's Industrial Competitiveness: A Special Report on the Protection of Intellectual Property Rights in Global Competition.

[34] U.S. Government Trade Policy: Views of the Copyright Industries, International Intellectual Property Alliance (prepared at the request of the Office of the U.S. Trade Rep.); CBS Inc., Trade Barriers to U.S. Motion Picture and Television, Prerecorded Entertainment, Publishing and Advertising Industries (September 1984) (refining information developed by a subcommitee that has advised the U.S. Trade Rep. in connection with GATT).

but that a notice-and-comment procedure should be employed. After two years of internal discussion, the first such notice was published on May 21, 1984.[35]

The Customs Service's rulemaking is continuing. On June 17, 1986, Customs requested public comment on two proposed modifications to those regulations.[36] Comments are due on August 18. One option is to require all gray-market imports to bear a label stating that the U.S. trademark owner does not consent to the importation. The other is to require that the trademark be removed or obscured before importation -- a procedure known as "demarking." The June 17 Federal Register notice follows several years of analysis dating back to the time of the U.S. Trade Representative's letter quoted above. The proposed legislation would abort this process of administrative review and lock the Administration into unwise regulations that Customs is reconsidering.

In short, S. 2614 would directly undercut the recently announced policy and the growing national resolve toward strengthening, not weakening, protection of intellectual property.

Conclusion

Trademarks and their territoriality serve consumers and entrepreneurs alike: they inform and facilitate consumer choice; they embody goodwill; they carry to consumers assurances of quality, consistency, and service in their particular markets; they induce entrepreneurs to meet the public tastes and needs; they enable entrepreneurs to enter markets with new products; and they encourage the trademark owner to spend toil and treasure in developing both products and efficient distribution.

The goodwill and market reputation arising from that outlay is collected and protected in the trademark. Those resources will be invested only when they are rewarded. And they will be penalized, not rewarded, when they are taken by free riders like gray marketeers.

Upon their basic principles, functions, and benefits, trademarks and their territorial protection must be sustained and strengthened. To that end and consistently with the growing national resolve to fortify the protection of intellectual property, S. 2614 should be rejected.

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[35] 45 Fed. Reg. 21453 (1984).

[36] 51 Fed. Reg. 22005-07 (1986).

6 Apollo Court
Succasunna, NJ 07876

August 11, 1986

Senate Finance Committee
Ms. Betty Scott-Boom
Committee on Finance
Room SD-219
Dirksen Senate Office Building
Washington, D.C. 20510

Dear Ms. Scott-Boom:

This letter is in regard to my experience with a gray market product and the proposed gray market goods bill (S. 2614), which I understand would legalize the gray market. As far as I am concerned, this bill is anti-consumer and would make bad law.

On November 16, 1986 I had the misfortune of purchasing a gray market camera. Prior to my purchase I was somewhat aware of gray market products but felt that the small savings at some gray market stores did not offset the value of the U.S. warranty and the other quality assurances of brand name products.

At the time of sale I specifically requested a well-known trademarked camera with a two-year U.S. factory authorized warranty. I was explicitly assured by the retailer that the camera was not gray market and came with such a warranty. After I purchased this camera, no warranty papers were found.

My repeated calls to the store resulted in delaying tactics and further aggravation. Calls to the U.S. camera distributor revealed that the camera was gray market, that the retailer who sold me the camera was not an authorized dealer, and that if my camera would require any repairs it would not be done under the U.S. factory authorized warranty since I had none.

At this time I had to retain legal counsel to pursue the dealer. It was not until the store manager was served with a summons to appear in court that he finally agreed to refund my purchase.

Senate Finance Committee
Ms. Betty Scott-Boom
August 11, 1986
Page 2

This occurrence caused me undue aggravation, lost time and additional expenses. If existing laws against the gray market were being enforced, this could have been avoided. I believe that many gray market products are being misrepresented to consumers as having proper warranties and other services, as in my case. In most cases, however, consumers assume that the brand name on the product automatically carries all of these assurances and do not know enough about the gray market even to ask. They don't find out about the differences in gray market products until they have a problem and it is too late. This leads to additional expenses for consumers and must be avoided. I therefore believe that instead of changing the law to the detriment of consumers, our existing laws should be fully enforced.

Should you require any additional information, I can be contacted on (201) 649-3308.

Thank you

Mario Codispoti

**WRITTEN STATEMENT BY DAVID A CONNELL
ON BEHALF OF
THE DISTILLERS COMPANY PLC OF EDINBURGH
TO THE
SENATE FINANCE SUBCOMMITTEE RE S2614
FOLLOWING THE HEARING OF 29 JULY 1986**

This submission is made on behalf of The Distillers Company plc (Distillers), a company incorporated in Edinburgh whose subsidiaries export to the USA some 48 brands of Scotch whisky and also export to or manufacture in the USA brands of Cognac, gin, vodka and speciality products. These brands include DEWARS and JOHNNIE WALKER Scotch whiskies and GORDON'S and TANQUERAY Gin.

Trading circumstances and conditions of competition vary considerably between one trade and another. Many of the assertions as to the causes of parallel imports made in S2614 and in testimony presented to the Committee are untrue as far as alcoholic beverages are concerned. We believe, however, we can best assist the Committee by dealing not with the causes of parallel trading but with what our experience in Europe and Japan has shown to be its consequences.

So far as alcoholic beverages are concerned parallel imports facilitate and encourage counterfeiting and spurious products. This is a more serious problem for drinks than it is for fashion articles or consumer durables. That considerable injury to health and some deaths resulted from frauds in relation to Austrian and Italian wine is well known. Mr Rizvi in his submission to the Committee pointed out that there have not yet been any reports of counterfeiting or damage to health as a result of parallel imports of liquor into the USA. That, however, is neither surprising nor very relevant. Parallel importation of spirits into the the USA is a recent phenomenon. Experience in Europe and Japan shows that there is a considerable delay between the initiation of parallel imports and the use or abuse of parallel import channels by the producers of counterfeit goods. This is what one would expect. During the initial period the problem of the parallel importer is to obtain a market for his goods. If he is successful in obtaining that market his difficulty becomes that of obtaining adequate supplies to fulfill demand. It is at that stage that it becomes easy for counterfeitors to feed their products into the distribution circuit.

There are no grounds for believing that experience in Europe is not a reliable indication of what is likely to happen in the USA. Indeed, the danger is likely to be greater in the USA by virtue of the fact that certain brands have very large sales in the USA compared with the rest of the world. Parallel supplies of these brands will be difficult to obtain. This would make the entrepreneur middlemen who procure supplies for parallel importers in the USA easy victims of counterfeiting conspiracies.

The reasons why parallel trading facilitates counterfeiting and similar frauds have been explained in a submission by the Scotch Whisky Association. We set out below examples of the counterfeiting of our brands in Europe and later in Japan and the connection between such counterfeiting and parallel trading. We attach as appendices documents and letters prepared at the relevant times for other purposes which we believe to be more valuable than specially prepared abbreviations.

(a) Labels bear code numbers to enable batches to be traced and recalled if necessary. In order to prevent the source being traced parallel traders in Europe adopted the practice of removing the original labels and replacing them with counterfeit ones. During 1971 to 1976 Distillers instituted 8 successful legal actions in respect of such counterfeiting. Brief details are attached in **Appendix A.**

In Japan too parallel importers of Scotch whisky have sold goods in counterfeit cartons and-or bearing counterfeit labels. A letter of 28 August 1980 to the Tokyo lawyer, Dr Kubota, provides a good illustration of the danger and difficulties created by such counterfeiting: copy is attached as **Appendix B.**

(b) The existence on the market of genuine goods bearing counterfeit labels makes the detection of spurious goods more difficult. Moreover, parallel importers are accustomed to middlemen being shy about their sources of supply for fear of being cut out of the chain; and middlemen in urgent need of supplies are loath to ask too many qestions. It is not surprising therefore that, just as parallel imports of genuine whisky with counterfeit labels followed parallel imports of genuine whisky with genuine labels, so they were in turn followed by parallel imports of spurious whisky with counterfeit labels:

(a) In 1972 James Buchanan & Company Limited learned of a conspiracy to bottle 1.7 million litres of cheap whisky under counterfeit BLACK & WHITE Scotch whisky labels. Documents seized from the conspirators showed that the whisky was to be sold to a parallel importer of Scotch whisky in Antwerp. (For further details please see item 2 of Memorandum dated 8 March 1974, copy of which is attached as **Appendix C.**)

(b) During 1976/7 John Walker & Sons Limited investigated a series of conspiracies to sell counterfeit JOHNNIE WALKER. As a result of their enquiries at least 10 separate legal actions were instituted against 30 different defendants, and over half a million counterfeit labels and thousands of cases of whisky bearing counterfeit labels were seized (further details available on request).

(c) On a lighter note reference is made to an Affidavit dated 13 December 1976 sworn by a defendant in one of the legal proceedings for counterfeiting in the High Court in London referred to in paragraph (b) above. He swore:

> t was then for the first time that they ..ggested that they might market them under Johnnie Walker Whiskey Labels after they had purchased the bottles of whiskey from us. I was very doubtful as to the legality of this but they assured us that by reason of what they called parallel trading this was legal upon the continent."

(d) Among the active parallel traders in genuine liquor in Europe, who also shipped to parallel importers in Japan, were the English company Interspirits Limited, the Dutch company BV Algemene Agentschappen van Wijnbouwers and Daniel Van Caem, who was a director of both companies. Van Caem and/or the companies not only supplied whisky to traders intending to sell it under counterfeit labels in Germany and Austria (where the whisky was seized and legal proceedings instituted) but was also involved in the sale of counterfeits of a famous branded wine, for which a judgment against them was given by the District Court of the Hague in the Netherlands on 22 November 1979.

(e) In 1977 a plot was uncovered in Manila for the export of counterfeit Scotch whisky through parallel channels to a number of markets including the USA, Japan and Australia. For further details please see Memorandum of 31 October 1984, copy of which is attached as **Appendix D.**

(f) In April 1984 a plot was uncovered which involved the manufacture of counterfeit Scotch whisky in Bulgaria and its export on a substantial scale through parallel channels in Italy to market or markets outside Europe. For details please see press cutting attached as **Appendix E.**

Summary and Conclusion

In Europe parallel imports of alcoholic liquors were followed by counterfeiting of the brands concerned. There is no reason to suppose that that experience is not relevant in the USA. Counterfeiting is particularly undesirable for ingested products. If there are in some trades horizontal price cartels or other price abuses they should be dealt with by means which do not involve the health risks of counterfeit liquor.

STATEMENT OF DISTILLERS/SOMERSET GROUP, INC. IN OPPOSITION TO S.2614

The Distillers Somerset Group, Inc. is a Delaware company with offices at 1114 Avenue of the Americas, New York, New York, 10006. For many years we have operated as the sole authorized importer of numerous well known brands of distilled alcoholic beverages including JOHNNIE WALKER Scotch whiskies, PIMM'S No. 1 Cup and TANQUERAY gin. Recently our business and that of many of our customers has been seriously injured by a growing number of unauthorized grey market sales in this country. As a result, we strongly oppose S.2614 and any other legislative or regulatory effort that would legitimize the grey market.

Our opposition to S.2614 is based on three distinct contentions: (1) this bill would allow the grey marketeers to unfairly compete by taking a "free-ride" on the substantial marketing efforts that our company expends to promote and sell our internationally known brands; (2) passage of S.2614 will promote deception of and cause harm to the consuming public; and 3) S.2614 conflicts with trademark laws and underlying policy considerations designed to protect the public as well as trademark owners.

THE FREE-RIDE ISSUE

Our company, like many other legitimate importers and trademark owners, invests literally millions of dollars annually in the United States in promoting and marketing our products. In the competitive free market system which exists in this country, such expenditures are a necessity and are recognized by virtually every major company as a cost of doing business. These expenditures serve at least three basic purposes: (1) to develop and maintain the goodwill symbolized by our trademarks; (2) to provide information to the public concerning the quality characteristics of our products; and (3) to maintain our competitive position by developing and promoting consumer loyalty for our products.

The grey marketeer has no interest in any of these areas. He is simply interested in profits for himself. By going outside existing authorized distribution networks, the grey marketeer takes a "free-ride" on the efforts of the authorized dealers. Simply put, the grey marketeer avoids the substantial costs of advertising and marketing which are required to maintain our position in the national market place. In addition to the costs associated with media advertising, our company also incurs additional necessary expenses for in-store promotional activities, sales force training, test marketing, external promotions, research and development operations, packaging, and market research. None of these expenses are incurred by the grey marketeer.

Only because of this "free ride" is the grey marketeer able to offer consumers bargain prices while at the same time reaping substantial profits for himself. However, such bargain sales would be impossible but for the goodwill generated, the information imparted and demand created by the advertising and promotion expenditures and the marketing efforts of legitimate distributors.

Claims by grey market importers that they do advertise for certain brands simply lack credibility. Any expenditures made by these importers serve no purpose other than to promote their own stores or distribution networks. They are not supporting any particular brand with any type of sustained effort. Their "marketing" relates only to their own interests not those of the brand.

It is clearly and blatantly unfair to allow grey marketeers to benefit from the legitimate and substantial marketing efforts of authorized distributors. Grey marketeers derive the same benefits from their activities as counterfeiters and deliberate trademark infringers and their objective is the same, i.e., to reap where they have not sown by taking a "free-ride" on goodwill created by others. The proposed legislation will not only serve to legitimize the unfair activities of the grey marketeers, but it will also discourage legitimate businesses from investing in advertising and other endeavors essential to competition.

HARM TO THE PUBLIC

Grey market goods are introduced into the United States through various channels of distribution beyond the scrutiny and control of the trademark owner. As a result, the potential for harm to the United States consuming public is greatly increased. Neither the authorized importer nor the Congress can assure the public that beverage alcohol coming into the United States through grey market channels is authentic or safe to consume. Indeed, the risk of counterfeit beverage alcohol being introduced to the United States by these various unknown sources is significantly increased.

At the present time, many grey market beverage alcohols are routed through the Soviet bloc, Middle-Eastern countries, and African nations. For example, recent grey market shipments of our products were found to have involved purchasers in Rumania and Lebanon. Many nations involved in the grey market are unfriendly or even hostile to the United States. Some are known to harbor terrorists and to covertly support terrorism. One can easily imagine a fanatic group or individual tampering with or contaminating a product bound for America. These fringe elements would naturally prefer to tamper with goods originally produced by an ally of the United States rather than goods originating in their own countries. The consequences could be disastrous. In addition, by purchasing products for resale from such hostile countries, the grey marketeers provide, hard currencies which will inevitably be used in a manner inconsistent with the interests of the United States.

The health and safety of the American public is an interest upon which one cannot place a value. For many years, the Congress has enacted legislation and established regulatory agencies designed to protect the American public from substandard and contaminated food and beverages. This bill is inconsistent with and will severely undermine those efforts.

Only legitimate, authorized distributors, working with féderal and state authorities, can take the necessary measures to protect American health and safety. These distributors know their products and stand behind them. For example, if there is a need to recall a particular alcohol beverage product, the legitimate authorized distributor can act promptly and effectively. If grounds for recalling grey market beverages arise, however, neither the authorized distributors nor the grey marketeers are in a position to take effective action. Grey marketeers often remove lot numbers and other identifying markings which are specifically designed to protect the public and facilitate tracking of particular shipments.

Established authorized distributors have an important stake in maintaining the quality and integrity of their brands. Grey marketeers on the other hand have no such interest since they can easily switch to another brand if their conduct damages or impairs the goodwill of any particular grey market product.

S.2614 totally ignores one issue of great concern to the American consuming public, i.e. the right to redress for injuries caused by defective products. Many times, the consumer simply is unaware that the product he has purchased is from the grey market. Even if the product is known to have passed through grey market channels, the consumer may have no means of identifying those responsible for distribution. If an injury arises due to a defect in the product, the American consumer would undoubtedly take action against the legitimate authorized distributor or the manufacturer. However, if the defect occurred because of a negligent or deliberate act by a grey marketeer outside the jurisdiction of United States courts, the consumer might be left with no remedy. What initially appears to the consumer as a bargain, may indeed become a very costly purchase.

If a consumer suffered injury or illness due to improper product handling or storage by a grey marketeer or because the consumer was allergic to a coloring agent or ingredient lawful in the country of original destination but not in the United States, who should bear liability? Moreover, who will recompense the trademark owner and lawful distributors for injury to goodwill caused by such an incident? The proposed legislation is silent on these issues.

CONFLICT WITH FEDERAL TRADEMARK STATUTES AND THE COMMON LAW

Trademarks are defined in the Lanham Act as including "any word, name, symbol or device or any combination thereof adopted and used by a manufacturer or merchant to identify and distinguish his goods, including a unique product, from those manufactured or sold by others and to indicate the source of the goods even if that source is unknown." 15 U.S.C. 1127.

It has long been recognized that trademarks play an indispensable role in the efficient operation of our free enterprise system. In general, a trademark functions and is accorded legal protection because it:

(a) designates the source or origin of a particular product or service, even though the source is to the consumer anonymous;

(b) denotes a particular standard of quality which is embodied in the product or service;

(c) identifies a product or service and distinguishes it from the products or services of others;

(d) symbolized the good will of its owner and motivates consumers to purchase the trademarked product or service;

(e) represents a substantial advertising investment and is treated as a species of property; or

(f) protects the public from confusion and deception, insures that consumers are able to purchase the products and services they want, and enables the courts to fashion a standard of acceptable business conduct.

1 Gilson, Trademark Protection and Practice, §1.03 (1985).

For consumers, the most important role performed by trademarks is the quality assurance function which protects consumers from confusion and deception. The purchasers of well known brands are often motivated by an expectation of a particular level of quality and by the knowledge that there is a reputable entity which will stand behind the product and guarantee satisfaction. The Congress of the United States recognized the importance of trademarks more than a century ago and has enacted a series of laws designed to protect the interests of the public as well as the trademark owners.

By opening the door to grey market sales, S.2614 conflicts with policies long embodied in trademark statutes and in the common law. When products are sold through grey market channels, the trademarks affixed to the products may no longer serve as a guarantee of quality since the trademark owner may no longer have any means of controlling the product.

The potential for quality deterioration is acute when alcoholic beverages are shipped through grey market channels as illustrated by the statement of Peter M. Thompson, who testified against enactment of S.2614 on behalf of the National Association of Beverage Importers and Distilled Spirits Council of the United States, Inc.

The trademark laws are also designed to protect the interests of American employers, whose success and very existence are often directly linked to their ability to protect their trademarks and reputation against those who would unfairly compete.

The substantial investment made by our company and other trademark owners is precisely the kind of activity that the trademark laws were designed to encourage and protect. Grey market importers enrich themselves from the goodwill and reputation of our trademarked brands without having incurred any of these investments. Clearly, these grey marketeers deprive American trademark owners of a significant part of expected return on their investments.

For every dollar that is diverted to the grey marketeers by sales of grey market goods, American trademark owners are directly injured. In effect, grey market importers are stealing from legitimate companies.

By preventing consumer confusion and deception and preserving a trademark owner's goodwill along with his ability to obtain economic returns on his product, trademark laws provide incentives for product development, marketing and the maintenance of product integrity. Indeed, as indicated in the Legislative History of the Trademark Act of 1946 (Lanham Act) states:

> "trademarks, indeed, are the essence of competition, because they make possible a choice between competing articles by enabling the buyer to distinguish one from the other. Trademarks encourage the maintenance of quality by securing to the producer the benefit of the good reputation which excellence creates. To protect trademarks, therefore, is to protect the public from deceit, to foster fair competition, and to secure to the business community the advantages of reputation and goodwill by preventing their diversion from those who have created them to those who have not."
> S.Rep.No. 1333, 79th Cong., 2d. Sess. 3 (1946).

Grey market goods are inherently confusing and deceptive. The potential for confusion is increased in the case of alcoholic beverages manufactured for foreign countries, since these products bear labels which usually do not meet federal and state regulations governing labeling and certificate of origin/age requirements. When these products are shipped into the United States by grey marketeers, they often pass through customs in improper form. Our company has uncovered several instances involving grey market shipments of our brands, where products lacking labeling information and other supporting documentation required by U.S. law have been distributed in this country, or where labels have been mutilated in such a way as to create doubts among consumers as to the authenticity of the brand.

Trademark laws have traditionally served to encourage legitimate businesses to compete against one another in a free and fair manner. The grey marketeer violates the basic tenets of this concept. With no interest in the product and no desire beyond profits, the grey marketeer subverts the very system that he thrives on.

It would indeed be unfortunate to disrupt our long established statutory system for trademark protection solely to advance the selfish interests of a few grey marketeers. The interests of the American public will be best served by legislation designed to discourage rather than promote grey market shipments. Accordingly, we join with others who have voiced opposition to S.2614 in urging that it be rejected.

COMMITTEE ON FINANCE
SUBCOMMITTEE ON INTERNATIONAL TRADE
UNITED STATES SENATE

COMMENTS IN OPPOSITION TO S.2614

FILED ON BEHALF OF
DURACELL INC.

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August 1, 1986

COMMENTS IN OPPOSITION TO S.2614
FILED ON BEHALF OF DURACELL INC.

I. DURACELL AND THE GRAY MARKET

A. Corporate Organization

Duracell Inc. ("Duracell") submits its comments on the proposed Gray Market Goods bill, S.2614, because we believe such legislation is not now warranted. Further, we believe that the bill in its present form is overbroad and fails to take into account the injury the gray market imposes on a U.S. manufacturer of perishable goods.

Duracell is a Delaware corporation with its principal place of business in Connecticut. Duracell is primarily engaged in the manufacture and sale of alkaline batteries, the vast majority of which are sold in the popular consumer sizes (the major cells): AA, AAA, C, D, and 9-volt. DURACELL batteries are used to power electronic, mechanical, photographic, and many other battery-powered devices. Duracell markets, promotes, and advertises alkaline batteries under several registered trademarks, one of the most important of which is the well-known DURACELL trademark.

Duracell U.S.A., an unincorporated division of Duracell Inc., produces all DURACELL major cell batteries sold by Duracell in the U.S. (domestic DURACELL batteries). Duracell employs approximately 4,000 persons in the United States to manufacture and distribute domestic alkaline batteries. Hundreds of millions of dollars have been spent to develop the goodwill that backs the DURACELL mark in this country.

Duracell Inc. wholly owns Duracell International Inc. which, in turn, has various wholly-owned subsidiaries throughout the world, including manufacturing and marketing entities. These foreign subsidiaries operate quite autonomously. Each foreign subsidiary has its own marketing and sales organization, determines its own pricing, plans and executes its own promotional activities, and is directed by its own management team.

Duracell International Inc. has several foreign subsidiaries which manufacture DURACELL alkaline batteries abroad (foreign DURACELL batteries). All of these batteries are intended to be distributed in foreign markets served by Duracell International Inc.'s foreign subsidiaries. None of these batteries are intended for distribution in the U.S. These foreign DURACELL batteries, marketed under foreign registrations covering the DURACELL trademark, have a trade dress similar to that used in the United States.

B. <u>Gray Market Batteries</u>

Although Duracell does not sponsor or authorize the importation or distribution of any of these foreign DURACELL batteries in the United States, for more than four years various individuals and corporations have been importing substantial quantities of foreign DURACELL batteries into this country. Gray market importers and distributors have taken a free-ride on the goodwill Duracell's U.S. investment has created.

Taking full advantage of the strong U.S. dollar as well as the well-known DURACELL mark, gray marketers are responsible for well over a hundred million unauthorized importations of foreign DURACELL batteries. Duracell is substantially injured by the unauthorized importation of foreign DURACELL batteries. Unlike the situation with many gray market goods which are manufactured outside of the United States, the injury here specifically affects Duracell's U.S. manufacturing and distribution facilities.

Not only are Duracell's U.S. operations and employees harmed by the gray market trade; the public interest is injured as well. Although importers sell foreign DURACELL batteries to Duracell's customers (wholesalers and retailers) at prices considerably below Duracell's domestic price, the consumer does not always receive that benefit. As the investigation before the International Trade Commission showed, prices charged to consumers for foreign DURACELL batteries and domestic DURACELL batteries do not generally differ. A major drug chain, for instance, sold several hundred thousand foreign DURACELL batteries side-by-side with domestic DURACELL batteries, all at the same price to consumers.

Moreover, unauthorized foreign DURACELL batteries are less preferable to American consumers than Duracell's domestic product in several ways. First, although foreign and domestic DURACELL batteries are both of high quality at their time of manufacture, foreign DURACELL batteries as sold in the U.S. by unsponsored importers run an unacceptably high risk of significant quality deterioration through mishandling and uncontrolled environmental exposures during ocean shipment. Second, unauthorized foreign DURACELL battery imports subvert Duracell's efforts to ensure that American consumers are protected in the event that a DURACELL battery does not meet Duracell's high quality standards. Foreign DURACELL batteries do not reveal a name and address and thus make it most difficult, if not impossible, for consumers to seek redress in the event that they are dissatisfied in any way with the foreign DURACELL batteries purchased by them.

Similarly, unauthorized foreign DURACELL battery imports harm consumers because they circumvent Duracell's efforts to prevent improper storage, use, or disposal. Thus, Duracell prints warnings and instructions on each major cell package that it distributes in the United States. Many foreign DURACELL batteries sold in this country are in foreign language packaging and therefore do not convey these important safeguards, all of which are intended to minimize the possibility of property damage and personal injury to the consumer.

C. The "Duracell Case"

In our efforts to redress the effects of the gray market on our operations, Duracell has engaged in difficult, expensive, time-consuming litigation. Initially, Duracell filed suits against two gray market importers in federal court in New York City. Although those suits were settled when the importers agreed to refrain from their practice, other importers stepped in to distribute foreign DURACELL batteries in the United States.

Duracell then filed a complaint with the International Trade Commission ("ITC") alleging that the importation and sale of foreign DURACELL batteries violate 19 U.S.C. § 1337 ("section 337"). After extensive discovery, a week-long evidentiary hearing, full briefing, and a hearing before the ITC, that agency agreed that the importation of foreign DURACELL batteries constitutes unfair competition in violation of section 337. The ITC Commissioners were unanimously convinced that Duracell had conclusively proven all the elements of a section 337 violation. Duracell is a U.S. industry, efficiently and economically operated, which is being substantially injured by the importation and sale of foreign DURACELL batteries that infringe Duracell's U.S. trademark and misappropriate its trade dress. Additionally, the ITC found that the public interest favored imposition of the exclusion order.

The President, however, determined that the ITC's ban on the importation of foreign DURACELL batteries was inconsistent with the current U.S. Customs Service regulations which permit importers to bring in foreign trademarked goods produced by a company related to the U.S. trademark owner. The President is empowered to disapprove for policy reasons remedies imposed by the ITC and did so in this case. Duracell appealed that disapproval to the Federal Circuit, contending that the President disapproved, not on policy grounds, but because he disagreed with the ITC's legal conclusion. The Federal Circuit held that it had no jurisdiction to hear the appeal.

II. THE PROPOSED BILL IS NOT WARRANTED

A. The Proposed Bill Is Premature

The proposed Gray Market Goods Bill, S.2614, is certainly not warranted at this time. Basically, the proposed bill would amend 19 U.S.C. § 1526 ("section 526") to permit gray market trade regardless of any statutory or other right the U.S. trademark owner may have. In other words, paramount importance is afforded the rights of the gray marketer over the rights of the U.S. trademark owner.

There is no current need for legislation in this area. Litigation is presently ongoing in an effort to determine the lawful boundaries of trade in the gray market. Until the courts have spoken, there is no need for preemptive action by Congress. Indeed it was Congress' attempt to speak definitively on the gray market before the courts had a full opportunity to consider the legal issues that has led to much of the uncertainty today. That is, the legislation at issue before us, section 526, was adopted to remedy the perceived error in lower courts' rulings on the gray market. However, in adopting section 526 before the Supreme Court delivered its ruling in A. Bourjois & Co. v. Katzel, 260 U.S. 689 (1923), Congress prompted the long-running dispute regarding the extent of the Congressional action and its interplay with the court cases. This scenario would recur here if Congress were to adopt the proposed legislation now despite the fact that litigation currently in the courts could resolve the issues. Legislation, enacted nearly simultaneously with a judicial pronouncement, would do little to clarify the legal status of the gray market but very well could be a separate source of confusion.

B. The Proposed Bill Is Too Broad

Most importantly, however, the proposed legislation is entirely too broad. It would eliminate not only the protection that section 526 nominally affords U.S. trademark owners but would also deprive U.S. trademark owners of the protections traditionally afforded them under the trademark laws. The glaring defect in the proposed legislation is that it specifically prohibits any trademark actions that would restrict any trade in any gray market. Thus, even gray market goods that meet the traditional definition of trademark infringement - a likelihood of consumer confusion - will be permitted entry and afforded protection that other infringing goods are not. For example, in the Duracell case before the International Trade Commission, we presented market research to show that the DURACELL trademark signifies to the U.S. consumer a fresh American-made Duracell-sponsored product. Those attributes are not shared by foreign DURACELL batteries; the U.S. consumer who, relying on the strong trademark and the quality it symbolizes, may purchase a battery without close scrutiny, is not getting the product he or she expects when purchasing a DURACELL battery.

Another deficiency in the bill's blanket approach is the failure to recognize that some gray market goods are of lesser quality than the authorized goods once in the ultimate consumers' hands. As is reflected in Duracell's case, a manufacturer's ability to follow and control the distribution of its perishable products is key to ensuring the integrity of its trademarks. Duracell carefully controls the transportation and storage conditions to maintain the quality of DURACELL batteries. Batteries distributed on the gray market are inherently not within the manufacturer's control; the fact that batteries have a limited shelf life indicates that gray batteries are not the same as foreign DURACELL batteries. By validating the gray market, the proposed legislation would endanger Duracell's ability to ensure that only the freshest DURACELL batteries reach the consumer.

Finally, the gray market is sometimes lauded because the manufacturer typically is perceived as a foreign corporation seeking to take advantage of wealthy U.S. consumers. Again, the overbroad nature of the proposed legislation can be seen as resulting from an inaccurate portrayal of the realities of the gray market. Once more, the Duracell case refutes the stereotype. The imported gray batteries compete with domestic DURACELL batteries, manufactured and distributed at facilities in this country. It is Duracell's manifest intent to produce in this country the alkaline batteries it distributes to U.S. consumers. Yet every sale of a foreign DURACELL battery in this country has its impact on Duracell's domestic operations. In Duracell's case, the proposed legislation would serve only to encourage imports, increase the trade deficit, and discourage domestic production. Furthermore, it is fact that U.S. consumers are not receiving a price break; the ITC investigation revealed that foreign DURACELL batteries and domestic DURACELL batteries sold side-by-side are sold at the same price.

III. CONCLUSION

We agree with the opponents of the proposed legislation that this bill is both unnecessary and premature at this time. We are also deeply concerned with the broad nature of the bill. It fails to take into account the injury to a perishable goods manufacturer when its reputation is taken out of its hands, the potential that gray market goods may meet the traditional trademark infringement test, and the position of the U.S. manufacturer whose product must compete with free-riding foreign goods.

STATEMENT OF THE ELECTRONIC INDUSTRIES ASSOCIATION/ CONSUMER ELECTRONICS GROUP IN OPPOSITION TO S. 2614 BEFORE THE SENATE FINANCE SUBCOMMITTEE ON INTERNATIONAL TRADE

The Consumer Electronics Group of the Electronic Industries Association (EIA/CEG) opposes S. 2614. EIA/CEG is the national trade association representing manufacturers and authorized distributors at the manufacturer's level of consumer electronics products.*

SUMMARY OF EIA/CEG POSITION

S. 2614 seeks to legalize gray market imports. It is based on faulty premises, ignores the harm gray market imports cause, and is untimely.

S. 2614 blindly ignores the widespread problems that gray market goods cause. The sponsors of the legislation premise the bill on their belief that no consumer problems exist with gray market imports. This is contrary to fact.

S. 2614 is untimely. The Reagan Administration and the courts are considering alternatives to unfettered gray market imports. The Reagan Administration may mandate labeling or demarking. The COPIAT decision, which held that Customs Service rules allowing gray market goods violate Federal law, may soon receive Supreme Court review. Legislative action at this time would be premature. Given these problems, EIA/CEG urges the Subcommittee to oppose S. 2614.

THE LEGISLATION IS BASED ON FAULTY PREMISES

S. 2614 is premised on the belief that U.S. consumers do not suffer any harm from gray market products. In his statement introducing the bill, Senator John H. Chafee (R-RI) states, "Sales of parallel imports (gray market goods) would not continue to rise year after year if consumers were being deceived or confused...." Sen. Chafee premises the legislation on his belief that consumers suffer no harm from gray market imports. This critical premise is flawed.

*These products include stereos, video and audio recorders, television receivers, radios and audio products, blank tape and home computers. A list of the EIA/CEG membership is attached as Appendix A.

This premise is contrary to the reason behind the national trend to protect consumers against gray market imports. Consumer protection offices nationwide are receiving hundreds of complaints from consumers who have been deceived when purchasing gray market products. States and cities have responded to consumer deception through legislative and regulatory action. Legislative or regulatory action to address the gray market problem has been taken in the states of California, Connecticut, Florida, Iowa, New Jersey, New York, and the cities of New York and San Francisco.

At the request of the State Attorney General, the New York State legislature passed, and the Governor signed, legislation which would require sellers of gray market goods to conspicuously warn consumers about the deficiencies of the gray market products they are selling. On December 12, 1985, the state of New York brought its first action against a retailer under the law for failing to inform consumers about the extremely limited warranty available with gray market articles. New York v. Sibley, Lindsey and Curr Co., (N.Y. Sup. Ct. Monroe Co. 10663/85).

In New York City, the Department of Consumer Affairs has proposed a regulation which would rectify the deficiences in the New York State law. The proposed regulation would require city retailers to tag each gray market product with a specific warning.

On May 28, 1986, the California Assembly passed a bill (AB 2735) which would require stringent disclosure by retailers about deficiencies of gray market goods. Under the bill, retailers must disclose if the product does not meet U.S. electrical standards or broadcast frequencies, if manufacturer's rebates do not apply, if replacement parts are not available, if a manufacturer's U.S. warranty does not apply, or if any other incompatibility exists. Disclosure must also be made in advertising and catalog sales. The bill cleared Senate Insurance, Claims & Corporations Committee on July 2, and is expected to be voted on by the Senate Appropriations Committee on August 11.

In San Francisco, the Board of Supervisors unanimously supported during June 1986 a resolution which asks the California Legislature to pass Assembly bill, AB 2735. The Board of Supervisors is also considering a proposal which would require San Francisco retailers to disclose to consumers in four languages the unauthorized import status of the product and the deficiencies it contains.

In Florida, a bill which would allow an action for damages against a retailer who failed to warn purchasers of gray market products cleared both the House Commerce Committee and Subcommittee by unanimous votes. H.B. 1114, as amended, was supported by consumerists as it required strict disclosure of the problems present in gray market sales. Although the bill had strong support, gray market retailers intent on continuing their deception managed to block the bill's passage prior to legislative adjournment.

In Iowa, the state legislature this year considered a bill which would require retail notification to consumers that they are purchasing gray market products. The bill, (HB 2149), modeled after New York State's law, did not pass prior to legislative adjournment.

In Connecticut, on June 10, 1986, the Governor signed a bill into law requiring retailers to disclose to consumers the problems associated with gray market products. This bill was also modeled on the New York State law.

In New Jersey, the State Attorney General on December 2, 1985, proposed a regulation to protect consumers against some of the problems associated with gray market imports. In introducing the proposal, he indicated that "consumers (should be able to) assess..... the economic disadvantages of purchasing gray market merchandise..... (C)lear cut guidelines.... will minimize the potential for unfair competitive advantage in the marketplace." The regulation is pending.

These proposals reflect a clear recognition by state legislatures, regulatory bodies and cities of the real consumer problems caused by gray market imports. They have not been inspired by lobbyists, they have been caused by thousands of complaining ripped-off consumers.

Several editorials and articles have appeared challenging legislators to take action against gray market importers. Consumers have been urged to be wary of gray market importers. Several examples are attached as Appendix B.

The sponsors of S. 2614 have rejected out-of-hand the harmful deception that gray market goods cause consumers. As the legislation seeks to legitimize gray market imports, it is essential that this premise be reexamined.

Given the wave of policy initiatives restricting and regulating gray market sales, it would be irresponsible to ignore the national trend, pretend real problems consumers face do not exist, and hastily pass legislation legitimizing gray market imports.

PROBLEMS CONSUMERS FACE

Consumers across the country are deceived and frustrated when they buy a gray market product only to learn later it is an inferior product which is not backed by a nationally known manufacturer, is not covered by a manufacturer's warranty or rebate program, does not have English language instructions, is not compatible with local electrical currents or broadcast frequencies, cannot be repaired because replacement parts are unavailable in this country, or has one of numerous other potential deficiencies.

Why Consumers Buy Products

The consumer purchasing decision is a combination of price and perceived quality of product. Gray market goods can often be sold at lower cost because the merchandise does not have the quality and characteristics of the authorized product. The perceived quality of the product is based on the brand name reputation. A product's reputation is made through national advertising, word-of-mouth and personal experience.

Gray market prices may sometimes attract a consumer into a store. But rarely does the consumer know he or she is getting a product which is different than the authorized product. When purchasing a product based on brand name, the consumer expects a whole range of services (warranty, replacement parts, service) to be affiliated with that name. Only after being disappointed with a gray market purchase does the consumer learn that the product was not imported through authorized means.

Problems with Gray Market Products

A gray market product may be of inferior quality compared to an authorized product since by definition it was never intended for import into the United States. Many gray market consumer electronics products are outdated models or models never introduced into the United States. These products frequently are distributed without operation manuals or safety instructions, or the manuals or instructions are printed in a foreign language. Replacement parts typically are unavailable for these goods and they may lack accessories usually available in the U.S. market.

Often gray market consumer electronics products fail to comply with Federal Communications Commission requirements for interference rejection or for type certification. Radios designed for the European market not only have different electrical requirements, but they use different frequency bandwidths. European television sets are virtually unusable as the United States uses a different television standard. Products not intended for sale in the United States typically do not meet UL requirements or contain UL listed parts. Consumers have experienced serious problems in using gray market consumer products.

Several consumer electronics manufacturers offer substantial well-advertised rebates and almost all manufacturers offer express warranties. These incentives play an important role in the consumer's purchasing decision. Consumers are usually surprised and upset upon learning that neither rebates nor warranty service are available for a gray market product. Consumers have become increasingly vocal on this issue and have lodged complaints with authorized distributors, the Federal Trade Commission and various state and local government agencies.

The Faulty Pricing Premise

The sponsor of S. 2614 has been attempting to frame the gray market issue in a business context. Supporters of S. 2614 state that a change in the gray market will force U.S. consumers to really suffer, by being forced to pay up to 40 percent more for consumer products, and that product availability will be limited only to major metropolitan areas. But a change in gray market importing procedures does not prevent retailers from charging a lower price for their products. For example, if a system of demarking was implemented, the retailers could continue to sell gray market goods at a reduced price, and the products would continue to be available to consumers in stores across the country.

In fact, gray market imports are focused on industries similar to the consumer electronics industry where markets are highly competitive, and there are a multitude of brands of the same or very similar products. In this extremely competitive environment, prices for products are continually being reduced, without reducing the diverse product selection. Therefore, strict enforcement of United States trademark rights against unauthorized distributors will not result in higher prices to consumers.

Additionally, some gray marketers sell their imported merchandise at the same or higher retail price than that of the legitimate trademarked goods, although they buy the merchandise at substantially less than the normal wholesale price. Frequently, the importer pockets the savings rather than passing them along to the consumer.

S. 2614 is based on the false premise that consumers do not suffer when unknowingly purchasing gray market products. This is contrary to the facts. The states are answering these cries of deception with measures to protect consumers from the harm that gray market goods cause them. S. 2614, which seeks to legalize gray market goods, ignore consumer complaints and perpetuates consumer deception.

The Legislation Ignores the Harm Gray Market Imports Cause Industry

The gray market is a rapidly increasing problem. Within the photography, watch, fragrance, cosmetic, and consumer electronic (audio and video equipment, etc.) industries alone, over $700 million in annual sales is lost to the gray market. Considering all the industries affected by the gray market, dollars lost to unauthorized importers may reach into the billions.

More than five percent of a consumer electronic product's price is estimated to reflect the cost of national advertising and an additional several percentage points, depending on the product, reflect the cost of warranty service. Thus, a gray market importer may have as much as a ten percent price advantage at the outset over an authorized distributor. Clearly, this results in lost sales. The gray market importer has reduced expenses by getting a "free ride" on the national advertising and warranty service which contribute to the name brand quality associated with a product. Further, the gray marketeer does not have to maintain an inventory or build a sales network.

But the dollar volume in lost sales does not come close to revealing the magnitude of the harm. Consumer electronics manufacturers, which include the actual U.S. manufacturer of a product, as well as the authorized American distributor of consumer electronics products, also suffer from a tarnished reputation caused by gray market sales.

The reputation of an authorized distributor suffers. An authorized distributor faces the Hobson's choice of servicing a gray market product which it did not sell and from which it will derive no income, or refusing to service the gray market product and damaging its reputation.

Gray market imports also disrupt manufacturers' marketing plans. For example at least three companies which are authorized American distributors of blank video tape have had rebate programs whereby consumer who purchase their blank tapes can obtain a rebate directly from the distributors. These companies unwillingly faced purchasers of gray market goods who expected a rebate.

It is not only the lost sales of gray market products, the confused customers and injured reputations; but perhaps worse and not subject to quantification, is the lost dealer/distributor network loyalty that the authorized American company has spent years in building. The authorized distributor makes a great investment in the authorized distribution chain which the gray marketeer does not. After spending large sums in warehousing, advertising, service support, credit, dealer service and training, the manufacturer faces gray market imports which entirely undercut the investment in loyalty and service that it has spent time, effort and money to establish.

It is evident that gray market imports disrupt distribution chains, and cause irreparable damage to the distribution network loyalty that fuels the U.S. economy.

The Legislation is Untimely

The regulatory and judicial machinery is moving towards creating a uniform national policy on gray market goods. Until this issue is resolved by the courts and regulators, legislative action or consideration is premature.

The U.S. Court of Appeals for the District of Columbia Circuit recently held that Customs Service rules allowing import of gray market goods violate Federal law. COPIAT v. United States, (D.C. Cir. May 6, 1986). This issue should be subject to Supreme Court review before being subject to Congressional rejection. EIA/CEG notes that it had similarly urged Congressional restraint after the Ninth Circuit Court of Appeals found home videotaping to be illegal and the case was before the Supreme Court for review. The Supreme Court's decision in that case turned out to be appropriate and well-accepted and most now agree that Congress did not need to act.

Legislation is particularly untimely since the Reagan Administration recently solicited public comments on gray market policy options. This marks the first time that the Administration has publicly stated that it is considering positive alternatives to the present Customs Service regulations. Mandatory demarking, is one alternative the Administration is considering which is consistent with the COPIAT opinion, recognizing that trademark owners maintain control over imports of products bearing the registered trademark.

S. 2614 which seeks to legalize gray market imports would directly conflict with the COPIAT decision, and would add greater confusion to the Administration's efforts to establish strong effective regulations to curtail the harm that gray market goods cause the U.S. economy.

CONCLUSION

EIA/CEG commends the subcommittee for openly examining the gray market problem. But EIA/CEG is concerned that the subcommittee will respond only to the cry of "lower prices" while ignoring the complex policy implications accompanying legislative legitimization of gray market imports.

S. 2614 is based entirely on the faulty premise that gray market goods do not hurt consumers. The numerous consumer inspired legislative and regulatory proposals to protect consumers from gray market products obviates the fallacy of this premise. S. 2614 simply ignores the harm that gray market goods cause consumers.

With the recent COPIAT decision and the Administration's request for comments, any legislation is untimely. It is premature for Congress to act on this legislation before the Supreme Court and the Reagan Administration has had the opportunity to explore the depth of the gray market problem and to implement an appropriate uniform policy.

Emergency Committee for American Trade 1211 Connecticut Ave Washington DC 20036 (202)659-5147

July 31, 1986

The Honorable Bob Packwood
Chairman
Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

I am writing to express the opposition of the Emergency Committee for American Trade (ECAT) to S.2614, a bill that would have the effect of legalizing certain "gray market" imports. In our judgment, the arguments advanced by those supporting gray market imports have obscured the fundamental issue of this controversy -- the integrity of trademarks.

A valid trademark on any piece of merchandise is valuable intellectual property. Owners of these trademarks have invested heavily in research, development, and promotional activities to create a demand for these goods. To disregard the integrity of trademarks is to violate one of the basic precepts of the American free-enterprise system.

At present, the focus of the gray market controversy, Section 526 of the Tariff Act of 1930, is the subject of litigation and Executive Branch review. A legislative solution, therefore, appears neither necessary nor timely. At a time when the United States is pressing for inclusion of intellectual property rights in the prospective new round of trade negotiations, it would appear that Congress would be sending the wrong message by approving S.2614, which undermines the integrity of trademarks.

On behalf of our 60 members and the five million employees they represent, we srongly urge you to oppose passage of S.2614.

Sincerely,

Robert L. McNeill

Robert L. McNeill
Executive Vice Chairman

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CABLE ADDRESSES
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"LALAW" LOS ANGELES
"DIEGOLAW" SAN DIEGO
"EURLAW" PARIS
"UBLAW" LONDON

August 15, 1986

BY HAND

Ms. Betty Sue Scott-Boom
Legislative Assistant
Committee on Finance
Subcommittee on International Trade
219 Dirksen Senate Office Building
Washington, D.C. 20510

Re: S. 2614: Price Competitive Products Act

Dear Ms. Scott-Boom:

Enclosed are five copies of a statement by Mr. John Roehling, President of the Equipment Company of Los Angeles (ECOLA), in support of S. 2614, the Price Competitive Products Act, which we would like to submit for the Subcommittee's hearing record.

We very much appreciate your willingness to keep the hearing record open until this date. Thank you.

Sincerely,

Nina Bang-Jensen

Nina Bang-Jensen

Enclosures

My name is John Roehling and I am President of the Equipment Company of Los Angeles ("ECOLA"), an importer and dealer of forklift trucks. I would like to voice our company's strong support for S. 2614.

As a former authorized dealer for a foreign manufacturer of forklifts and now an independent distributor of identical forklifts made by the same manufacturer, ECOLA's experience provides, we believe, important evidence of both discriminatory pricing in the U.S. by foreign manufacturers and the tremendous pro-competitive effect of so-called "gray market" imports.

The forklifts that ECOLA sells are imported from Asia, usually Japan, and include Toyota, TCM, Nissan, Komatsu and Mitsubishi vehicles. From 1981-1983, ECOLA was an authorized dealer for TCM, a Japanese manufacturer of forklifts. ECOLA relinquished its authorized dealership in 1983, however, when it realized that identical TCM forklifts were being sold in other countries for less than half of TCM's suggested list price for forklifts in the United States. ECOLA and other U.S. companies, therefore, began importing TCM forklifts directly from other countries at substantial savings.

The impact on the U.S. market has been tremendous. Forklifts are now being sold in the U.S. at approximately half what they sold for six years ago. In 1980, the authorized dealer invoices for Toyota, TCM, Nissan, Komatsu and Mitsubishi forklifts were approximately $15,000 per unit and the suggested list prices were around $20,000 per unit. Yet, by importing those forklifts directly, ECOLA is now able to sell them for approximately $10,000 apiece. While the authorized dealers have had to slash their prices by almost one half in order to compete, we are still underpricing them. Not surprisingly, dealers are selling more forklifts than ever before and many of those sales are to customers who might not have been able to afford them previously.

Opponents of S. 2614 have been vocal in alleging that the products sold by independent, unauthorized distributors such as ECOLA are deficient. The forklifts we are selling are, however, identical to those sold by the authorized dealers. I have attached a copy of a report by the engineering firm of Kick-Craig Associates of Sante Fe Springs, California which examined the imported forklifts sold by ECOLA as well as those of the authorized dealers. The report confirmed that the products are identical (Attachment A). The forklifts we sell, therefore, meet the same health and safety regulations as those sold by authorized dealers. A copy of a certificate from the State of California's Occupational Safety and Health Administration affirming that is attached (Attachment B). Indeed, by offering forklifts for sale at such substantial savings, we believe that some of our customers who previously made do with obsolete and unsafe forklifts are now able to buy new, safer equipment. If there is a health and safety issue, as some opponents of S. 2614 claim, we are on the right side of it.

Opponents of S. 2614 have also tried to make much of the fact that those who purchase products from unauthorized dealers are not able to obtain a manufacturer's warranty. ECOLA provides its customers with its own parts and labor warranty. Our customers properly feel that our warranty provides them with sufficiently broad protection. A copy of our warranty is attached (Attachment C).

Our customers, who range from small sole proprietorships to state agencies to school districts to giants like the Hughes Tool Company, are well aware that they are not purchasing forklifts from an authorized distributor and that they are not receiving a manufacturer's warranty. If Congress or the Customs Service thinks it necessary to provide more formal notice to our customers by, for example, affixing a label to the forklifts to that effect, we have no strong objection to doing so.

On the other hand, proposals for "demarking" (i.e., removing) trademarks in order to indicate that the product is not being sold by the holders of the U.S. trademark are entirely impracticable and unjustified. For example, on the Toyota forklifts, Toyota's name has been cast into the vehicle's counterweights (the massive piece at the back of the forklift which keeps the vehicle balanced) in four-inch high letters. In addition, the name Toyota appears on the engine cover in 2- or 3-inch high letters that have been perforated into the surface by a metal punch process. The only way to remove the trademark from the products, therefore, would be to fill in the letters on the counterweight somehow and remove the perforations from the engine cover. Such an expensive defacing of the product is neither practicable or justified. The forklifts we sell are identical to the forklifts sold by authorized dealers. They are not lesser products; they are the same products.

S.2614's detractors also contend that independent distributors who import gray market goods are "free-riding" on good-will and name-recognition carefully cultivated by the authorized dealers through advertising. In fact, however, ECOLA probably spends fifty times more on advertising than the average authorized forklift dealers. Typically, the authorized dealers confine their advertising to the yellow pages of the telephone book and occasional advertisements in trade journals. ECOLA, on the other hand, engages in direct mail solicitations and advertises regularly in major newspapers as well as trade journals and trade newspapers.

The gray market in forklifts developed solely because foreign manufacturers were selling their products in the U.S. at vastly inflated prices relative to their prices elsewhere. If the authorized distributors have a complaint against anyone it should be against the manufacturers in Japan and elsewhere who charge their distributors in the U.S. substantially more than their distributors in other countries for the same product. Such discriminatory pricing practices penalize U.S. businesses twice. First, they must pay exorbitant prices for forklifts and then they must compete against foreign manufacturers who are able to buy the same forklifts at half the price in their own countries.

We support S. 2614 which incorporates existing Customs Service regulations and practice because it will end the uncertainty caused by recent conflicting decisions in the Circuit Courts. As you can well imagine, it is unsettling to discover that a practice one has engaged in with the full knowledge and approval of the U.S. government has been struck down by some courts and affirmed by others. Passage of S. 2614 would provide much needed certainty and allow us to continue to provide U.S. businesses with forklifts at prices that are competitive with those paid by their competitors in other countries.

Thank you.

FÉDÉRATION INTERNATIONALE
des
Industries et du Commerce en Gros
des Vins
Spiritueux, Eaux-de-vie et Liqueurs
F.I.V.S.

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29th F

SUBMISSION TO :-
INTERNATIONAL TRADE SUB-COMMITTEE,
SENATE FINANCE COMMITTEE.

11th August, 1986.

RE: HEARING ON GRAY MARKET GOODS

I have the honour to submit as President of the International Federation of Wines & Spirits (F.I.V.S.) which was founded in 1951 and has its headquarters in Paris serving worldwide membership of Wine & Spirit Associations dedicated to improving the quality and trading conditions of wines and spirits internationally. With regard to the current debate on the "gray market" which is generally referred to as "parallel trading" elsewhere, I wish to make a few fundamental points :-

1. The alcoholic beverage industry generally and the wine and spirit industries in particular, have characteristics which make them totally different from most other industries such as those of perfumery or pharmaceutics. Analogies with other industries, therefore, should be made with caution.

2. It is irrelevant to-day to draw comparisons between U.S. legislation and that of other countries or within the EEC because local conditions are totally different. It is important to note that the EEC is still a very youthful and immature Body which adopted draconian measures to speed up the improvement towards unity among Member States. EEC officialdom therefore favoured internal parallel trading between Member States.

3. It is important to distinguish international trade from internal trade.

4. International export trade to and from the U.S. can be developed only by high investment in advertising and promotion of high quality brands but the proprietors of well known brands see "gray" or "parallel" trading as one of the most serious threats to their long-term investment. They feel that officialdom should devote much more time to deeper understanding of the fundamentals of to-day's international trading conditions.

5. Indiscriminate international parallel trading in wines and spirits will surely result in the destruction of the high standing of the world's most renowned international brands. To avoid such destruction, producers and brand owners would have to remove their brands from many markets in order to prevent them being passed on to other markets.

6. Such a situation would create serious impediments to exporters of famous U.S. brands of wines and spirits.

7. It is important to appreciate that trading conditions and regulations and taxation vary greatly throughout the world. Exporters simply must accommodate themselves to local conditions if they are to succeed at all. For instance, they must charge lower prices to markets which are protected by high ad valorem import duties and invite their importers to shoulder the burden of advertising and promotional expenses.

8. Conditions outside their control, therefore, often compel exporters to adopt different prices in different markets throughout the world if they are to be competitive.

9. Such attempts to surmount contrasting market conditions are frustrated when parallel/gray traders are permitted to take advantage not only of these differences but also to take advantage of the long-term world wide investment made by the proprietors of international brands.

10. It is therefore essential that parallel/gray trading should not be condoned or be regarded as an international virtue and that the greatest dangers of parallel/gray trading be removed.

11. The aim of our Federation is to encourage freer trade in wines and spirits through the removal of tariff and non-tariff barriers. Only when barriers are removed and trading conditions internationally are identical to a domestic market will there be a climate which will justify parallel/gray trading.

12. These comments do not cover many other important considerations such as the difficulties of monitoring fraudulent goods, protecting consumers from incorrect labelling and the use of colouring matters and flavouring, all of which await international harmonization. Until that time arrives, the problems of supervising unapproved imports into the U.S. would appear to be insurmountable.

13. The wine and spirit trade throughout the world has admired U.S. legislation as an improver of the climate in world trade for wines and spirits. We are therefore distressed at the prospect of any removal of this good example since everyone would suffer except for a few profiteers who would take advantage of the investment made by truly international exporters of high quality brands.

Cordially yours,

Aleck Crichton

ALECK C. CRICHTON,
President.

IRISH WHISKEY DISTILLERS ASSOCIATION

Telephone 725566
Telex 25455

Bow Street Distillery,
Smithfield,
Dublin 7.

12th August 1986

Committee on Finance
Washington DC 20510
United States of America

RE: UNITED STATES OF AMERICA - PARALLEL IMPORTS

Dear Sirs

The Irish Whiskey Distillers Association, which represents the producers of Irish Whiskey, believes that the form of parallel trade currently carried on in the United States in relation to alcoholic beverages is, ultimately, not in the best interests of consumers, producers or distributors.

From the producer's point of view, the damage inflicted by parallel trade on marketing strategies can be substantial. In the case of alcoholic beverages, interbrand competition is intense and requires considerable advertising and promotional expenditure on building brand names. These are legitimate costs which must be reflected in the price of the products. The parallel trader derives maximum benefit from this expenditure, without contributing to the costs involved.

Parallel trade undermines the system of exclusive distributorship which is necessary for the successful marketing of major international brands.

Because of the distortions to trade caused by widely divergent levels of taxation on alcoholic beverages throughout the world, producers are forced to develop specific marketing strategies for different markets. This becomes impossible when parallel trade is widespread and the task of developing sales of a brand in highly competitive markets becomes even more formidable.

From the consumer's point of view, parallel traders have, on occasions, been casual in complying with legislation which was designed for consumer protection. For example, in order to satisfy US labelling legislation, the parallel importer of goods into the United States is usually obliged to alter the original label on the products or attach an additional label to the products. Apart from any interference with the Trade Mark, this can create substantial consumer confusion and, in some cases, deception. For instance, we are aware that the labels on a consignment of Jameson Irish Whiskey, which was imported into Alaska, were altered to read:-

"Produce of Scotland . Blended Scotch."

Furthermore, as different labels are used for different markets, frequently the labels on the products which are paralleled do not meet the requirements of the Bureau of Alcohol, Tobacco and Firearms. For example the back label for Jameson Irish Whiskey contains the legend:-

"Your appreciation of its quality is guaranteed"

Such a guarantee might infringe the Bureau of Alcohol, Tobacco and Firearms prohibition against offering guarantees other than enforceable money back guarantees.

It should also be noted that, where parallel trade is widespread, the ability of a producer to organise a product recall may be substantially impaired, since the identity of the person or persons from whom the parallel importer purchased the product may be difficult, or even impossible, to establish.

In addition, the increase in parallel trade may, in turn, lead to the risk of an upsurge in the production of counterfeit goods. The parallel importer's ignorance of the source of the products which are being purchased may preclude the parallel importer from inquiring closely into their authenticity.

For these reasons, we would urge you to take action to prevent the spread of parallel trade in alcoholic beverages into the United States of America. The Association would like to file a more detailed submission with the Committee shortly.

Yours sincerely

CARL O'SULLIVAN

THE GIN RECTIFIERS AND DISTILLERS ASSOCIATION

DIRECTOR
MAJOR-GENERAL W.F. COOPER

37 WATERFORD HOUSE
110 KENSINGTON PARK ROAD
LONDON W11 2PJ
TEL: 01-229 9222

The International Trade Subcommittee
Committee on Finance
United States Senate

7 August 1986

Gentlemen,

1. Our two Associations, which represent the producers of Gin and Vodka in Great Britain, and whose prodcuts are exported to the United States in considerable quantity, wish to record our oppostion to S. 2614. The reasons for our opposition are set out below in as brief a form as we can manage.

<u>The Preamble to S. 2614</u>

2. In respect of our products some of the statements made in the preamble to S. 2614 are inaccurate and misleading. Examples are:-

   a. Parallel imports are not always identical to the products specifically made for the US market. (See paragraph 3 below)

   b. Parallel traders have no firm responsibility for the promotion and long term interest of the brand, and there is no doubt that they can, and do, free-ride on the promotional costs of appointed distributors. Nor do they offer the same pre- or post-sale services (see paragraph 9 and 10 below)

   c. The appointed distributors are by no means always subsidiaries of the manufacturers of the product

   d. In the field of imported white spirits the charge that foreign producers are exploiting the US consumer is not correct (see paragraph 12 below)

The Maintenance of Quality Standards

3. Those Gins of British origin which have established world-wide markets have done so because of a reputation for high quality. (The same can be said for British Vodka although exports are very much smaller than those for Gin: only one top-grade British Vodka is exported to the US). This standard of quality is only maintained as a result of tight control by the producer, who works under certain restraints:-

   a. Some countries, notably the USA, sot clear Standards of Identity which must be met. In the USA a registered methold of distillation has to be lodged with BATF

   b. Certain other, third world, countries set their trade barriers so high that it is only possible to trade there by producing under licence in those countries - perhaps using molasses or wine spirit, whereas only cereal spirit is acceptable in the USA

   c. Even within the same plant different formulae may be used for different export markets to conform to the regulations or consumer taste in those markets

4. None of the variations listed at 3 a. b. & c. affects the basic quality of the product, but if parallel importing continues unabated it is easy to see how goods destined for one market may be diverted to the USA where they would not conform to the strict standards of content and distillation methods which apply there. The producer would be quite unable to exercise any control over the export of his product to the USA and could accept no responsibility for any deviation from the laid-down US specifications. The only way in which he can exercise these responsibilities is through his authorised distributor.

5. What was said in paragraph 4 applies to genuine top-quality Gin marketed in the USA by parallel importers. There are other dangers. The routes taken by parallel importers are often long and tortuous. They can lead trough third world countries, back to Europe and thence to the USA, and they can lead from Western Europe through Iron Curtain countries to the USA. The point is that the goods can be outside any conventional form of control for long periods. They are bought by parallel importers from entrepreneurial traders in Europe, the third world or the Eastern Bloc who have no interest at all in the brand, nor responsibility for it. Such a system invites counterfeiting and this has already occurred in parallel imports in Europe and Japan, with Scotch Whisky the main sufferer.

6. The temptation to cheat, by adulteration or labelling frauds, is always strong in the case of high quality, high price goods. Our contention is that the more the parallel trade is permitted to expand the greater will be the temptation and the opportunity for unscrupulous traders to counterfeit. Such counterfeiting is hard to detect and even harder to police. Within the USA the authorised distributors have a duty to police counterfeit labels but their task becomes truly Herculean if parallel imports are increased. They could well be faced with, genuine labels on goods distributed by them AND different labels on genuine Gin or Vodka on the gray market (producers are forced to use differing labels to cater for the vagaries of different markets). As if this were not enough they could well be faced with counterfeit labels on genuine products imported via the gray market (and the product could be perfectly genuine without conforming exactly to US Standards of Identity, see paragraphs 3 and 4). There are also labels on goods already on the gray market which have been defaced or mutilated in ways which may be legal but which make it extremely difficult for even the producer to identify the origin of the goods. Finally there is the possibility of counterfeit goods.

Suggested Cost Savings through Parallel Imports

7. Much has been made of the potential savings to the US consumer which would accrue if S. 2614 were adopted. We can only speak for our own industry where the case for parallel importing has been forcibly (and sometimes amusingly) put by the representatives of the Washington State Liquor Control Board and All Planet Exports Ltd and Exacto Etablissement. We have carefully read their evidence and feel strongly that the whole story has not been told.

8. The authorised distributors are responsible for the advertising and promotion of the brands they distribute, and their charges reflect this fact. All Planet Exports Ltd make much of their proposals to advertise brands and the refusal of their offers from nine out of fourteen producers. What else could they possibly have expected when they were asking companies to default on long standing agreements with their authorised distributors? The righteous indignation rings false.

9. Similarly, the explanation of the parallel importer's costs on pages 2 and 3 of All Planet Exports Ltd testimony can only come out in the manner shown there - that is, with an eventual profit to the parallel importer - because the advertising and promotional costs for the brand in the United States are being carried by the authorised distributor. Without the expensive promotion of a brand, in all sorts of ways and consistently over many years, a brand can have no nationwide recognition and will have small chance of success. Only as a result of this long term work does a brand become attractive to the gray market.

10. Parallel importers can take advantage of the work and investment of others in the short term, but experience of markets where there has been much parallel importing (Europe and Japan, and the example is taken from Scotch Whisky) is that brands most affected lose market share. This is because promotion and non-price competition is reduced and parallel traders have made offers they cannot fulfill, causing doubts in other traders' minds on availability of the brand. If parallel importers were to pay promotional and advertising costs their prices would be bound to increase after a short period, but there is no compelling reason for them to meet such costs since, by the very nature of their trade, they cannot commit themselves to brand loyalty.

11. In the testimony of the Washington State Liquor Control Board tables are given showing big differentials between the prices charged by authorised importers to Washington State on the one hand and to Canadian Liquor Boards on the other. These differences are created mainly because of the totally different structure of the two markets. In Canada, by law, British distillers are bound to supply directly to the liquor boards, whereas in the United States they respect the special structure of the market which was set up after Prohibition to protect the US consumer. The Washington State Liquor Control Board is not, in fact, comparing like with like, and nor is All Planet Exports Ltd.

12. The differences in prices charged by the British distillers from market to market are relatively small, and derive largely from currency fluctuations. The main part of the differential quoted by the Washington State Liquor Board results from the internal structure of the US market.

Conclusions

13. The main differences in the costs quoted by All Planet Exports Ltd and the Washington State Liquor Board do not originate as a result of British Gin and Vodka distillers varying prices between markets.

14. The British Gin and Vodka producers are unable to accept any responsibility or liability for goods purporting to be of their manufacture and imported on the gray market.

15. The British Gin and Vodka distillers do not believe that the US consumer will benefit in the long term from the gray market. They consider that the existing structure of the market provides sensible control for the sale of alcoholic beverages and helps to ensure the continued protection of the consumer.

Respectively submitted,

W F Cooper

W F COOPER
Director

Statement of the Industrial Truck Association: S.2614

The Industrial Truck Association ("ITA"), on behalf of its member-companies, is pleased to submit these comments concerning S.2614 presently under consideration by the International Trade Subcommittee of the Senate Finance Committee. While understanding the Subcommittee's time constraints, ITA regrets that its request to testify about the proposed legislation was not granted and hopes that the comments herein receive the Subcommittee's careful consideration. After a brief explanation of ITA's membership and interest in S.2614, we offer our views against the legislation as proposed.

ITA is the national trade association representing domestic and foreign manufacturers of industrial forklift trucks and of component parts for forklift trucks. Established in 1951, ITA today has 23 regular members and 20 associate members. Nearly one-half of the Association's regular members are foreign manufacturers, distributing their forklift trucks through authorized dealers and distributors. Finally, it is important for the Subcommittee to know that ITA is the principal initiator and developer of voluntary safety standards for forklift trucks sold in this country.

The effect of S.2614 would be to give Congressional blessing to the importation of foreign-manufactured products which were never intended for the U.S. market, and which are sold here without the manufacturer's supervision. approval, or even knowledge. In ITA's view, the repercussions of this policy when applied to forklift trucks and other types of complex industrial equipment have not been adequately considered by the Subcommittee.

From ITA's review of the oral and written testimony submitted thus far to the Subcommittee, it appears that the focus of attention has been on so-called "consumer" items: watches, perfumes, champagne and the like. Indeed, these are the three products that Senator Chafee used as examples in his statement in support of the legislation. The roster of witnesses also bespeaks a preoccupation with these and other mass-consumption articles of trade.

Perhaps not surprisingly, both those for and those against the gray market invoke the welfare of the consumer in support of their positions: gray market proponents cite the benefit to the consumer of less expensive trademarked merchandise, while gray market antagonists warn of consumer deception, lack of adequate warranty service, and other ills. ITA, in opposing S.2614, would like to address the safety, rather then the pocketbook, of the American worker.

Unlike wristwatches, perfume or champagne, industrial forklift trucks, along with innumerable other articles of heavy industrial equipment, present a host of safety issues in their design, manufacture and use. But with the exception of the National Highway Transportation Safety Administration's comprehensive authority over automobile safety, there is no federal regulatory body charged with ensuring the safety of such equipment at the point of manufacture or distribution. Nor do the states have such regulatory bodies. In fact, the only federal regulatory agency whose charter is to ensure product safety at the point of manufacture and distribution is the Consumer Product Safety Commission, a relatively low-funded agency with jurisdiction only over "consumer products," not major industrial equipment.

The absence of a pervasive federal agency in the field does not, however, mean that there are no societal influences advancing the safe design of industrial machinery. At least as to industrial forklift trucks, we can identify three major driving forces that help to ensure the safety of the equipment. One major safety influence is the industry itself, through its development of voluntary safety standards for the products its members sell. Equally important is the Occupational Safety and Health Administration ("OSHA"), which regulates the safety of forklift trucks, not at the point of manufacture or distribution, but in the workplace. Finally, there is the twin threat of products liability losses and out-of-control insurance costs. In ITA's view, these are the primary influences that serve to drive and shape the safe design and operation of industrial forklift trucks. In fact, it is probably fair to say that these are the key propellers of safety for the great majority of industrial equipment used in this country.

ITA's point is that none of these influences operates in a vacuum. Each is dependent for its effectiveness upon the web of relationships, customs and understandings that develop among a manufacturer, its authorized distributors, and its customers. A manufacturer who sells an unsafe forklift truck will not be fined or otherwise penalized by the government -- the government has never defined a "safe" forklift truck in the first place. But the manufacturer of an unsafe product may lose customers who have OSHA problems, or may suffer product liability losses as a result of failing to meet safety standards that it participated in developing. Although complex and variable, these safety-enhancing influences are real and, we submit, effective. The Subcommittee must carefully consider how those influences will operate -- or fail to operate -- if Congress sanctions an unfettered gray market in this type of equipment.

For over 30 years, ITA's General Engineering Committee has been deeply involved in the initiation and development of safety standards known as "Recommended Practices." ITA's

Recommended Practices Manual now comprises several hundred pages and addresses all of the major aspects of lift truck safety, including: rated lifting capacity, stability, brakes, tires and wheels, operator controls for travel and lifting, steering, power systems, operator protection devices, visibility, and emissions. As stated in the Foreword of the Recommended Practices Manual, the development of Recommended Practices "is a dynamic field in which new ideas and developments are constantly being sought and achieved." After a particular Recommended Practice has been approved by ITA's Board of Directors, it is typically forwarded to nationally known standards-making groups for possible inclusion in their compendia of standards. The American National Standards Institute ("ANSI") and Underwriters Laboratories are the two principal safety-standard bodies that incorporate ITA Recommended Practices.

Over the decades, ITA's standards work has been the most important and resource-intensive of all the Association's activities. The members of ITA's General Engineering Committee constitute an elite group of industry experts, unquestionably the country's most knowledgeable group of engineers concerning safety requirements for forklift trucks. Engineering representatives from ITA's foreign members, including large Swedish, Canadian and Japanese firms, have long participated fully in the General Engineering Committee's deliberations and actions.

Indeed, knowledge about and participation in U.S. safety standards-writing is every bit as important to ITA's foreign manufacturers as it is to their U.S. counterparts. The United States is an exceedingly important market for these foreign companies. They have a vested interest, just as U.S.-based manufacturers have a vested interest, in ensuring that their products comply with all applicable U.S. safety standards.

ITA would have little concern if foreign standards were the same as, or at least as stringent as, U.S. standards. They are not. It is impossible to catalogue all of the differences between U.S. and foreign standards for forklift trucks because foreign standards themselves vary greatly from continent to continent and country to country. But to take one example, the standard promulgated by the International Standards Organization for the structural integrity of overhead guards on lift trucks, which are intended to protect the operator from the hazard of falling objects, is significantly less stringent then the ANSI requirement. In addition, the Underwriters Laboratories electrical requirements addressing the risk of fire hazards are not imposed outside the U.S., nor are visibility requirements as comprehensive abroad as they are in this country. These are but a few examples of how a gray market lift truck, perfectly suitable for sale in the country of origin or country of destination, will fail to meet the minimum U.S. requirements. And there are many other situations where a particular design is not necessarily inherently safer, but custom and familiarity have rendered the design safer for this market. Warning symbols and conventions as to the movement of operating controls are examples of this problem. An important aspect of developing material safety standards is simply to achieve some uniformity so that machine operators are not threatened by completely unfamiliar equipment.

ITA fears that gray marketeers will not concern themselves with these important issues. A foreign manufacturer of forklift trucks has an important stake in its U.S. customers' satisfaction, and deliberately designs for the U.S. market based upon marketing research, participation in U.S. industry groups, and the normal give-and-take that full industry participants inevitably share. Unfortunately, the gray marketeer has neither the incentive, the information, nor the wherewithal necessary to conform to U.S. standards. Even if the unauthorized importer of lift trucks were willing to slash his profit margin by making expenditures to bring the equipment into conformity with U.S. specifications (an assumption in which only the naive will indulge), he would nonetheless be helpless to implement the corrections, having neither the knowledge nor the facilities to do so.

ITA urges the Subcommittee not to disregard the important safety differences between a forklift truck intended for sale in the U.S. and one which arrives here surreptitiously via the gray market. The industry's voluntary safety standards largely account for those differences, but such activities have little or no effect on the unauthorized distributor.

Occupational Safety and Health Administration

The same essential point is true as to OSHA. While OSHA does not directly regulate the manufacture or distribution of products, its jurisdiction over safety in the workplace makes the agency a formidable force in determining safe product design as to countless types of equipment. The vast majority of industrial lift trucks are used in businesses that fall under OSHA's broad jurisdiction, and manufacturers for the U.S. market have no choice but to heed OSHA's views. Customers demand equipment that will pass OSHA inspection, and they look immediately to the manufacturer when OSHA problems arise.

As with voluntary safety standards, understanding and keeping pace with OSHA requirements virtually demands an ongoing presence in the United States market. ITA's foreign members are as attuned to OSHA regulations, interpretations and field activities as are the Association's domestic members. Gray marketeers are not. Their transience and lack of any relationship with the product manufacturer render it impossible for them to match the commitment of the manufacturer and its authorized distributor.

Of course, if the Subcommittee were confident that noncomplying gray market equipment would be ferreted out and made to conform to U.S. requirements, the safety issue would not loom so large. But there is no such assurance. There is no point - of-entry inspection, no first-sale inspection, and no inspection on subsequent sale -- OSHA inspects only at the worksite. Even then, the prospects of discovering a non-complying gray market forklift among a fleet of manufacturer-authorized forklifts are slim, particularly if the nonconformance is not readily observable.

This is not to say that a foreign manufacturer, or a domestic manufacturer for that matter, could not succeed in selling noncomplying vehicles that might escape OSHA's detection. But any manufacturer that depends on the U.S. market risks ruining customer relations if its products cause OSHA to issue citations against the customer. In contrast, while some gray marketeers may have "customer relations" of a fashion, many do not, and none have the on-going relationships that enable a manufacturer to understand and satisfy its customers' needs regarding complex industrial equipment.

It is an important responsibility of a foreign manufacturer's authorized dealer or distributor to act as the interface between the customer and the manufacturer. An authorized U.S. distributor has sufficient stake in the U.S. lift truck market to communicate the user's changing needs to the manufacturer and generally to understand the market. But there is no one to perform these functions in the gray market. This lack of involvement is all the more disturbing when one considers the multitude of state agencies, paralleling OSHA, that regulate the safety of workplace equipment. A particular forklift truck may be suitable for sale in New York, but require modification to pass state-agency inspection in California. It is challenging enough for foreign manufacturers and their long-standing authorized dealers to master these overlapping and sometimes contradictory state regulatory schemes. The Subcommittee may rest assured that a transient gray market dealer, interested more in a ready profit than in increasing market share and generating business good will, will not even attempt the task.

A case in point, recently settled in federal court in California, demonstrates that ITA's concerns are hardly idle ones. In United States v. 119 Forklifts, No. CV86-2632-HLH (Bx) (C.D. Calif., July 1, 1986), U.S. Customs constructively seized 119 forklift trucks imported by a gray marketeer, Equipment Company of Los Angeles ("ECOLA"). The manufacturer's serial numbers had been altered apparently in an attempt by foreign distributors to evade certain territorial marketing restrictions overseas. The seized lift trucks met neither Federal OSHA regulations nor applicable ANSI standards. Nor did they meet

California OSHA regulations. The U.S. District Court for the Central District of California conditioned settlement of the case and return of the lift trucks on the express requirements that they be certified by an independent expert as being in compliance with Federal and California OSHA regulations and all applicable ANSI requirements. The court retained continuing jurisdiction over the case for the purpose of enforcing the settlement provisions.

This case is proof positive that the gray marketeer will heed neither voluntary industry standards nor federal regulations in making sales in this country. Of course, a noncomplying lift truck is no less unsafe just because its serial number may be intact. But the California case merely confirms common sense, i.e., those without incentive to meet safety requirements will not do so voluntarily.

Product Liability

The third major societal influence toward safer product design is this country's tort system. ITA need not educate the Subcommittee about the overwhelming influence of United States product liability law on manufacturing decisions today. It is no hyperbole to say that, in many cases, design decisions are being made by judges and juries. Of course, the chaos in the insurance industry nationwide has deeply affected product liability insurance premiums. Whatever the real causes of the national insurance crisis, product liability insurers routinely cite the trend in the number and size of jury awards to justify several-fold premium increases.

Nor is it any secret that the product liability law of the United States is vastly different from that of the rest of the world. Foreign manufacturers, often through their authorized distributors, follow product liability developments in this country in order to avoid liability in the U.S. courts. A design considered satisfactory abroad may well be held to be defective under American principles of strict liability. Given the extent to which litigation defines the adequacy of a machine's design or construction in this country, it is important that manufacturers of equipment intended for the U.S. market stay abreast of legal developments. Thus, if the foreign manufacturer never intended that a particular product be sold in the U.S., its design and construction may be wholly inappropriate for use here.

Of course, product liability is a state law matter, and state laws vary considerably. As with state-agency regulation, manufacturers and their distributors need to be aware of these differences. For example, different warranties may attach to a piece of equipment, or different disclosures may be required, depending upon the state in which the equipment is sold. Unauthorized distributors will not concern themselves with these nuances, because they are not likely to be the ones paying the judgments.

The Subcommittee must also consider an increasingly important aspect of product liability that would be greatly and adversely affected by Congressional endorsement of the gray market. That is the matter of post-sale recall campaigns conducted by manufacturers to correct known safety problems on equipment in use. More and more product manufacturers are implementing recall campaigns, partly as a result of pressure from the courts. The U.S. Consumer Product Safety Commission (which does not have jurisdiction over industrial lift trucks) is one federal agency that has specific statutory power to order the recall and repair of dangerous products. But even without government compulsion, many companies initiate these programs to redress serious safety problems that are discovered after sale.

These manufacturer-initiated recall and service programs depend for their success on the ability to trace and locate products and customers. Without that ability, the chances of finding and correcting a particular unit are haphazard and exceedingly slim. Thus, manufacturers need to be able to trace the distribution of their products through the channels of commerce to find and notify the present owners. This will challenge even the best record-keeping manufacturers where there have been multiple transfers of a product. Certainly no recall program is ever 100% effective. But when the first U.S. sale is made without the manufacturer's knowledge by an unauthorized distributor, the task becomes virtually impossible. Press releases and trade publication advertising are never a substitute for personal notification to identified users. In short, an extensive gray market effectively destroys a manufacturer's ability to conduct adequate safety recall campaigns. This alone should give the Subcommittee considerable pause.

Concluding Remarks

ITA is familiar and sympathetic with the points made by those consumer-goods manufacturers who oppose S.2614. The issues of consumer deception, deterioration of merchandise, and inadequacy of warranties are serious and cannot be lightly dismissed. ITA also agrees with the philosophical proposition that the gray market removes or greatly diminishes the value of a trademark right, and questions the sincerity of those who deny any "free-rider" problem.

But rather than repeating those points, ITA has chosen to emphasize the important safety issues that have been all but ignored in the testimony to date. There is nothing philosophical about this issue -- it takes only a minimal appreciation of how safer machines come into being in this country to realize that the gray marketeer is simply out of the loop. Unfamiliar heavy equipment, never intended to be sold to U.S. users, is dangerous.

Regardless of how the Subcommittee resolves the competing interests of the public when it comes to everyday consumer items, the effect of the gray market on the safety of industrial equipment must be reckoned with.

ITA appreciates this opportunity to state its views in opposition to S.2614.

8th AUGUST 1986

TESTIMONY TO THE UNITED STATES SENATE

CONCERNING GRAY MARKET GOODS BILL S2614

BY:

The Irish Cream Liqueurs Association, composed of;

R & A Bailey & Co. Ltd.
T.J. Carolan & Co. Ltd.
R.J. Emmett & Co. Ltd.
Irish Distillers Group Ltd.

who wish to express their views, opposing those set out in S2614, as they believe that Gray Marketing is detrimental to the interest of U.S. consumers because;

a. It endangers the quality of product entering U.S. distribution channels and thereby offers a potential threat to the health of U.S. consumers

b. It reduces free competition and consumer choice, and might very well lead to higher retail prices, and results in unfair competition, and eventually loss of jobs, in smaller retailers.

c. It encourages the production of counterfeit product

d. It encourages unfair trade practice, eminating from Eastern Bloc countries

e. Economic Competition

Gray Marketeers do not contribute fairly to the real costs of giving the trade a full service, nor do they support the promotion of products.

f. Gray Marketeers are not subject to the controls imposed by Governments to ensure that the distribution of alcohol is in the hands of responsible people within authorised Distribution channels.

g. It is at variance with Trade Mark law.

(a) QUALITY AND CONSUMER PROTECTION

The quality of the product is frequently reduced in standard when not handled through authorised channels.

Because Irish Creams have a limited shelf-life, it is essential to continuously ship fresh stocks to markets, and to control and monitor rotations in a fully organised manner. Because of the buying methods of Gray marketers, product outside its desired age specification frequently appears through these unauthorised channels.

Because of the delicate nature of the product, and its sensitivity to temperature change, it is essential that it is shipped to markets with a wide variety of climates, such as experienced in the United States, in temperature controlled containers. This is not done by Gray marketers as there is a cost penalty.

In order to ensure that product is properly rotated in warehouse, and supplied to retailers, Baileys apply special codes and colour coding systems to U.S. stock, to ensure that this can happen. This facility is not available to Gray marketers who do not work directly with the product manufacturer.

Legal requirements on ingredients vary from market to market. Baileys in the U.S. is specially formulated to comply with BATF requirements on vanilla and nature-identical vanillin. Stock available to gray market does not comply with such requirements.

(b) FREE COMPETITION

Marketing of Baileys through authorised distribution systems ensures that a fair and equitable price is offered to all retailers equally, allowing for their ability to buy volume and thereby gain quantity discounts. This ensures the correct service to consumers in terms of availability at a fair price, whether in large or small stores, and in all parts of the country.

In contrast, Gray marketeers offer low prices to a highly select and small number of price-cutters by ignoring the needs of the smaller retailer, thereby creating unfair price competition, and reducing consumer choice. The development of Gray marketeers gives an unfair advantage to major outlets, and threatens the survival of the mom-and-pop store, creating a retail monopoly of supply.

This practice also results in reduction of consumer choice, as many of the larger outlets are only interested in the largest and fastest-selling brands. Equally, the Gray Marketeers are only interested in purchasing these large brands which results in the inability of smaller brands to compete effectively, thereby reducing consumer choice.

(c) COUNTERFEITING

Because no direct link exists between the Gray Marketeers and the product manufacturer, there is a distinct risk of interference with the labelling and packaging of products, and in the most extreme cases, with the product itself. In a number of instances this has been proved to promote the counterfeiting of international products.

(d) EASTERN BLOC PURCHASES

Several of these counterfeit products have come from Eastern Bloc markets, interested in undermining the success of free enterprise corporations, and taking a short-term profit. Because of the pressures on Gray Marketeers to maintain supplies, and the difficulty they have in obtaining them, there has in the past proved to be a temptation to them to obtain supplies through these channels.

(e) ECONOMIC COMPETITION

Price is not the only area of competitive activity. Authorised distributor systems ensure that non-price inter-brand competition is maintained, and an equitable share of the costs of this competitive activity is paid by manufacturer, distributor and retailer, with the objective of maintaining the long-term success of all their businesses, and ensuring a wide spread of consumer choice.

Distributors maintain National Sales, Distribution and support services, at heavy cost, to ensure that all customers receive a full sales and after-sales service, ensuring not only product availability and consumer choice, but also a means of redress in the event of consumer dissatisfaction with product.

Evidence in Europe and Japan has shown that where Gray Marketing has been allowed to develop, it has resulted in the decline of product markets where price, and price alone, became the sole area of brand competition, with a detrimental effect on the consumer goodwill towards the affected products.

(f) U.S. DISTRIBUTION

Following the repeal of prohibition, the United States has one of the best regulated markets in alcohol in the world. This has ensured that the selling, promotion and marketing of alcoholic products is in the hands of responsible, well-managed Corporations who, while pursuing their commercial ends, remain, at the same time, well aware of their corporate responsibilities and the well-being of the U.S. consumer. They take a responsible attitude to promotion and advertising, and are aware of and have responded to the potential hazards which could be brought about because of the abuse of alcohol. We believe that it is in the interests of all - consumers, manufacturers, distributors and retailers - that this system should be supported and maintained.

(g) TRADE MARKS

Trade Marks protect the goodwill and investment made by manufacturers and their authorised distributors in their products, and thereby provide the incentive to invest in both existing and new products. They ensure that consumers are better informed and have a greater confidence in trade mark products, which are easy to distinguish. In order to establish and maintain the reputation of trade marks, manufacturers and distributors continutally invest in selling, advertising and back-up systems to maintain quality, thereby ensuring consumer satisfaction and goodwill for their products. This is an area of considerable investment and risk for manufacturers and their authorized distributors. Gray Marketeers, on the contrary, free-ride on the investment made by manufacturers and their authorized distributors, exploiting the goodwill and reputation of products, although they have made no investment in the establishment of these products' reputation; in effect, Gray Market Systems exist as parasites, on wealth created by established trade marks.

CONCLUSIONS

We believe the interests of U.S. consumers is best served by the adherence to a set of laws which regulate the market to protect the health of the nation, and to ensure free and fair competition among manufacturers and retailers alike. Market forces have and will continue to ensure that service and prices remain competitive. The development of Gray Marketeers who do not undertake full responsibility for the products they distribute is against consumer interest. Accordingly, we believe that everything should be done to ensure that the practice of Gray Marketing is outlawed. American consumers have the right to such protection.

8th August 1986.

TESTIMONY TO THE UNITED STATES SENATE BY JAMES BRUXNER, CHAIRMAN AND CHIEF EXECUTIVE OF JUSTERINI & BROOKS LTD CONCERNING GREY MARKET GOODS BILL S2614 (July 29 1986)

SUMMARY

1. Justerini & Brooks Ltd produce and market worldwide the J&B Rare brand of Scotch Whisky. They operate in virtually every country in the world and therefore have extensive experience of international marketing.

2. The importation, local marketing and distribution of the J&B brand is carried out in each country by an exclusive importer appointed by Justerini & Brooks under contract to service that market.

3. J&B is sold at a worldwide FOB export price which is approximately the same to all overseas importers.

4. Importers in each market have a clearly defined role to play in the marketing of the brand and this includes its promotion, selling, warehousing, distribution advertising and quality assurance all of which requires a substantial expenditure of money which must be recouped from the importer's margin as well as his profit. These are costs which the parallel operator does not incur.

5. In the USA the distribution and sale of alcoholic liquor products is closely regulated by Federal and State law. A three tier system of distribution exists which ensures that importers/distillers, wholesalers and retailers operate in distinct bands with no common ownership. The grey market is an attempt to break down the three tier system.

6. Justerini & Brooks Ltd have had experience of their brand being falsified in countries as wide apart as Greece, Portugal and possibly Bulgaria. Parallel operators may (wittingly or not) trade in false merchandise.

7. J&B Rare Scotch Whisky although intrinsically the same product everywhere has, by law, to vary in certain markets in terms of alcoholic strength, bottle size and description on the labels. Many of these are illegal in the United States.

8. Justerini & Brooks Ltd submits that the US Senate should reject the bill on the grounds that its implementation is not in the interests of the US consumer and that the grey marketing of alcoholic liquor should not be allowed to undermine the competitive marketing of brands.

1. BACKGROUND

Justerini & Brooks Ltd are the proprietors, producers and worldwide marketers of the J&B Rare Scotch Whisky brand. It is exported in bottle from the UK to virtually every market in the world including those behind the Iron Curtain. It is the second largest brand of Scotch Whisky in the world and commands a premium price over its major competitors. The brand has been in existence since the turn of the century and the company was founded in 1749.

Because of the size and geographical spread of this operation the company has extensive experience of international marketing and of the conditions under which alcoholic liquor products are distributed in different countries.

2. DISTRIBUTORS

In each country Justerini & Brooks has appointed an exclusive distributor to handle the brand. A contract is signed to cover this arrrangement and it clearly spells out the task of the distributor who is responsible for the importation, warehousing, distribution, selling, advertising and promotion of the brand in the market place. These functions, of course, cost money. It is essential, therefore, that the importer sells on into the wholesale trade at a margin high enough to cover these costs and also to make a reasonable profit.

3. PRICING

J&B Rare Scotch Whisky is sold to it distributors at the same price on an FOB basis in virtually every country. The same is true of the USA where the brand is sold to the American importer, The Paddington Corporation. The only difference is that in this market Justerini & Brooks sells in Dollars where in all other markets they sell in Pounds Sterling. The Dollar price is approximately the same as the sterling price but it may vary from time to time owing to the fluctuation in the rate of exchange between the two currencies. It is quite untrue, therefore, to assert, as did Planet Exports Ltd, that J&B as a manufacturer sells at a much higher price in one country than in another.

4. IMPORTERS COSTS

Because of the tasks outlined in (2) above import distributors do have substantial costs which they have to defray. The fact is that parallel market operators attempt to purchase goods at the FOB price in Scotland and sell on in the market place to the wholesale or retail trade at a price lower than that which has to be charged by the importer. Parallel operators do not have warehousing, selling, advertising, merchandising or promotion costs to pay. They are only able to sell the brands in high demand because that demand has already been created at high cost by the appointed importer.

5. REGULATION

In the USA the selling and distribution of alcoholic liquor products is closely regulated (as in most markets in the world) by Federal and State law. As a foreign company Jsuterini & Brooks is anxious that its brand shall be handled entirely in accord with these laws. It is indeed one of the tasks of the official importer to ensure that the product and its packaging complies with the various regulations and that the quality of product and details of packaging do not infringe the law. It is vital that a single source controls this aspect of doing business so that responsibility for legality is not obscured.

6. FALSIFICATION

It is not surprising that with its very large sale and prestige throughout the world J&B has on occasion been falsified by imitators. This has certainly occurred in Greece and Portugal and attempts were made to export the false product to other countries. It may also have happened in Bulgaria where the state security service is known to have falsified at least one of our competitors. If parallel operators are allowed to handle goods entering the United States there is no guarantee as to whether they are falsified or not. Only an expert can tell the difference between unopened bottles purporting to be the same brand and, of course, the sole importer would not handle a false item. If parallel operators are allowed to continue there is a grave risk of false product entering the United States market which may damage the brand and trade mark and, far worse, might poison consumers. In such circumstances Justerini & Brooks would be powerless to accept any responsibility.

7. CONSISTENCY

The J&B Rare brand is absolutely consistent the world over in terms of product except for in certain markets the law dictates certain differences in either alcoholic strength, esters content or age. In addition the packaging of the product varies again according to local law and wording frequently has to appear on labels which would be illegal in the USA. A parallel operator may well buy goods destined for, say, the Lebanon, which are in a non-standard bottle and with a non-refillable cap which would be unacceptable in most US bars. The risk is therefore run by anyone purchasing the goods that the US authorities may confiscate the goods and again neither Justerini & Brooks nor its importer would be able to accept responsibility.

8. SUBMISSION

Justerini & Brooks respectfully submits that the existence of parallel operators in the liquor industry is an indication that a parasitic trader who has no interest in the long term building of brands or on consumer protection is able, by not being involved in advertising or promotion costs, to under cut prices. While low prices are, of course, of benefit to the consumer they are no substitute for guarantee of quality of product, its availability and promotion. The American consumer has a wide range of products competing in the market place for his attention. Scotch Whisky prices vary widely from brand to brand and the parallel operator is merely trying to gain a rapid profit from this situation. Justerini & Brooks believes strongly that the consumer is best protected by the existing system which has been regulated by the US Government for many years, which gives a wide selection of choice and which contributes substantially to both federal and state funds by way of taxes.

BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL TRADE
COMMITTEE ON FINANCE
UNITED STATES SENATE

STATEMENT OF CHRISTOPHER C. DEMUTH
CONCERNING S. 2614
AUGUST 12, 1986

My name is Christopher C. DeMuth. I am Managing Director of Lexecon Inc. and Editor-in-Chief of *Regulation* magazine; my curriculum vitae is attached to this statement. During the past eighteen months I have conducted economic research on the subject of gray-market importation for the Coalition to Preserve the Integrity of American Trademarks (COPIAT). I am the principal author of two Lexecon Inc. reports, "The Economics of Gray-Market Imports" (May 1985) and "Gray-Market Compromise: Demarking vs. Labeling" (September 1985), which have been provided to the staff of this Subcommittee.

The purpose of this statement is to summarize aspects of my research pertinent to the Subcommittee's consideration of S. 2614. This bill would, in effect, enact in law the Customs Service's current regulations under Section 526 of the Tariff Act of 1930. Section 526 provides that products manufactured abroad bearing U.S.-registered trademarks may be imported into the United States only with the consent of the U.S. trademark owner. The Customs Service's current practice, however, is to enforce this provision only where the U.S. trademark owner is not affiliated with a foreign owner of the same trademark -- as where a U.S. distributor is an independent licensee of a foreign manufacturer. Where a U.S. trademark owner is a distribution subsidiary of a foreign manufacturer, or is a domestic manufacturer who also manufactures abroad, products bearing its trademark may be imported without its consent; such unconsented imports are called "gray-market imports" or "parallel imports." By making the regulatory distinction a statutory distinction, S. 2614 would cut short judicial review of the Customs Services' regulations and sanction gray-market importation of a quite substantial number of consumer products with large U.S. markets.

My statement is organized into four parts. First, I discuss the fundamental issue of the economic causes and consequences of gray-market imports. Second, I discuss certain ancillary issues which are the subject of frequent misunderstandings in debates over gray-market policy. Third, I consider the merits of the current Customs Service policy described above. Fourth, I consider (very briefly) the merits of the alternative Customs policies, "demarking" and "labeling," currently being considered by the Treasury Department. All of these issues are discussed in greater detail in the Lexecon studies; my purpose here is to highlight points I believe to be of particular interest to members of this Subcommittee.

1. <u>Causes and Consequences</u>

Gray-market opponents (such as COPIAT's member firms) argue that gray-market importation is caused by "free riding" off the domestic marketing and distribution investments of U.S. trademark owners. They assert, in other words, that gray-market importers profit by selling products bearing valuable, well-known trademarks, without having paid any of the costs of establishing and maintaining the market reputation of those trademarks. Gray-market opponents argue, in addition, that gray-market imports are frequently inferior in quality to the products of authorized distributors, and that the cost savings of supplying inferior products is an additional cause of gray-market importation.

Supporters of gray-market importation (such as importers and retailers of gray-market products) argue that gray-market imports are instead caused by "international price discrimination" against the United States. They assert that many manufacturers (both U.S. and foreign) sell their products at higher prices in the United States than in foreign countries -- enabling gray-market importers to purchase products abroad at the lower price, ship them to the United States, and sell them here at prices equal to or lower than the U.S. price.

The policies espoused by gray-market opponents and supporters are economically consistent with their views of the causes of the gray market. Gray-market opponents believe the Customs Services' current, liberal policy should be replaced by strict enforcement of the requirements of Section 526. If the opponents are correct that the gray-market is caused by free riding and sale of inferior products, then their policy position is also correct. Free riding and inferior products are harmful to consumer welfare. Free riding makes it impossible for firms to invest adequately in product quality and product marketing (because some of the returns from these investments are siphoned off by others), and inferior products defraud consumers who receive a lower quality product than they reasonably expected (based on a product's brand reputation) and paid for. In this view, enforcement of Section 526 is simply one application of general trademark policy -- giving U.S. trademark owners a property right in the returns to their marketing investments, regardless of whether their products are sold only in the United States or in other nations as well.

Gray-market proponents, on the other hand, believe that Section 526 should be enforced leniently (or perhaps repealed). If the proponents are correct that gray-market imports are caused by international price discrimination against the United States, then their policy position is also correct. Price discrimination between national markets may or may not be beneficial for the world economy as a whole, but it is usually harmful to consumers in nations where the prices are highest. If gray-market importers are simply arbitragers in international product markets, bringing U.S. consumers the benefits of lower foreign prices without offsetting costs of diminished U.S. marketing investments or product inferiority, then their activities should not be interfered with by Section 526 trademark enforcement.

There is less economic data bearing on the gray-market debate than one would wish for. Systematic data comparing international price levels is hard to come by, and data on the sources of particular gray-market shipments is usually impossible to come by. (The sources of gray-market shipments are deliberately, sometimes elaborately concealed, because all such shipments originate in some distributor, wholesaler, or retailer breaching his distribution contract). Nevertheless, there are two general considerations which go a very long way in resolving the gray-market debate, and which are supported by the data that is available. These considerations suggest strongly that the gray market is substantially a free-riding rather than price-discrimination phenomenon, and that the correct U.S. policy is thorough enforcement of Section 526.

The first consideration is that, in the absence of trademark enforcement, free riding is certain to be prevalent in consumer products markets such as those currently affected by gray-market importation. <u>This is so even when prices are no higher -- and indeed even when they are lower -- in the United States</u>. It is crucial that this point be clearly understood by anyone who wishes to make sense of the gray-market controversy. Many who believe they have mastered the issue continue to believe that free riding depends on U.S. prices being <u>somewhat</u> higher than foreign prices, and this is a mistake.

To see why, imagine that a camera manufacturer sells his camera for $100 to all national distributors (in local currency equivalents), and that each national distributor then invests $20 per camera in domestic marketing and distribution and resells to retailers for $125 per camera. Then any foreign distributor who can ship to U.S. retailers for less than $20 will earn more selling on the U.S. gray market than selling in his own domestic market: by free riding off the U.S. distributor's $20-per-camera marketing investment, the foreign distributor avoids having to make this investment himself in his home market, and pays only the (lower) transportation cost to the United States. If the cost of transportation to the United States is $10 per camera, the foreign distributor may find U.S. gray-market sales more profitable than sales in his market even if the U.S. retailer price is up to $10 lower than the foreign retailer price. This example is of course highly simplified, but the important general point is this: Where prices and marketing expenditures are constant across nations, free riding will occur (absent U.S. trademark enforcement) whenever a product's transportation cost to the United States is less than its marketing costs in the United States.

The second proposition is that international price discrimination against the United States is possible only in very restricted circumstances: where a manufacturer possesses a significant degree of "market power" over price (requiring a large share of all sales of the type of product in question), and where consumer demand for the manufacturer's product is stronger -- less "elastic" -- in the United States then elsewhere. A manufacturer facing competition from rival manufacturers of the same general product cannot engage in price discrimination: his rivals would profit by undercutting his price in the higher-price market, thereby forcing him back down to the competitive price. And even a manufacturer with a complete monopoly will sell at a higher price in the United States only if U.S. demand is less elastic than foreign demand. In either case, gray-market imports will contribute nothing to U.S. economic welfare.[1]

The conditions for free riding are less restricted than the conditions for price discrimination. They also appear to be far more prevalent in the markets actually subject to gray-market

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1. I should note that, in international product markets, "price discrimination" refers solely to different manufacturers' prices to distributors in different countries. Thus, if a camera sells for $100 to distributors in Italy and the United States, the Italian distributor invests $10 per camera in marketing and promotion while the U.S. distributor invests $20 in marketing and promotion, and the camera retails for $120 in Italy and $130 in the United States, there is no "price discrimination" involved. In this case the camera's international (manufacturers') price is no higher to the United States, but the costs of marketing in the United States are higher and the U.S. retail price reflects these higher costs. Gray-market imports from Italy will have no arbitrage effect in this case; they will merely free ride off the U.S. distributor's (presumably competitive) marketing investments and force a reduction in these investments.

importation. Brand name cameras, perfumes, spirits, watches, electronic equipment, and similar consumer products all feature relatively high marketing and promotion costs and relatively low transportation costs, which (as we have seen) makes free riding likely in the absence of trademark enforcement. These same products are sold in markets that feature intense interbrand competition -- especially in the United States -- which makes price discrimination against the United States highly implausible. There are, moreover, several documented cases of active gray-markets in products with equal or lower prices in the United States than in foreign "source" markets, which can only be attributed to free riding. Finally, gray-market importation is not limited to the United States but occurs in all advanced economies, including Japan and the EEC nations. This is consistent with the free-riding explanation and inconsistent with the price discrimination explanation; if the price discrimination explanation were correct, the gray market would be a one-way street leading towards the United States.

These considerations argue strongly for thorough enforcement of Section 526. The case for enforcing U.S. trademarks in international product markets is the same as the case for enforcing them in domestic markets, except to the extent price discrimination against the United States is real and significant. But there is reason for considerable skepticism about the price discrimination theory, and the burden of proof should be on those who assert that manufacturers are able to charge higher prices for identical products in U.S. markets. This burden has not been met by any systematic evidence that I am aware of, and I very much doubt that it can be met.

2. <u>Ancillary Issues</u>

Before turning to the merits of S. 2614 and the alternative policies under consideration at the Treasury Department, I will touch briefly on three ancillary issues which are the subject of frequent confusion in discussions of gray-market policy (including some of the testimony submitted to this Subcommittee).

The first issue is the important distinction between "pure" free riding on the one hand, and free riding involving the sale of inferior-quality products on the other. Gray-market opponents have offered several examples of gray-market imports that are similar or identical in appearance to the products of authorized distributors (and bear the identical trademarks in all events), but that in fact are inferior in some respect -- they lack the full U.S. warranty, are wired for foreign currents, or are designed or formulated for foreign tastes or environmental conditions. These examples are consistent with the economics of gray-market imports, which suggests that the quality of gray-market imports will generally be inferior to the quality of authorized products. Gray-market importers have a much smaller stake than manufacturers and authorized importers in the continued brand reputation of the products they import, because their expected future sales are much smaller and less certain. For this reason, gray-market importers have less incentive to invest in the quality of the products they market -- through careful handling and monitoring of inventory, avoidance of products unsuitable for U.S. markets, careful selection of retail outlets, and similar measures. When consumers purchase gray-market imports that are defective or unsuitable in some way, in the reasonable but mistaken belief that the products are equal to those distributed by the owner of the trademark, their losses are immediate and palpable.

It is important to bear in mind, however, that the economic harm from gray-market imports is at least as great (and probably much greater) in the case of "pure" free riding -- where gray-market products are not inferior to authorized products, but are simply exploiting the market reputation established by the authorized distributors. While gray-market products may be of lower quality than authorized products on average, many individual gray-market products will be equal in quality to authorized products, and in some types of products there may be no difference at all between gray-market and authorized versions. But even in these cases -- indeed especially in these cases -- free-riding imports will injure consumers by leading manufacturers and their authorized distributors to invest inadequately in activities vulnerable to free riding. These include investments in product quality itself (because trademark owners will receive only part of the returns from maintaining product quality at the level of their trademarks' commercial reputation), and marketing investments that are as important to consumer welfare as product-quality investments (such as the training of retail sales personnel in the features of complex products such as cameras and consumer electronics, and promotional campaigns which increase inter-brand competition and facilitate the introduction of new products and new brands of established products).

So the merits of the gray-market debate do not depend on the incidence of "horror stories" about defective products and enraged consumers; these are merely examples of one kind of problem that arises when trademark rights cannot be enforced. Trademark rights serve two economic functions, a consumer information function and a property right function. The dual function of trademarks has been recognized by courts from Justice Holmes opinion in the Katzel case in 1923 to the D.C. Court of Appeals opinion in the COPIAT case earlier this year. And here as in other areas of intellectual property law, the economic justification of property rights is not just that they benefit one or another group of producers, but that they benefit consumers as well.

The second issue is the effect of gray-market imports on product prices. Unfortunately, this issue has tended to be cast in terms of whether gray-market products sell at lower prices than the products of authorized importers. This is a spurious formulation of the price issue. Where two products are identical, they will tend to sell for the same price in the same market, regardless of their source or the sellers' costs of acquiring them; if one seller can obtain a product at a lower cost than his competitors, the seller and not his customers will enjoy the benefits of the lower cost. There is usually some dispersion of prices in any product market, so one can always pick instances where a gray-market product is selling for a lower price -- or higher price -- than an authorized product. But all of the price data I have examined suggests that equivalent gray-market and authorized products sell in the same general price range. Where gray-market products sell in a lower price range, this is because it is evident to consumers that the gray-market products are irregular in some respect, such as cameras that lack the U.S. warranty and batteries whose packaging is in a foreign language.

The real price issue is whether the presence of gray-market imports leads to lower prices for all versions of a product, gray-market and authorized. Their is no unambiguous answer to this question. In the short run, gray-market imports may lead to generally lower prices by increasing the quantity of products being offered for sale. This, however, is simply free riding at work, eroding the economic returns of authorized distributors' marketing investments by lowering their prices. In the longer run, as authorized distributors are forced to cut back on their marketing investments, and market demand for their products falls, prices could be either higher or lower than in the absence of gray-market imports. (Prices will be higher, for example, if unit production costs are higher at the lower levels of production, or if price competition is less vigorous when producers spend less on informing consumers about their products.) The important point, however, is that consumers will presumably be worse off regardless of whether prices are higher or lower, because fewer products will be available and consumers will be less informed about those that are available.

Here again gray-market policy is simply a specific instance of trademark policy. If all U.S. trademark laws were abolished tomorrow, one would observe a short-run decline in the price of identified brands of products -- as anyone could market products of any cost and quality and call them "Crest" toothpaste, "Wheaties" cereal, or "Chevrolet" automobiles. In the longer run, consumer prices for toothpaste, cereal, and automobiles might be either higher or lower in such a world of "generic products only." But regardless of the price effect, consumers would be poorer than before trademark rights had been abolished. After all, in a world of enforceable trademarks, producers are free to sell "generic" products at bargain prices, and will take business away from branded products to the extent consumers find generic products preferable. But in a world without trademarks the consumer's options are more limited, because no producer can attempt the alternative strategy of offering products with unique attributes identified with a unique tradename.

The third ancillary issue is the effect of international currency fluctuations -- and especially the relatively "strong" dollar of recent years -- on gray-market importation. While no systematic evidence exists on the point, there is general agreement that U.S. gray-market importation waxes and wanes with the rise and fall of the dollar in international currency markets. It is sometimes asserted that this relationship shows that the gray-market is caused by price discrimination -- that when the dollar strengthens, manufacturers take advantage of the U.S. demand for foreign products by charging relatively higher prices in the U.S. market. While this is possible, it is only one of several possibilities. When the dollar grows in value relative to other currencies, the dollar price of foreign goods falls and more foreign goods are imported into the United States. At the lower dollar price, U.S. demand for a given product may be more elastic, less elastic, or equally elastic as before the currency change. And even where U.S. demand did become less elastic, this would lead to increased price discrimination only in those cases -- apparently rare in markets affected by gray-market importation -- where individual manufacturers possess a significant degree of market power. An economist would not, therefore, expect to see any systematic relationship between the dollar's relative value and the incidence of price discrimination against U.S. markets.

On the other hand, there _is_ a direct and systematic relationship between the relative strength of the U.S. dollar and the incentives for foreign free riding on U.S. marketing investments. When the dollar increases in value, the value of domestic marketing investments, as measured in foreign currencies, grows commensurately. For example, in our simple numerical illustration in the previous section, if the dollar gains 10 percent over foreign currencies, the value of U.S. distributors' marketing investments grows to $22 in foreign-currency equivalents, while the value of foreign distributors' marketing investments in their own countries remains unchanged. Since international shipping need not be purchased in dollars (if foreign shippers are using U.S. shipping companies they can shift to foreign shippers when the dollar gains value), an appreciating dollar therefore increases foreign distributors' profits of selling on the U.S. gray market relative to the profits of selling in their own markets. So if it is in fact true that the volume of U.S. gray-market importation of a wide variety of products has increased with increases in the dollar's relative value, this is further evidence that the gray market results from free riding off U.S. marketing investments.

3. The Current Customs Service Regulations

The current Customs Service regulations, which S. 2416 would enact into statutory law, generally prohibit gray-market importation only where U.S. trademark owners are not affiliated with foreign owners of the same trademark. Where U.S. manufacturers distribute their products abroad through affiliated distributors, and where foreign distributors distribute in the United States through affiliated distributors, gray-market imports are permitted. Since corporate affiliation is the usual form of organization where products enjoy substantial markets in several countries, the Customs policy is a *de facto* policy of trademark nonenforcement except for products with relatively small U.S. markets.

The analysis of the previous two sections indicates that this policy is mistaken and that Section 526 should be enforced according to its terms: U.S. trademark owners should be permitted to protect their domestic marketing investments from free riding (both from "pure" free riding and from the marketing of sub-standard products bearing their trademarks) by enforcing their trademarks against unauthorized importers. But the more important point, apropos of this Subcommittee's consideration of S. 2416, is that the current Custom's policy is nonsensical under any view of the economic causes and consequences of gray-market imports. The form of business organization between manufacturers and distributors in different countries has nothing to do with the potential for free riding, marketing of inferior quality products, or price discrimination against the United States. A foreign manufacturer who distributes through an independent licensee in the United States could still engage in price discrimination if circumstances permitted (if he had monopoly power, and if U.S. demand was less elastic than demand in other countries). U.S. manufacturers who distribute abroad through subsidiaries, and foreign manufacturers who distribute in the United States through subsidiaries, are still vulnerable to free riding if circumstances permit (if their U.S. marketing costs are large enough and shipping costs to the United States are small enough). The origins of the enforcement distinction set forth in the current Customs regulations are obscure, but they simply have no relationship to the economics of gray-market importation, and should not be set in statutory concrete under any coherent view of the gray-market issue.

4. The Administration's Proposals

In a recent notice of inquiry (51 Fed. Reg. 22005, June 17, 1986), the Department of the Treasury has solicited public comments on two alternatives to the Customs Services current enforcement policy under Section 526. The alternative policies would permit importation of gray-market products (regardless of forms of corporate organization), but only if U.S.-owned trademarks were removed or covered ("demarking") or if the products carried a mandatory label advising consumers that the imports had not been imported and distributed by the manufacturer's authorized distributors ("labeling").

Either of these policies would be superior to the Customs Services current enforcement policy, regardless of one's view of the causes of gray-market importation. Unlike the current policy, demarking (and to a lesser extent labeling) would address the problems of free riding and inferior products as well as the problem of price discrimination. Foreign manufacturers would be unable to discriminate in price against U.S. markets under either a demarking or labeling policy, because gray-market importers could obtain such products abroad and sell them (demarked or labeled) in the United States, undercutting the price charged by the authorized U.S. distributors. But demarking or labeling would oblige gray-market importers to undertake some U.S. marketing and distribution efforts of their own, thereby diminishing the problems of free riding and inferior products. Either policy would protect consumers against unknowing purchases of gray-market products, which in turn would give gray-market importers proper incentives for monitoring the quality of their products. Demarking, however, would be far superior in protecting against free riding, because it (unlike labeling) would greatly reduce the ability of gray-market importers to appropriate the value of the trademark itself. At the same time, demarking would be as good as labeling in averting possible price discrimination, and would be much simpler to administer -- so it is clearly the better of the Treasury proposals. The Treasury Department is on the right track in attempting to rationalize its trademark enforcement policy; its efforts should be encouraged, not blocked by a hasty legislative reaction.

COMMITTEE ON FINANCE
SUBCOMMITTEE ON INTERNATIONAL TRADE
UNITED STATES SENATE

COMMENTS ON S. 2614

FILED ON BEHALF OF
MARTIN'S HEREND IMPORTS, INC.

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August 12, 1986

COMMENTS OF MARTIN'S HEREND IMPORTS, INC. ON S.2614

These comments are submitted on behalf of Martin's Herend Imports, Inc. ("Martin's Herend"), of McLean, Virginia, in opposition to S. 2614, which seeks to amend Section 526 of the Tariff Act of 1930, as amended, 19 U.S.C. § 1526. Martin's Herend is the owner of the trademark "Herend Hungary Handpainted" (and design) in the United States, and has the sole and exclusive right to import and distribute Herend porcelain manufactured in Hungary in the United States. Herend porcelain is widely acknowledged to be one of the finest porcelains manufactured in the world.

With the recent rise in popularity of Herend porcelain over the past few years, especially in the United States, and the resulting increase in demand, Martin's Herend has also seen a dramatic increase in the unauthorized importation of "gray market" Herend porcelain. Such unauthorized importations, besides infringing the proprietary rights of Martin's Herend in the trademark "Herend Hungary Handpainted" (and design), have also caused the company financial harm inasmuch as every sale of a gray market good is one sale less for Martin's Herend.

Section 526 of the Tariff Act of 1930, as originally enacted and presently constituted, prohibits the importation into the United States of (1) "any merchandise of foreign manufacture" which (2) bears a trademark owned by a citizen of, or by a corporation ... organized within the United States" unless (3) the "written consent" of the U.S. trademark owner to such importation is obtained, (4) when said trademark has been properly registered with the U.S. Patent and Trademark Office and recorded with the U.S. Customs Service. 19 U.S.C. § 1526(a). The present Customs Service regulations, however, allow merchandise of foreign manufacture bearing a trademark owned by a U.S. citizen or corporation to enter the United States without such written authorization in all but very limited circumstances, i.e., where the U.S. trademark owner is not related to the foreign manufacturer and has not authorized the foreign manufacturer to apply the mark.

Martin's Herend falls within the limited class of entities which the Customs Service acknowledges is entitled to have unauthorized importations of gray market goods excluded from entry into the United States, but such entitlement has failed to translate into effective protection, in large part due to the confusion which has surrounded the Customs Service administration and enforcement of Section 526.

Section 526 was first enacted into law as part of the Tariff Act of 1922, and was then reenacted in the same form as part of the Tariff Act of 1930. This statutory provision unequivocally provides, by its clear and unambiguous language, for the exclusion of so-called "gray market" trademark goods from entry into the United States. COPIAT v. United States, 790 F.2d 903, 907-908 (D.C. Cir. 1986); Vivitar Corporation v. United States, 761 F.2d 1552, 1560-1561 (Fed. Cir. 1985), cert. denied, 106 S.Ct. 701 (1986). The Customs Service (or Treasury Department, of which the Customs Service is a part) has promulgated regulations since 1923 to administer and enforce Section 526, and while the regulations promulgated by the Customs Service immediately after its enactment (Articles 476-478 of the 1923 Treasury Regulations) and reenactment (Article 518(a) of the 1931 Treasury Regulations), like the statute itself, provided for no exception from the statutory prohibition against the importation of gray market goods,1/ beginning in 1936 the Customs Service began to carve out in its regulations certain exceptions (i.e., related party exceptions) to the statutory protection afforded by Section 526. The scope of these exceptions expanded and contracted over the next 35 years, and at times the protection offered by the Customs Service did not even coincide with that afforded by the language of its own regulations. See Vivitar Corporation v. United States, supra, 761 F.2d at 1567.

The Customs Service has attempted to justify its narrowing of the scope of protection afforded by Section 526 on the grounds that Congress, when originally enacting this provision in 1922, intended to limit the protection afforded thereby only to U.S. trademark owners who were not related to the foreign manufacturer, or did not authorize the use of its trademark by said foreign manufacturer. This justification has been explicitly rejected by two United States Circuit Courts of Appeal -- the Federal Circuit (Vivitar Corporation v. United States, supra, 761 F.2d at 1565) and the District of Columbia Circuit (COPIAT v. United States, supra, 790 F.2d at 908) -- and implicitly rejected by a third (Olympus Corporation v. United States, Docket No. 85-66282 (2d Cir., decided June 9, 1986)).

1/ Indeed, in Sturges v. Clark D. Pease, Inc., 48 F.2d 1035 (2d Cir. 1931), the court found the scope of Section 526 to be so "drastic" as to preclude even the importation of trademarked goods for personal use without the written authorization of the trademark owner. Id. at 1037. Section 526 was amended in 1978 to allow for importations of trademarked goods for personal use. See 19 U.S.C. § 1526(d).

Since 1972, the Customs Service regulations have remained unchanged. These regulations (now codified in 19 CFR 133.21(c)(1)-(3)) remove from the scope of protection afforded by Section 526 importations of foreign merchandise bearing a U.S.-owned trademark (1) when both the foreign and U.S. trademark are owned by the same person or business entity, (2) when the foreign and domestic trademark owners are parent and subsidiary companies or are otherwise subject to common ownership or control, and (3) when the articles of foreign manufacture bear a recorded trademark applied under authorization of the U.S. trademark owner. It is these exceptions to the scope of protection afforded by Section 526 which S. 2614 seeks to codify.

The issue we wish to address in this statement, however, is not the validity of the Customs Service regulations which allow the entry of gray market goods into the United States in derogation of the intellectual property rights of U.S. trademark owners, but the wisdom of such a policy. We are far from the first to do so. See, e.g., Osawa & Co. v. B & H Photo, 589 F.Supp. 1163, 1177 (S.D.N.Y. 1984) ("Equally questionable are the wisdom and necessity for such regulations."); Olympus Corporation v. United States, supra, Slip Op. at 11 ("While we find the regulation of questionable wisdom..."). These regulations, by failing to provide to all U.S. trademark owners the right to determine what goods may be sold in this country bearing its mark, fails to recognize the fact that a trademark has a separate legal existence under every country's law, and that the primary function of a trademark under the law is to symbolize the local goodwill of the domestic owner of the trademark. See A. Bourjois & Co. v. Katzel, 260 U.S. 689 (1923). This so-called "territoriality" principal of trademarks has been accepted as an underlying principal of U.S. trademark law since the decision of the U.S. Supreme Court in the Katzel case.

"Goodwill" is the term commonly used to describe the advantage that accrues to a business from the successful functioning of its trademark. It is an intangible, albeit quite significant, asset of many businesses, and has long been recognized as being entitled to special legal protection from acts, especially those acts of actual or potential competitors, which injure or detract from its value. Such protection is considered necessary to further the functioning of a competitive economy. See generally, Bell & Howell: Mamiya Co. v. Masel Supply Co., 548 F.Supp. 1063, 1069 (E.D.N.Y. 1982), rev'd on other grounds, 719 F.2d 42 (2d Cir. 1983). Congress, in enacting the Lanham Trademark Act in 1946, clearly recognized the importance of the goodwill associated with a trademark and the trademark owner's right to be the sole beneficiary of that goodwill. The Senate Finance Committee Report accompanying the enactment of the Lanham Act stated (S.Rep. No. 1333, 79th Cong., 2d Sess. 4 (1946)):

> Trademarks encourage the maintenance of quality by securing to the producer the benefit of the good reputation which excellence creates. To protect trademarks, therefore, is to protect the public from deceit, to foster fair competition, and to secure to the business community the advantages of reputation and good will by preventing their diversion from those who have created them to those who have not.

The right of a trademark owner to the return from its investment in the goodwill represented by its mark is deeply embedded in the law. The law of trademarks is a subset of the law of unfair competition,2/ and it is a well-settled law of unfair competition that the redirection of profits away from the parties that made the investment to those who have not is not only unfair, but also illegal. See International News Service v. Associated Press, 248 U.S. 215 (1918); Truck Equipment Service Co. v. Fruehauf Corp., 536 F.2d 1210, 1215 (8th Cir.) cert. denied, 429 U.S. 861 (1976) ("Full and fair competition requires that those who invest time, money and energy into the development of goodwill and a favorable reputation be allowed to reap the advantages of their investment.")

Martin's Herend is the owner of the Herend trademark in the United States, and over the past 29 years has expended tremendous amounts of time, effort and money in order to make the mark, and the product bearing this mark, associated with the goodwill this company has established for itself throughout the United States. This goodwill was established during this period not only by advertising, but by providing a high degree of service to its clients. The consuming public has come to associate goods bearing the Herend trademark with Martin's Herend, and gray marketeers who import Herend porcelain appropriate the benefits of Martin's Herend goodwill for themselves; goodwill to which they are not legally entitled and for which they have not expended any time, effort or money in creating. They are "free riding" on the efforts of Martin's Herend, and such unfair competition is one of the evils trademark law is supposed to prohibit.

When a trademark comes to symbolize a trade or business, as it has in the case of the mark "Herend Hungary Handpainted" (and design), the trademark owner is entitled to the exclusive

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2/ See S.Rep. No. 1333, supra. ("Unfair competition is the genus of which trade-mark infringement is one of the species ... All trademark cases are cases of unfair competition and involve the same legal wrong.")

right to use that mark on all goods of the same type which he manufactures or sponsors. Callman, The Law Of Unfair Competition, Trademarks, And Monopolies § 17.07 (1983). Implicit in the exclusive right to use a mark is the right to exclude others from using it. DeWalt Inc. v. Magna Power Tool Corp., 289 F.2d 656, 661 (CCPA 1961); Chromium Industries, Inc. v. Mirror Polishing & Plating Co., Inc., 448 F.Supp. 544, 555 (D.Ill. 1978). Providing such protection to U.S. trademark owners also benefits the consuming public. As noted by the Senate Finance Committee in 1946 (S. Rep. No. 1333, supra):

> Trade-marks, indeed, are the essence of competition, because they make possible a choice between competing articles by enabling the buyer to distinguish one from the other. Trade-marks encourage the maintenance of quality by securing to the producer the benefit of the good reputation which excellence creates. To protect trade-marks, thereofre, is to protect the public from deceit ...

S. 2614, if enacted into law, would allow gray marketeers to "free ride" on the efforts of U.S. trademark owners and to divert to themselves the benefits of the efforts of others. Congress, when initially enacting Section 526, and the courts which initially construed this statutory provision (see e.g., Sturges v. Clark D. Pease, Inc., 48 F.2d 1035 (2d Cir. 1931), found that its protection was to apply to all U.S. trademark owners, without exception. To allow gray market goods to enter the United States under any circumstance runs contrary to the territoriality principal of trademarks, which has been consistently recognized as one of the fundamental tenets of trademark law for over 60 years. This principal recognizes that a trademark represents a distinct goodwill in different geographic markets, and that the trademark owner in each distinct market is entitled to the exclusive use of its mark in that market, and implicit in this right of exclusive use is the right to exclude others from using this mark.

Section 526, as construed by the Customs Service, an agency, it should be noted, with no particular expertise in trademark law, recognizes this right in only limited circumstances. For Congress to adopt this construction of Section 526, as S. 2614 does, would run contrary to longstanding and well-established principals of trademark law, and would give Congressional acquiesence to those who "free ride" on the hard work and efforts of U.S. trademark owners. For these reasons, we respectfully express our strongest opposition to S. 2614, and strongly urge that Congress not enact this bill into law.

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Gray Market Imports Under U.S. Law

The licensing of trademarks for use in various geographic areas of the world is a major marketing tool in international trade. The licensing of foreign manufacturers and distributors often plays a key role in the marketing and distribution plans of the trademark owner. The success of an importing company may be totally dependent upon its right to exclusively import and distribute goods bearing a specific trademark of a foreign manufacturer, or its right to locally manufacture and distribute goods bearing a foreign manufacturer's trademark under a license agreement. Trademarked goods which are traded outside of or in violation of these distribution and licensing agreements constitute the "gray market." Such goods, or "gray market imports," have increased in the United States in the last few years, due in part to the relatively high value of the U.S. dollar, making it increasingly attractive for importers to purchase goods abroad for importation into the United States. Several recent major court and administrative decisions, some now on appeal, have made gray market imports one of the more important intellectual property and international trade issues in the United States.

Gray market imports are generally defined to be: (1) products imported into the United States which have been manufactured by a foreign company pursuant to a licensing agreement whereby the owner of the United States trademark grants to the foreign company rights to use that mark only in a specific non-U.S. geographic area; (2) imported goods which bear the trademark owned by a foreign manufacturer which has granted to a U.S. company the rights to import and distribute its products exclusively in the United States; or (3) goods imported into the United States, bearing the trademark of a foreign manufacturer, which compete with goods manufactured in the United States or imported into the United States by a U.S. company which has either purchased all rights in the trademark or has obtained an exclusive license to use that trademark in the United States. A gray market problem may also arise when a foreign manufacturer grants rights to use its trademark to a U.S. company and one or more foreign, non-U.S. licensees, and the products of one of the foreign, non-U.S. licensees enter the United States and compete with the products of the U.S. licensee. In all cases, the marks are true and genuine trademarks, valid under the respective national jurisdictions of their country of registration. As will be seen, the fact of whether or not the complaining U.S. company is a licensee or licensor of the trademark

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will generally be determinative of whether or not the gray market imports can be excluded from the United States, or whether importers or distributors of such products may be enjoined from further U.S. importation and distribution. A failure by some courts to understand the international commercial marketplace and an overemphasis on the rights and expectations of the consumer of the specific goods involved has often contributed to the development of what may be considered an unfair and unrealistic policy with respect to gray market imports.

U.S. companies have sought relief from gray market imports under one or more of the following: (1) federal trademark infringement in violation of the Lanham Trademark Act,[1] (2) the Genuine Goods Exclusion Act,[2] and (3) theories of common law unfair competition.

Plaintiffs alleging federal trademark infringement by gray market imports have generally relied on three sections of the Lanham Act – Secs. 32,[3] 42,[4] and 43(a).[5] To be successful under either Sec. 32 or 43(a), a plaintiff must show a likelihood of confusion resulting from the complained-of use of the mark, *i.e.* whether an appreciable number of purchasers is likely to be misled as to the source or characteristics of the defendant's products.

A trademark serves several functions. Primarily, it enables buyers to identify the goods of one seller and distinguish them from the goods of others. Thus, it may signify that all goods bearing the same trademark come from a single, although unknown, source. Further, it may signify that all goods bearing the

1 15 U.S.C. § 1051 *et seq.*

2 Section 526 of the Tariff Act of 1930, 19 U.S.C. § 1526. The relevant portions of that statute provide:

"(a) ... it 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 by a person domiciled in the United States, ... unless written consent of the owner of such trademark is produced at the time of making entry.

...

(c) Any person dealing in such merchandise may be enjoined from dealing therein within the United States or may be required to export or destroy such merchandise or to remove or obliterate such trademark and shall be liable for the same damages and profits provided for wrongful use of a trademark. ..."

(Items imported for personal use are exempted from the statute.)

3 15 U.S.C. § 1114.

4 15 U.S.C. § 1124.

5 15 U.S.C. § 1125(a).

same trademark are of equal quality. A trademark also assists the seller in advertising and marketing his goods. A trademark is an objective symbol of the goodwill built up by the trademark owner.[6] It has often been stated that the function of trademark law is to prevent consumer confusion and to protect a trademark owner's investment in goodwill. As such, "a trademark is auxiliary to the goodwill of its user and is inseparable from that goodwill."[7] Since the goodwill of a business is defined and measured in the geographic areas in which a business operates or markets its goods and services, the right to use a trademark is thus closely linked to its use geographically. Thus, two basic concepts: (1) that a trademark has a separate legal existence under each country's law, and (2) that the primary function of a trademark under that law is to symbolize the local business goodwill of the domestic owner of the mark, have been expressed as components of the principle of territoriality of trademarks.[8] The basis for the principle of territoriality has been stated to be that trademark rights were created to "facilitate the protection of one's goodwill in trade by placing a distinguishing mark or symbol – a commercial signature – upon the merchandise or the package in which it is sold."[9] The principle of the territoriality of trademarks should be contrasted with the "universality" theory of trademarks. Under this theory, goods which bear a validly applied trademark may be sold anywhere in the world without infringing the rights of any foreign persons owning rights under the mark. Here it is important to distinguish trademarks from other forms of intellectual property whose existence begins with governmental recognition, such as patents.

> [T]he right to a trademark does not depend upon the statutory enactments. The right originates in common law by prior appropriation and use.... Registration does not perfect a trademark right; although under the Lanham Act it may eventually confer certain new rights to the mark, at the outset it does not grant any greater right than that which would be recognized at common law without registration. Unlike the patent and copyright, trademarks are not created by governmental grant. "The trademark, whether registered or not, is a creature of the common law."[10]

The principle of territoriality in U.S. trademark law was first stated by the Supreme Court in *A. Bourjois & Company, Inc. v. Katzel,*[11] and has been

6 J. McCarthy, "Trademarks and Unfair Competition" Sections 2:7, 3:1 (1984).

7 H. Nims, "Unfair Competition and Trademarks" 520 (4th ed. 1947).

8 *In re Certain Alkaline Batteries,* Inv. No. 337-TA-165, U.S.I.T.C. Pub. No. 1616 (November 1984), page 7 (hereafter referred to as the *Duracell* case).

9 *Duracell* case, at 7.

10 R. Callman, "The Law of Unfair Competition, Trademarks, and Monopolies" § 25.03, at 14 (1983).

11 260 U.S. 689 (1923).

followed in a series of subsequent cases. In *Bourjois,* the plaintiff, a New York corporation, purchased from a French company the entire rights of the French company to market its face powder in the United States, including the rights in the U.S. registered trademark "Java." The face powder sold by the plaintiff was made in France by the French company, but packaged for sale in the United States by the plaintiff. The defendant bought the same face powder directly from the French company in France and imported the face powder into the United States in its original (French-packaged) boxes bearing the trademark "Java." The French company had apparently retained all rights in the mark "Java" for use on its product outside of the United States. In reversing a lower court finding of non-infringement, the Supreme Court stated:

> 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 came from the plaintiff although not made by it. It is sold and could only be sold with the goodwill of the business that the plaintiff bought . . . it stakes the reputation of the plaintiff upon the character of the goods. . . .[12]

In dealing with gray market imports, several recent cases have reaffirmed the principle of territoriality of trademarks.[13]

Relying upon the *Bourjois* decision, the Court in *Bell and Howell: Mamiya Company v. Masel Supply Co.*[14] pronounced the principle of the territoriality of trademarks as undeniably established in American trademark law. The *Bourjois* decision was cited as a specific rejection of the principle of trademark "universality."[15] In *Bell and Howell: Mamiya,* the plaintiff was a U.S. corporation which was the registered owner of United States trademark registrations for three MAMIYA trademarks and exclusively imported and sold in the United States certain photographic equipment bearing these trademarks. The defendant had imported cameras bearing the same trademarks from Hong Kong which it resold in the United States without authorization from the plaintiff. The cameras imported and distributed by both the plaintiff

12 260 U.S. 689, 692 (1923).

13 *Bell & Howell: Mamiya Co. v. Masel Supply Co.*, 548 F. Supp. 1063 (E.D.N.Y. 1982), reversed on other grounds, 719 F. 2nd 42 (2nd Cir. 1983); and *Osawa & Company v. B & H Photo,* 589 F. Supp. 1163 (S.D.N.Y. 1984).

14 548 F. Supp. 1063 (E.D.N.Y. 1982).

15 The "universality" principle stood for the principle that "goods manufactured abroad under trademark and then imported and sold in the United States 'did not' infringe the rights of the owner of the American trademark, simply because the goods were genuine and the public, therefore, was undeceived." 548 F. Supp. 1063, 1066.

and the defendant were manufactured by the same Japanese company and had been exported from Japan by the same Japanese exporting company. In finding that the defendant's imports had infringed the U.S. trademark rights of the plaintiff, the court stated that:

> Where the mark a merchant uses in this country is one that a foreign manufacturer or merchant has originated or used on the very goods the merchant imports and sells here, protection can still be accorded the merchant if it is the registered owner of the trademark. This result follows from the principle of territoriality previously mentioned in connection with *Bourjois v. Katzel.* ... Conceptually, the principle that protection of a trademark in a particular country depends on the laws of that country and not on the continued effect of the laws of another sovereign readily supports the existence of separate goodwills pertaining to the same trademark, in conjunction with the business carried on in separate countries, for example, manufacture and distribution, each symbolized by a trademark registration.[16]

The court went on to discuss the history of "source of origin" in Sec. 32 of the Lanham Act, one of the statutory bases upon which the plaintiff was suing. In so doing the court rejected the earlier case of *U.S. v. Guerlain,*[17] whose court had found local goodwill to rest in the product and not in the trademark owner. The *Bell & Howell: Mamiya* court concluded by stating that:

> Implicit in this assertion is the assumption that the "source or origin" of a product inevitably must be its manufacturer. That view is wholly inconsistent with the numerous American trademark decisions recognizing the exclusive American distributor as the owner of trademark rights.[18]

The same plaintiff subsequently brought another case against different defendants in another court. In *Osawa & Company v. B. & H. Photo,*[19] the court again rejected the universality theory and adopted the principle of territoriality of trademarks. The plaintiff was found to have established substantial goodwill in the U.S. marketplace, separate and distinct from the goodwill emanating from the goods themselves, that the local goodwill was the result of plaintiff's many marketing and related activities in the United States, and

16 548 F. Supp. 1063, 1070. The Court also defined the territoriality principle to signify that: "The protection of a trademark in a certain country depends exclusively on the law of that country, and that the effects of a trademark ownership by use or registration in a country do not reach beyond the borders of that country." II S. LADAS, "Patents, Trademarks, and Related Rights" 1340 (1975).

17 155 F. Supp. 77 (S.D.N.Y. 1957), vacated and remanded, 358 U.S. 915 (1958), dismissed with prejudice, 172 F. Supp. 107 (S.D.N.Y. 1958).

18 548 F. Supp. 1063, 1077.

19 589 F. Supp. 1163 (S.D.N.Y. 1984).

specifically that "the Mamiya trademark in the U.S. represents a goodwill generated and importantly influenced by these activities. It is not the same trademark either in law or in fact as the Mamiya trademark at the place of manufacture, where it designates only the goodwill to the manufacturer."[20]

Despite the fact that several courts and scholars have found that the principle of territoriality of trademarks supports a finding that gray market imports may infringe a valid U.S. registered trademark, the rights of U.S. trademark owners to exclude such gray market imports from entry into the United States have been limited by the U.S. Customs Service interpretation and enforcement of Sec. 42 of the Lanham Act and the Genuine Goods Exclusion Act. Court challenges to these interpretations and regulations have to date proved unsuccessful. Section 42 of the Lanham Trade-Mark Act of 1946[21] provides that:

> ... no article of imported merchandise which shall copy or simulate the name of any domestic manufacture, or manufacturer, or trader ... or which shall copy or simulate a trademark registered in accordance with the provisions of this chapter or shall bear a name or mark calculated to induce the public to believe that the article is manufactured in the United States ... shall be admitted to entry at any customhouse of the United States. ...[22]

Section 42 of the Lanham Act is a reenactment and successor of Sec. 27 of the Trademark Act of 1905.[23] In two cases,[24] the Second Circuit Court of Appeals, the most important commercial United States court of the time, had held in 1916 and 1923 that genuine trademarks on imported merchandise did not "copy or simulate" a United States trademark within the meaning of Sec. 27. Before the Supreme Court could issue its opinion in *Bourjois v. Katzel*, the U.S. Congress enacted Sec. 526 of the Tariff Act of 1922. In 1923, the Supreme Court, without reference to Sec. 526, reversed the lower court decision in *Bourjois* and held that goods bearing a genuine trademark, but imported without the consent of the U.S. exclusive distributor which owned the U.S. trademark rights in the identical trademark, infringed the registered U.S. trademark. In a related case,[25] the Supreme Court again held that genuine trademarks on foreign goods copied or simulated United States

20 *Id.*, at 1174.

21 15 U.S.C. § 1124.

22 *Id.*

23 33 Stat. 730.

24 *Fred Gretsch Mfg. Co. v. Schoening*, 238 F. 780 (2d. Cir. 1916); *A. Bourjois & Co. v. Katzel*, 275 F. 539 (2d. Cir. 1921).

25 *A. Bourjois & Co. v. Aldridge*, 263. U.S. 675 (1923).

trademarks under Sec. 27 of the Trademark Act of 1905, and were therefore subject to exclusion from entry. In 1930, Sec. 526 was reenacted in its entirety as Sec. 526 of the Tariff Act of 1930.[26]

In 1923 and 1931, the U.S. Customs Service adopted regulations incorporating virtually word for word Sec. 526. In 1972, the Customs Service adopted entirely new regulations implementing both Sec. 526 and Sec. 42 of the Lanham Act.[27] Subparagraph (c) of these regulations severely limits the applicability of Sec. 526 and Sec. 42 to gray market imports, and their exclusion:

> *(c) Restrictions not Applicable*
>
> The restrictions set forth in paragraphs (a) and (b) of this section do not apply to imported articles when either:
>
> (1) both the foreign and the U.S. trademark or trade name are owned by the same person or business entity;
>
> (2) the foreign and domestic trademark 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 trademark or trade name applied under authorization of the U.S. owner.[28]

The U.S. Customs Service regulations and interpretation of Section 526, and the correspondingly restricted interpretation of Section 526, have recently been upheld in *Vivitar Corp. v. U.S.*,[29] in which the owner of a U.S. registered trademark sought to exclude products bearing its trademark which had been manufactured overseas pursuant to a licensing agreement, yet *imported* into the United States *without its consent.* After a detailed review of the legislative history of Sec. 526, particularly the fact that it was enacted in response to the Second Circuit court's opinion in *Bourjois,* the court upheld the Customs Service interpretation of Sec. 526, which limits the right to exclude genuine goods to those U.S. companies which have purchased rights to use the mark in the United States from a foreign trademark owner. The court found that the protection of Sec. 526 was *not intended* to extend to

26 19 U.S.C. § 1526.

27 37 Fed. Reg. 20677 (Oct. 3, 1972), 19 C.F.R. § 133.21.

28 *Id.*

29 593 F. Supp. 420 (C.I.T. 1984); aff'd, Court of Appeals for the Federal Circuit, Appeal No. 84-1638 (May 6, 1985).

cases in which the same entity owned *both* the foreign and domestic trademarks. The court noted that a 1936 regulation implementing Sec. 526 barred a company from registering a trademark in both the United States and abroad, selling the trademarked goods in both markets, and restricting the importation of the goods it sells abroad. The court also noted that the essential thrust of this regulation has remained unchanged since 1936 and is embodied in the current Customs regulations. In conclusion, the court upheld the practice of the U.S. Customs Service since 1936 which

> ... in essence, has construed § 1526(a) so as to deny American trademark owners the right to exclude goods manufactured abroad bearing their trademarks, when control of the foreign trademark is in the hands of the American trademark owner.[30]

In responding to plaintiff's arguments that the Customs Service interpretation of Sec. 526 was unreasonable because it permitted gray market importers to unfairly exploit plaintiff's goodwill by taking a "free ride" on plaintiff's reputation in the United States, the court stated that

> ... the fundamental answer to this argument is that it poses a problem that § 1526(a) was not intended to deal with. Congress enacted § 1526(a) as a special remedy to protect American businesses that purchase foreign trademarks from imports that violate the rights the businesses purchase. On the other hand, free riding can be a form of unfair competition affecting any trademark owner. Free riding is regulated under the Lanham Act, 15 U.S.C. § 1114, and by non-statutory law. ... Plaintiff would apparently have the court infer that Congress intended § 1526(a) as an additional remedy for violations of the law of unfair competition generally. There is no evidence that Congress intended such a sweeping scope to § 1526(a), and the court declines to so interpret it.
>
> If plaintiff is suffering from unfair competition generally, relief might be available under the Lanham Act or other laws.[31]

On appeal, the Court of Appeals for the Federal Circuit affirmed the Court of International Trade's judgment in *Vivitar*, but on narrower grounds.[32] After a thorough review of the legislative history of Sec. 526 and its relationship to the *Bourjois* cases, the court found the legislative history "too unfocused and misinformed to serve as a definitive basis for interpretation" of Sec. 526.[33] The court observed that:

30 *Id.*, at 432.

31 *Id.*, at 435.

32 *Vivitar Corp. v. U.S.*, Court of Appeals for the Federal Circuit, Appeal No. 84-1638, reprinted at 6 I.T.R.D. 2169 (May 6, 1985).

33 6 I.T.R.D., at 2177.

> Congress did not debate or intend to change trademark law to make uniform what the various courts might hold to be infringements. Rather, it ignored trademark law and, by amendment to customs law, gave a U.S. owner of a trademark a right to exclude foreign goods bearing the same trademark as the U.S. company had registered in the U.S. and recorded with Customs. Ownership of a U.S. trademark registration was condition to an exercise of that right, but trademark infringement by the importer was not.[34]

As a result, the court concluded that, "no limitations, based on indications of Congressional intent at the time of enactment, can be read into the statute itself."[35] Therefore, the Customs regulations at issue were found not to define or limit the protection afforded a U.S. trademark owner under Sec. 526. The "longstanding administrative interpretation" argument of the U.S. government was also found to afford no basis for a definitive statutory interpretation due to inconsistent regulations and interpretations by the Customs Service since 1923. In addition, the court summarily dismissed the argument that Congress had impliedly ratified Customs' administrative practice through failure to change Sec. 526.

Despite its rather extensive reversal of the major bases upon which other courts had found support for Customs' interpretation and enforcement of Sec. 526, the court did uphold the Customs regulations as a reasonable exercise of administratively initiated enforcement. In reaching this result, the court noted that since Congress did not confer legislative authority on the Customs Service in connection with administration of Sec. 526, the Customs regulations cannot affect the actual scope of a trademark owner's rights vis-à-vis an importer under the statute. Therefore, the Customs regulations are not controlling on the question of what gray market goods should be excluded, but "do no more than define Custom's role in initiating administrative enforcement of the statute ... [and] are not *contrary* to the statute."[36] Even though Customs is not required to exclude all gray market imports *sua sponte*, a trademark owner is entitled to obtain a judicial determination of infringement by the gray market imports and thereafter to have such imports excluded by Customs. It is clear from the court's reasoning that Customs will be required to exclude gray market imports judicially determined to infringe a U.S. trademark owner's rights which it might otherwise not have excluded if the U.S. trademark owner had sought to use the Customs administrative procedure in the first instance.

34 *Id.*, at 2177.

35 *Id.*, at 2179.

36 *Id.*, at 2183.

Vivitar has filed a petition for writ of certiorari with the U.S. Supreme Court for review of the decision of the Court of Appeals for the Federal Circuit, arguing that the court erred in affirming Customs' regulations on grounds not relied upon by Customs and on Customs' prior administrative practice.

A direct judicial challenge to the Customs Regulations was unsuccessful before another court in *COPIAT v. U.S.*[37] A coalition of American companies sought a declaration that the regulations were inconsistent with the Tariff Act of 1930 and the Lanham Trademark Act of 1946, an injunction prohibiting enforcement of these regulations, and an order directing that the statutes be enforced in accordance with their expressed terms. The U.S. District Court for the District of Columbia held that the construction of Sec. 526 of the Tariff Act by the Customs Service, as embodied in the challenged regulations, is sufficiently reasonable.

> The regulations clearly implement the limited purpose for which section 526 was enacted and are consistent with and effectuate the intent of Congress to permit entry of trademarked goods not involving the [*Bourjois*] situation.[38]

In reaching this conclusion, the court concluded that Sec. 42 of the Lanham Act applies only to merchandise bearing counterfeit or spurious trademarks that copy or simulate genuine trademarks. The court held that the *Bourjois* decisions were premised largely on the equities of the case and that they stand for the proposition that a trademark on imported merchandise may be deemed to copy or simulate only if the United States trademark registrant who purchased the rights to the trademark was truly independent of the foreign entity applying the mark abroad and had developed its own goodwill in the American marketplace.

This conclusion is, in the author's opinion, at odds with the findings of other courts regarding the law of the *Bourjois* decisions. In analyses of the chronological development of the predecessor of Sec. 42 of the Lanham Act, Sec. 27 of the Trademark Act of 1905, and the *Bourjois* decisions, the courts in *Osawa & Company* and *Bell & Howell: Mamiya* both concluded that foreign goods with genuine marks imported in derogation of the U.S. trademark owner's rights do "copy or simulate" the U.S. registered trademarks. Since the Supreme court, in the *Bourjois* decisions, reversed the Court of Appeals decisions relying on earlier cases which had held that Sec. 27 could not be invoked by the owner of a valid U.S. trademark against goods bearing the genuine mark of a foreign manufacturer, there is strong support for the

37 598 F. Supp. 844 (D.C. Cir. 1984).

38 *Id.*, at 852.

argument that these earlier cases were overruled by the Supreme Court.[39] Additional support for the argument that goods bearing genuine foreign trademarks may copy or simulate the same mark registered in the United States may be found in an opinion issued shortly after the *Bourjois* decisions. In *Coty, Inc. v. LeBlume Import Company, Inc.*,[40] the court stated that:

> Section 526(a) ... was intended only to supply the *casus omissus*, supposed to exist in section 27 of the Act of 1905 ..., because of the decision of the Circuit Court of Appeals in *Bourjois v. Katzel*. ... Had the Supreme Court reversed the decision last spring, it would not have been enacted at all.[41]

The court in *COPIAT v. U.S.* also based its opinion on the acquiescence of Congress in the Customs Service interpretation over a long period of time. It concluded therefore that the Customs regulations were in conformity with the intent of Congress, or else Congress would have changed Sec. 526. (This reasoning should be compared to that of the appellate court in *Vivitar*, which explicitly rejected the congressional acquiescence theory by stating: "Legislation by total silence is too tenuous a theory to merit extended discussion.")[42]

When one examines the development of the current Customs regulations, one is struck by the degree to which Customs has narrowed the scope of protection under Sec. 526. From 1923 until 1936, the Customs Service embraced the widest possible application of Sec. 526 and did not limit its application to only unrelated U.S. companies which had purchased the U.S. trademark rights from a foreign company. In 1936, a provision was added to the regulations to the effect that an identical foreign trademark did not copy or simulate within the meaning of Sec. 27 if the same person owned both the foreign and the U.S. trademarks. The other restrictions of § 133.21(c) were not added until 1972, 50 years after the original enactment of Sec. 526.

A partial explanation of why the Customs Service restricted the application of Sec. 526, and Sec. 42 of the Lanham Act, so long after it had given such a broad application of the law, partially lies in the case of *U.S. v. Guerlain, Inc.*, and the antitrust theories behind it. In that case, the U.S. Justice Department had brought suit against three perfume manufacturers, owners of U.S. trademarks, alleging violations of Sec. 2 of the Sherman Act in the companies' use of Sec. 526 to restrict the distribution of their own products. The court agreed and interpreted Sec. 526 to be inapplicable to the U.S. arm

39 *See, e.g., Gretsch v. Schoening*, 238 F. 780 (2nd Cir., 1916).

40 292 F. 264 (S.D.N.Y. 1923), *aff'd*, 293 F. 344 (2d Cir. 1923).

41 *Id.*, at 268–269.

42 *Vivitar Corp. v. U.S.*, 6 I.T.R.D. 2169, 2182.

of an international enterprise which sought to stop the importation of the enterprise's products. On appeal, the U.S. Government moved for dismissal to allow for the enactment of legislation restricting Sec. 526's applicability. A bill to repeal Sec. 526 was introduced in 1959 and was supported by the Departments of Justice, Treasury (the parent agency of the Customs Service), State, and Commerce (the parent agency of the Patent and Trademark Office). Congress never acted on the bill.

Although there is strong support in subsequent cases for the proposition that the Antitrust Division of the Justice Department has clearly repudiated the position taken in *Guerlain*, the Customs Service has continued to adhere to a restrictive interpretation of Sec. 526, based partially, if not completely, upon the *Guerlain* case. Indeed, as late as December 23, 1983, Secretary of the Treasury Regan stated that the "Customs Service regulations in question ... are based on a judicial decision in the consolidated 'perfume' cases."[43] This is none other than the *Guerlain* case. The lower court in *Vivitar* also noted in its analysis of the Customs regulations the control of the U.S. trademark owner over the use of the trademark by foreign licensees. However, it did not consider the lack of control which is exercisable by the licensee over its purchasers.

While numerous cases have supported the theory that foreign goods bearing a genuine trademark do copy or simulate U.S. registered trademarks, other courts continue to hold the opposite position. In *El Greco Leather Products Company, Inc. v. Shoe World, Inc.*,[44] the court held that the importation without plaintiff's consent of goods bearing its trademark, originally manufactured abroad with its authorization, but rejected due to late delivery, and subsequently imported into the United States without its authorization, did not constitute trademark infringement under the Lanham Act. In reaching this conclusion, the court relied on two cases interpreting state common law trademark rights, but failed to consider any of the prior cases specifically addressing the gray market imports issue. This case clearly demonstrates the wide difference of opinion among U.S. courts as to what types of gray market imports, if any, infringe U.S. trademarks. At this point, it should be noted that several of the more important recent gray market cases are currently on appeal. The issue is also currently before a presidential trade policy committee, and will probably not finally be settled until the Supreme Court again issues an opinion on the subject.

43 Memorandum of Points and Authorities in Support of Plaintiff's Motion for Summary Judgment, in *COPIAT v. U.S.*, at 41. The *Guerlain* decision has been carefully criticized in M. HANDLER, "Trademarks – Assets or Liabilities," 48 T.M.R. 661 (1958).

44 599 F. Supp. 1380 (E.D.N.Y. 1984).

In addition to Sec. 526 of the Tariff Act and Sec. 42 of the Lanham Act, some plaintiffs have also alleged trademark infringement by gray market imports under Sec. 32 of the Lanham Act.[45] Despite the fact that many plaintiffs still have not succeeded in excluding gray market imports, U.S. companies have been consistently more successful in obtaining a finding of trademark infringement under this section. The courts in both *Osawa* and *Bell & Howell: Mamiya* found that the principle of the territoriality of trademarks supported the conclusion that genuine foreign trademarks could reproduce, counterfeit, copy, or colorably imitate U.S. registered trademarks since each trademark has a separate legal basis, a different factual significance, and an independent goodwill in each country.[46] Although courts are divided on how narrowly or broadly Sec. 32 should be construed, it would appear that a majority have found trademark infringement under Sec. 32.[47] Those courts which have not supported a finding of trademark infringement under these circumstances have done so due to a different interpretation of the principle of trademark territoriality.[48]

The recent *Duracell* decision of the U.S. International Trade Commission,[49] and the President's disapproval of this decision, have made gray market imports a major international trade issue in the United States. In *Duracell*, the complainant, a U.S. manufacturer of batteries and owner of three U.S.

45 15 U.S.C. § 1114. Section 32(1) provides in part:
"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 which such use is likely to cause confusion, or to cause mistake, or to deceive ... shall be liable in a civil action by the registrant."

46 The Court in *Osawa* noted that: "The (territoriality) principle has become still more solidly implanted in United States law by the 1962 amendment to § 32 of the Lanham Act, 15 U.S.C. 1114, which repealed the requirement that a plaintiff in a trademark action show confusion as to 'source of origin' of the goods."

47 *See, e.g., Adolph Coors Co. v. A. Geuderson & Sons, Inc.*, 486 F. Supp. 131 (D. Col. 1980); *Trail Chevrolet, Inc. v. General Motors Corp.*, 381 F. 2d 353 (5th Cir. 1967); *Menendez v. Faber, Cole & Gregg, Inc.*, 345 F. Supp. 527 (S.D.N.Y. 1972) (the potential difference in quality arising from misdesignation of source of origin was enough to support trademark infringement); *Weil Ceramics & Glass, Inc. v. Bernard Dash and Jalyn Corporation*, No. 84-21575 (D.N.J. August 14, 1985) (order granting partial summary judgment).

48 *See, e.g., El Greco Leather Products Co., Inc. v. Shoe World, Inc., supra*, wherein the Court stated that: "the absence of a trademark holder's authorization to its (foreign) manufacturer to sell genuine goods cannot constitute trademark infringement under the Lanham Act." 599 F. Supp. 1380, 1393.

49 *In re Certain Alkaline Batteries*, Inv. No. 337-TA-165, U.S.I.T.C. Pub. 1616 (November 1984).

registered trademarks, sought to exclude imports of batteries made in Belgium pursuant to a licensing agreement and bearing the U.S. registered trademarks. This action was brought under Sec. 337 of the Tariff Act of 1930,[50] alleging infringement of a registered trademark, misappropriation of trade dress, false representation and false designation of geographic origin, failure to mark country of origin, and failure to identify the quantity of the contents of imported packages. Following a hearing, the judge found in favor of the complainant on all counts. The Commission then reviewed the judge's finding of trademark infringement, misappropriation of trade dress, and false designation of origin.[51]

In its decision, the majority of the Commission reaffirmed the principle of territoriality of trademarks as a fundamental principle of U.S. trademark law. Although the majority then concurred in the judge's finding that there had been no violation of Sec. 526, citing the Court of International Trade *Vivitar* opinion, it did hold that "the common law of trademarks affords a remedy for infringement of a trademark-holder's territorial right independent of the Customs Law or the Lanham Act."[52]

It also found that Sec. 42 of the Lanham Act had been violated, and that the gray market goods at issue did copy or simulate the complainant's registered trademarks. It held that by reenacting the same language of Sec. 27 of the Trademark Act of 1905 into Sec. 42 of the Lanham Act, Congress had incorporated the interpretations of Sec. 27 which the Supreme Court had made in the *Bourjois* cases.

50 19 U.S.C. § 1337. This section provides in part that:
"(a) Unfair methods of competition and unfair acts in the importation of articles into the United States, or in their sale by the owner, importer, consignee, or agent of either, the effect or tendency of which is to destroy or substantially injure an industry, efficiently and economically operated, in the United States, or to prevent the establishment of such an industry, or to restrain or monopolize trade and commerce in the United States, are declared unlawful, and when found by the Commission to exist shall be dealt with, in addition to any other provisions of law, as provided in this section."
Investigations under § 1337 are conducted by the U.S. International Trade Commission, an independent federal agency composed of five Commissioners appointed by the President. Once a complaint is accepted by the Commission, an investigation before an administrative law judge is conducted. After a trial type hearing, the judge issues a decision which the Commission may adopt as its own, or review and then issue its own decision. If the complainant can prove a violation of the statute, it may obtain an exclusion order barring the unlawful imports from entry into the United States.

51 The Commission also determined to review the judge's finding that the imports had caused substantial injury to the complainants.

52 *Duracell* case, at 20.

The three majority Commissioners also found that the imported batteries violated Sec. 32 of the Lanham Act. They discussed this aspect of the case in some detail, specifically noting that when the foreign-made batteries are sold in Europe, they are not a "copy" of the U.S. trademarked batteries, although they are identical to them. However, when the batteries are imported and sold in the United States, the Belgian trademark becomes a copy of the U.S. trademark. In so finding, the majority specifically noted the potential expectation of the product's consumer in the United States regarding the quality of the product – in other words, the goodwill of the U.S. trademark owner. The potential for confusion, particularly as to sponsorship of the product, was also found to be great, since differences in quality are unlikely to be detected by a consumer before the product is purchased. The majority Commissioners also found a potential for confusion as to source of origin, in this case as to the source of distribution rather than manufacture. They noted that this finding of likelihood of confusion was supported by the physical similarity of the U.S. and foreign batteries, the testimony of an expert witness, and a survey of consumers conducted by the complainant. In addition, they found that the respondents (the importers) were liable for misappropriation of trade dress, false designation of origin, and failure to comply with the Fair Packaging and Labeling Act.[53]

One of the three majority Commissioners, Vice Chairman Leibeler, noted for the record her additional views that Sec. 526 was applicable to the case and that it had been violated by the imported batteries. She supported a "plain meaning" interpretation of Sec. 526, and criticized the lower court in *Vivitar* for not giving greater weight to statements by the Customs Service in the *Bell & Howell: Mamiya* case, in which the Customs Service stated that there was no clear evidence of legislative intent to deny the owner of the U.S. trademark the protection of Sec. 526 because the U.S. owner was owned or controlled by the foreign manufacturer. Chairman Leibeler stated that:

> An interpretation of section 526 limiting its applicability to transactions between unrelated entities is premised on an improper view of trademarks. This view of trademarks is based on the theory of universality, which ignores the independent goodwill the trademark can represent in separate national markets.[54]

In separate views, the two other Commissioners, Chairman Stern and Commissioner Rohr, generally disagreed with the majority. They found that Sec. 526 was not a proper basis upon which to exclude the imported batteries.

53 15 U.S.C. §§ 1452 and 1453.

54 *Duracell* opinion, additional views of Vice Chairman LEIBELER, at 3.

Agreeing with the lower court in *Vivitar,* they found the Customs regulations interpreting Sec. 526 to be binding because the legislative history of Sec. 526 strongly suggests that, in enacting the section, Congress was concerned only with providing a special remedy to protect American businesses that purchase foreign trademarks from imports that violate the rights the American businesses purchase. In so holding, Commissioners Stern and Rohr noted that the lower court *Vivitar* decision was more compelling on the issues of proper interpretation of Sec. 526 and the authority of the Customs Service regulations than the *Osawa* decision, which only involved the question of whether the Customs Service regulations were applied properly.[55]

While the minority agreed with the judge that Sec. 42 of the Lanham Act does incorporate the concept of territoriality into U.S. trademark law, it disagreed with his application of the principle and his incorporation of the requirement of confusion by the customer as to the source of origin of the goods. The minority stated that under Sec. 42 only "likeness" must be proven, and confusion is to be presumed. It then went on to find that the Customs Service, in its implementation of this statute, had interpreted the presumption of confusion to apply only in the context of independent and unrelated companies.[56]

The minority did, however, agree with the majority that Sec. 32 of the Lanham Act had been violated in that the trademark and trade dress used on the foreign batteries were a "reproduction, counterfeit, copy, or colorable imitation" of the U.S. trademark and trade dress when the batteries bearing the foreign (although identical) trademark entered the U.S. market. Since the principle of territoriality established that the two trademarks were legally not the *same* marks, the foreign trademark was a *copy* of the U.S. trademark. The minority also found a strong likelihood of "confusion of goodwill," which they defined as confusion relating to ancillary services which the trademark holder provides up to the point of sale which affects the consumer's perception of the goods.[57]

55 It should be noted that in the *Osawa* case, the Customs Service had granted an exclusion order to the plaintiff. The defendant argued that if the regulations had been properly applied by Customs, the plaintiff would not have been entitled to an exclusion order, since both the plaintiff and the defendant were subject to "common control." 589 F. Supp. 1163, 1177.

56 They did not address the argument raised elsewhere that the Customs Service is without authority to interpret trademark law.

57 *Duracell* opinion, views of Chairman Stern and Commission ROHR, at 19.

Although the Commissioners differed regarding the appropriate remedy, the majority recommending a general exclusion order and the minority recommending labeling of the European batteries prior to entry into the United States, the Commissioners were all in agreement that at least Sec. 32 of the Lanham Act had been violated by the imported batteries.

Within the 60-day period during which the President may act under the statute, he disapproved the Commission's determination, for "policy reasons," on January 4, 1985. In disapproving the decision, the President stated that:

> The Commission's interpretation of section 42 of the Lanham Act (15 U.S.C. 1124), one of several grounds for the Commission's determination, is at odds with the longstanding regulatory interpretation by the Department of the Treasury, which is responsible for the provisions of that section. The Administration has advanced the Treasury Department's interpretation in a number of pending court cases. Recent decisions of the U.S. District Court for the District of Columbia and the Court of International Trade explicitly uphold the Treasury Department's interpretation. Allowing the Commission's determination to stand could be viewed as an alteration of the interpretation. ... The Departments of Treasury and Commerce ... have solicited data from the public concerning the issue of parallel market importation and are reviewing responses with a view toward formulating a cohesive policy in this area. Failure to disapprove the Commission's determination could be viewed as a change in the current policy prior to the completion of this process.

The *Duracell* case was appealed to the Court of Appeals for the Federal Circuit. The ITC asserted that the court lacks jurisdiction to review the President's disapproval on the grounds that the court only has jurisdiction to review a final ITC determination and that the disapproval was not a final Commission determination. The U.S. owner of the "Duracell" trademark argued that the President's decision was based on improper policy reasons and that the policy upon which a disapproval is based must be a present policy as opposed to a future or anticipated one. Presidential disapprovals have been issued in only three prior Sec. 337 investigations, and have all been based on trade or foreign policy grounds.[58] The President's disapproval of the

58 *Certain Welded Stainless Steel Pipe and Tube*, Inv. No. 337-TA-29, U.S.I.T.C. Pub. No. 863 (1978), reprinted at 1 ITRD 5245; *Certain Headboxes and Papermaking Machine Forming Sections for the Continuous Production of Paper and Components Thereof*, Inv. No. 337-TA-82, U.S.I.T.C. Pub. No. 1138 (1981), reprinted at 2 ITRD 5481; and *In re Certain Molded-In Sandwich Panel Inserts*, Inv. No. 337-TA-99, U.S.I.T.C. Pub. No. 1297 (1982), aff'd, 721 F. 2d 1305 (C.A.F.C. 1983).

Duracell decision was questionable for several reasons. The presidential disapproval provision of Sec. 337 was intended to provide the President with authority to disapprove ITC determinations only for policy reasons, and not for the purpose of reversing a Commission finding of a violation of Sec. 337.[59] It was clearly not intended by Congress to authorize the President to disapprove a determination of the ITC, an independent agency, because of conflict with another agency regarding the appropriate policy with respect to the issue of law before the ITC. In addition, the language of Sec. 337 specifically empowers the ITC to find certain acts and methods of competition unfair and remedy them, "in addition to other provisions of law." It has consistently been held that the ITC has wide discretion in determining what practices are to be regarded as unfair and should not be limited by the technical definitions of unfair methods of competition applied in other decisions.[60] In its opinion in *Duracell,* the Commission went to great lengths to clarify that its decision was based on the common law of trademarks and that the gray market imports complained of constituted unfair acts under Sec. 337.[60a]

A working group of the White House Cabinet Council on Commerce and Trade has recently addressed the issue of gray market imports in a policy paper. The attention of the group to this problem at the executive level is due to the recent gray market cases which have resulted in differing interpretations of U.S. law, and to political pressure from both gray market importers and U.S. trademark owners. Six policy options were recommended by this

59 S. Rep. 1298, 93rd Cong., 2d Sess. 199 (1974).

60 *See, e.g., In re Von Clemm,* 229 F. 2d 441 (C.C.P.A. 1955); *Frischer & Co., Inc. v. Bakelite Corp.,* 39 F. 2d 247 (1930).

60a On December 9, 1985, The Court of Appeals for the Federal Circuit dismissed the appeal for lack of jurisdiction. The Court held that the President's disapproval was not a final Commission determination, and therefore not judicially reviewable. The Court also went on to find that even if the President's disapproval was reviewable, his action was in accordance with law. The Court found no requirement in Section 337 or its legislative history that the President articulate or detail his reasons for a disapproval, and that "policy reasons" could include the reasons cited in his disapproval.

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Working Group on Intellectual Property.[61] The Administration may favor the option of "demarking" (Option V), which would allow entry and sale of gray market imports in the United States only if the trademark were removed. Opponents of this option contend that such removal is often impossible without permanent damage to the product, or that the product is so configured as to make removal of the trademark impossible or meaningless, and that removed trademarks may be subsequently reapplied to the gray market goods. The policy paper of the Working Group on Intellectual Property was based upon economic data submitted in response to a notice published by the Customs Service and the Patent and Trademark Office on May 21, 1984 inviting public comment and presenting a questionnaire concerning gray market imports.[62] The Working Group noted that responses to the questionnaire indicated that gray market imports may have adverse effects on U.S. trademark owners, although these effects cannot be quantified since

61 The Policy Paper lists the following options:

Option I. Status quo: Maintain the present enforcement policy regarding trademark protection, that is, allow the importation of grey market goods.

Option II. Allow grey market competition, but impose mandatory consumer protection labeling requirements on grey market retailers, informing consumers of the warranty and service protection provided and that the goods are neither authorized nor warranted by the U.S. trademark owner.

Option III. Amend section 337 of the Tariff Act of 1930 so that, in investigations involving parallel imports, after a showing of trademark infringement, the complainant would be required only to show substantial injury to itself as the owner of the trademark in the United States, rather than substantial injury to "an industry, efficiently and economically operated, in the United States."

Option IV. Continue the policy to allow parallel imports in situations where the foreign producer is related to the U.S. trademark owner, but only if the imported goods are completely "identical" with their domestic counterparts. The "identity" would be determined on the basis of shape, taste, color, freshness, composition, trade dress, function, durability, similarity of warranty, availability of repair service, etc. U.S. trademark owners would be permitted to show "non-identity" and importers could contest such a showing. Proceedings could be conducted by an Administrative Law Judge in the Department of Treasury, for example, and would be judicially reviewable.

Option V. Allow the importation of goods only if the infringing trademark is removed or obliterated. Importers could affix their own trademark on the goods.

Option VI. Establish a new policy prohibiting "parallel imports" of goods bearing trademarks without the written consent of the U.S. trademark owner.

Conclusion. The Working Group on Intellectual Property has not been able to agree on any single recommendation regarding parallel imports. Arguments exist on both sides of the issue, extending even to the middle groups suggested in Options II to V. Accordingly, the Working Group presents these six options to the Cabinet Council for its consideration in establishing a policy on the question of parallel imports.

62 49 Fed. Reg. 21453 (May 21, 1984).

parties responding to the questionnaire were reluctant to disclose proprietary information on relative market shares and other economic data. It remains to be seen whether the various U.S. federal agencies concerned will be able to reach a consensus of opinion regarding the proper scope of protection from gray market imports.

Conclusion

While the scope of exclusion of gray market imports under present statutory law may not be a proper question for U.S. trademark law, the application of the principle of territoriality does provide results which protect the expectations of U.S. trademark owners and of consumers of their products. In applying Sec. 32 of the Lanham Act to gray market imports, many courts and administrative bodies have found trademark infringement. Those courts which have not found trademark infringement due to a different interpretation or non-application of the principle of territoriality seem to have failed to appreciate the realities of the commercial marketplace and the commercial importance of trademarks to a company's local (national) goodwill and marketing.

The present state of the law is clearly inadequate to properly protect U.S. trademark owners from gray market imports. A cohesive legal statement of what types of gray market imports may be excluded from the United States is necessary. The issue will not be settled until either the U.S. Supreme Court or the U.S. Congress clarifies and defines the scope of protection. Absent such action, the difference of opinion existing between those judges and government officials who advocate the maximum protection of trademark rights, and those who view any such protection as a form of monopolization, will continue to result in diverse decisions and policy statements on gray market imports. Trademarks are an important and vital part of most businesses. Without the broadest possible protection for these trademarks from gray market imports, and a recognition of the territorial goodwill manifested in them, this author believes that fair international commerce will continue to be hindered. Trademark owners may begin to place less value in their trademarks and the goodwill behind them. And, consumers may lose faith and trust in many trademarked products as a result of confusion and unreliability in the marketplace. The realities of an increasingly interdependent global marketplace must be balanced against the rights and expectations of consumers and trademark owners.

COMMITTEE ON FINANCE

SUBCOMMITTEE ON INTERNATIONAL TRADE

UNITED STATES SENATE

COMMENTS ON S. 2614

FILED ON BEHALF OF

MITSUBISHI MOTOR SALES OF
AMERICA, INC.

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August 12, 1986

Mitsubishi Motor Sales of America, Inc. ("MITSUBISHI-AMERICA") is the exclusive United States distributor in the United States for automobiles manufactured by Mitsubishi Motors Corporation ("MMC") which bear the MITSUBISHI brand trademark and logo. While MMC is the owner of the trademark "MITSUBISHI" as applied to automobiles in the United States, MITSUBISHI-AMERICA is obligated to and has expended millions of dollars to carefully nurture the high quality reputation of the MITSUBISHI brand motor vehicles which it sells in the United States, not only through advertising, but through a specially selected dealer network which provides services under MITSUBISHI-AMERICA's comprehensive limited warranty.

As a California corporation, MITSUBISHI-AMERICA is seriously concerned about the impact of gray market motor vehicles both on MITSUBISHI-AMERICA's reputation and goodwill and on the actual physical well-being of consumers of gray market motor vehicles. MITSUBISHI-AMERICA submits this statement for the purpose of voicing its objection and concern regarding two specific aspects of the stated rationale for and the impact of S. 2614: first, the misconception that "other than price, the [gray market] products and [genuine products] are identical" and, second, the adverse effect of a stated policy in favor of gray market on trademark infringement cases under Section 32(1) and 43(a) of the Lanham Act.

In the sponsor's comments in introducing S. 2614, the observation is made that genuine trademark goods are brought to U.S. consumers either through a U.S. authorized distributor or through independent U.S. importers who purchase the goods from foreign authorized distributors, to wit: "Other than price, the products are identical." This statement is simply incorrect with respect to motor vehicles which, if not specifically manufactured for the United States market, will differ in significant respects from the product distributed by the authorized distributor. A comparison between the motor vehicles imported by MITSUBISHI-AMERICA and those which may enter the United States through the gray market readily illustrates the fact that the consumer of the gray market product purchases a markedly different and inferior product.

When a consumer purchases a MITSUBISHI-AMERICA Mitsubishi which has been imported into this country by MITSUBISHI-AMERICA, this consumer receives a genuine MITSUBISHI brand vehicle accompanied by MITSUBISHI-AMERICA's comprehensive warranty, and further receives written and verbal assurance that the vehicle has been thoroughly inspected at the U.S. Port of Entry for any safety problems, that the vehicle has been given specialized predelivery inspection with critical safety checks by the authorized MITSUBISHI-AMERICA dealer, that it carries the warranty and pricing information required by federal law, that the consumer has been informed of his rights under state "lemon laws," and that the consumer will be notified in the event that a voluntary service campaign to correct any problems or a recall to correct any malfunctions or defects is initiated by MITSUBISHI-AMERICA.

As an automobile importer/distributor, MITSUBISHI-AMERICA is subject to and must comply with the most extensive network of safety regulations and disclosure requirements in the world, most of which exist for protection of the consumer. These laws include (a) highly technical federal and state regulations relating to emission standards, which require, inter alia, various engine modifications depending upon that part of the country in which the vehicle will be operated, and which require importers to warrant compliance with the applicable laws for five years under threat of a $10,000 penalty per noncomplying vehicle; (b) detailed federal reporting requirements relating to defects, recalls and warranties; (c) specific state and federal labelling requirements regarding price and origin (commonly known as "Monroney labels") and fuel economy; (d) state licensing laws which often require distributors to post surety bonds and file warranties in order to obtain a license to distribute vehicles in the state; and (e) state laws requiring MITSUBISHI-AMERICA to notify all customers of their right to make claims to the importer under so-called "lemon laws." MITSUBISHI-AMERICA spends millions of dollars annually to ensure proper compliance with all these laws.

An automobile bearing marks identical to those on the vehicle distributed by MITSUBISHI-AMERICA but imported through the gray market will appear to the consumer to be the identical product but in fact it is inferior in significant respects. The gray market vehicles most likely will not carry "Monroney labels," will not not carry the federally mandated "Emission Performance Warranty," will not have been inspected at the Port of Entry by knowledgeable MITSUBISHI-AMERICA representatives for possible safety problems or damage and may be accompanied by an owner's manual which differs from that offered by MITSUBISHI-AMERICA. While the gray market owner's manual may direct the consumer to contact his "authorized Mitsubishi dealer," MITSUBISHI-AMERICA's authorized dealers do not provide any of the standard warranty protection to gray market vehicles which are extended to those products distributed by MITSUBISHI-AMERICA.

Most importantly, a consumer purchasing a gray market motor vehicle will be outside the channels for notification of recalls and other safety problems. This creates a serious risk of harm to the public from the sale of these gray market motor vehicles. This safety aspect is present not only in gray market motor vehicles but in other products, such as electronic goods, which are regulated on both the state and federal level.

By virtue of the foregoing illustration, MITSUBISHI-AMERICA wishes to call attention to the fact that gray market goods can and do differ significantly, often in ways potentially harmful to the consumer, from the product distributed by the authorized U.S. distributor. The cost of complying with federal regulations, ensuring consumer safety, and advertising to create and maintain a high quality image is borne by the authorized distributor and represents an obvious cost factor in the pricing of the product. The gray market importer bears none of the responsibility for compliance or for developing the market shouldered by the authorized U.S. distributor and can therefore quite naturally offer the product at a lesser price. But the product being offered, at least in the case of motor vehicles, is also a lesser product.

Several courts have found a likelihood of confusion between the authorized product and the gray market product precisely because the gray market products were not identical to the products intended for sale in the United States. Selchow and Richter Co. v. Goldex Corp., 612 F.Supp. 19, 225 U.S.P.Q. 815 (S.D. FLA. 1985); Osawa & Co. v. B&H Photo, 589 F.Supp. 1163, 223 U.S.P.Q. 124 (S.D.N.Y. 1984). While the proposed bill S. 2614 does not purport to modify Sections 32(1) and 43(a) of the Lanham Act under which these cases were decided, the comments of the sponsors may cause future courts to read the intent of Congress as implicitly overruling those cases excluding gray market goods on a likelihood of confusion theory. Those cases are grounded in the "territoriality doctrine" of trademarks, first established by the U.S. Supreme Court in A. Bourjois & Co. v. Katzel, 260 U.S. 689 (1923), under which it has long been established that the United States trademark has a separate and distinct goodwill from the goodwill attaching to that mark outside the United States. This long standing rule of trademark construction should not be implicitly overruled in this context without very careful consideration as to the consequences.

MITSUBISHI-AMERICA respectfully submits that S. 2614, purporting to state a congressional intent in favor of gray market, is not the context for reconsideration of the territoriality doctrine. Even as the legislation purports to establish congressional intent in favor of gray market, the law as proposed would still permit the exclusion of gray market goods in the circumstances permitted under the present customs regulations. Thus, to state an intent in favor of gray market importation in support of a law which in fact prohibits gray market importation in a number of circumstances will only serve to further confuse an already confused area of the law. In the case of sophisticated consumer products, MITSUBISHI-AMERICA submits that such confusion will not benefit the consumer and may, in fact, cause considerable harm.

TO: THE INTERNATIONAL TRADE SUBCOMMITTEE,
SENATE FINANCE COMMITTEE

RE: S. 2614
THE PRICE COMPETITIVE PRODUCTS ACT OF 1986
HEARING ON "GRAY MARKET GOODS"

FINAL SUBMISSION OF THE

NATIONAL ASSOCIATION OF
BEVERAGE IMPORTERS, INC.

ROBERT J. MAXWELL, PRESIDENT
NATIONAL ASSOCIATION OF
BEVERAGE IMPORTERS, INC.
1025 VERMONT AVE., NW
SUITE 1205
WASHINGTON, DC 20005

AUGUST 11, 1986

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The Hearings

On July 29, 1986 the Senate Finance Committee conducted hearings on S. 2614. This submission is made by the National Association of Beverage Importers (NABI) as a supplement, and a partial summary to testimony given in opposition to this bill. We call particular attention to the testimony of Mr. Peter Thompson who appeared on behalf of the Paddington Corporation, NABI, and DISCUS.

The Bill

1) It would deprive trademark owners of the right to utilize the Customs Service in preventing unauthorized importation of trademarked merchandise.

2) It would remove the right of the trademark owner to prosecute a private right of action against unauthorized importation of trademarked merchandise.

Gray Market Goods

3) It would legitimatize the "free ride" of the unauthorized importer. This could be dangerous to the consumer, and damaging to the trademark owner. In this connection we call particular attention to the observations of Senator Heinz in reference to Pepsi Cola at Page 30 of the record:

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> Let's assume I am the Pepsi Company, and I sign an agreement with Mexico that they can make Pepsi Cola in Mexico and sell it only to Mexico, not in the United States. And the reason I do that is they have slightly different taste down in Mexico and I don't want Americans getting this different tasting Pepsi Cola ... Now, people in Mexico get a hold of this Pepsi Cola. It is cheaper. Wage rates are lower in Mexico. Sugar prices are lower in Mexico. And it somehow gets into the United States and starts showing up in K Mart shelves, and wherever. And it is being sold. But the consumer thinks it is regular old Pepsi Cola. And they think -- they tast it and it tastes awful, and they think that Pepsi Cola has pulled a fast one, you know.

The foregoing capsulizes the plight of the authorized importer of ingestible products concerning gray market imports.

1) The trademarked product produced for the U.S. market may not be identical with the trademarked product produced for another country.

2) Where a different formula is used it could harm the importer and the trademark owner.

3) The different formula could be in contravention of U.S. food

3

standards.

Beyond these very cogent points, there is an overriding concern of unfairness. An authorized importer spends years to develop the brand in the United States through advertising and promotion. The gray marketeer should not be permitted to trade on the good will that this importer has built up without having shared in the responsibility, and effort of having built up the this demand.

Necessity for Further Study

1) As indicated above, S. 2614 deals very decisively with trademarks and intellectual property rights. As such the proposed legislation should be studied by the Senate Judiciary Committee.

2) There is a Customs Service study of the possible option of labeling and demarking. Action on this bill should be deferred pending the recommendation of the Customs Service on these options.

3) At the hearing on S. 2614, some crucial questions were raised concerning not only the rights of the public in having cheaper merchandise, but the rights of the trademark owner, and authorized distributor, in protecting the good name of his merchandise.

STATEMENT SUPPORT OF S. 2614
BY
RICHARD B. KELLY, GENERAL COUNSEL

NATIONAL ASSOCIATION OF CATALOG SHOWROOM MERCHANDISERS

SUBCOMMITTEE ON INTERNATIONAL TRADE,
COMMITTEE ON FINANCE
JULY 29, 1986
9:30 A.M.

DIRKSEN SENATE OFFICE BUILDING - ROOM 215

Members of the Committee: we very much appreciate the opportunity to appear before the Committee today in support of free and open competition in the sale of foreign made consumer products to United States citizens.

We believe that virtually everyone recognizes that in 1986 we live in a world economy. It is therefore particularly distressing for discount retailers such as catalog showrooms, which seek to sell brand named products for below full list price, to find that foreign manufacturers and their U.S. marketing affiliates, often wholly subsidiaries, seek to deny such retail price retail competition.

Catalog showrooms and other discount retailers are sometimes excluded from selling to such consumer product lines because they sell for less. Foreign manufacturer control of consumer product lines has become the primary battle ground for objections to parallel imports. It is particularly ironic that these foreign manufacturers attempt to prevent retail price competition in the United States by calling the sale of identical legitimate merchandise an issue of "grey market goods", thereby suggesting somehow competition is semi - illicit.

Catalog Showrooms, who sell for less are often denied product availability because of their retail selling price. These products include watches, frangrances, silverware, china, ceramics cameras and some audio equipment.

With the permission of the Committee we will submit a a more detailed statement as to a wide nature of these abuses and various attempts through state legislation and lawsuits to inhibit such competition.

We would point out to the Committee that when a particular product line such as watches is dominated by producers from any one country such as Japan, there is an added potential for concerted control over product availability and price. Furthermore, to the extent U.S. sales are controlled through wholly owned U.S. marketing subsidiaries there is an added facility to charge a higher than worldwide price in the United States thereby raising prices to consumers, and reducing income taxes in this country. Such control, fostered by a lack of actual and potential competition, does not inure to the benefit of the U.S. economy.

In the interim we enclose, for whatever use it may to the Committee and it's staff, the draft of a law review article I prepared for submittal to the University of North Carolina Law School Journal of International Law and Commerce which discusses legal background surrounding these issues.

We believe it appropriate to conclude by emphasizing, as many other proponents of free and open competition have noted, that no significant international trading partner of the United States prohibits parallel imports. Citation to various cases in foreign countries on this issue are included in the papers submitted to the Committee.

It is incomprehensible why the United States would permit foreign manufacturers to utilize the pretext of a need to promote foreign manufacture of such goods as a reason to deny retail price competition in the United States.

Claims of exclusive intellectual property rights for United States distribution ring hollow after the goods have been sold, and after a profit has been made placing these goods in the free flow of international competition. It seems to us without any substantial merit for the wholly owned subsidiary of a foreign manufacturer to attempt to claim a subsequent right to prevent competition from parallel imports. Yet they do so.

Most cases have upheld the Customers Regulations. However after the recent Copiat decision to the contrary, we believe it appropriate for the Senate to clarify Congressional intent. We believe S. 2614 the appropriate means to do so.

Respectfully submitted

Richard B. Kelly, General Counsel

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Showroom Merchandisers

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STATEMENT OF NATIONAL MASS RETAILING INSTITUTE SUBMITTED TO THE INTERNATIONAL TRADE SUBCOMMITTEE OF THE SENATE FINANCE COMMITTEE ON S.2614

"A Bill to Provide for Parallel Imports in Order to Provide Savings for U.S. Consumers"

The National Mass Retailing Institute ("NMRI") is honored to present this statement to the International Trade Subcommittee of the Senate Finance Committee on S.2614, a bill of vital importance to United States consumers.

NMRI

The National Mass Retailing Institute is a trade association representing over 100 major discount retailing chains which operate over 15,000 stores in all 50 states. Our members' sales represent an ovewhelming majority of the $126.1 billion per year discount industry. In many states, discount sales are a full one-fifth of the total retail sales made. Discount Store News, July 21, 1986, p.29.

NMRI stores operate ~~in all~~ states of the United States under a simple, but powerful, marketing philosophy: discount retailers sell a high volume of goods at prices generally well below manufacturers' suggested list prices, the prices often charged by manufacturers' authorized dealers.

The discount retail industry has enjoyed explosive growth in the last two decades. Indeed, studies indicate that the dollar volume of sales made by surveyed discount stores increased by 2800% from 1960 to 1982. "The True Look of the Discount Industry," 23 Discount Merchandiser 40 (1983). The explanation for that growth is simple: American consumers have turned to discount stores because those stores offer an attractive blend of low prices, desired products, and valued services. Because discount retailers and consumers benefit from a retailer's right to offer low prices, NMRI is vitally interested in preservation of the rule of law that parallel imports be allowed to enter into United States commerce. The discount industry owes its success, and its survival, to a retailer's ability to be competitive in pricing and marketing of brand-name goods; access to parallel imports is an important part of the discount retailer's business.

The Issue: Parallel Imports

In his remarks made when introducing this bill, Senator Chafee defined parallel imports:

> "Parallel imports are genuine, trademarked articles manufactured abroad and purchased on the world markets by independent American importers. ...The products are manufactured in the same plants, but imported and sold through different channels at vastly different prices."

Senator Chafee also described what parallel imports are not:

> "...Parallel imports are not counterfeit goods or cheap imitations of brand name, trademarked goods. They are genuine goods, manufactured by the trademark holder and they do not displace American manufacturing jobs."

132 Cong. Rec. S8741-8742 (Daily ed. June 26, 1986).

In short, parallel imports are first-quality, genuine goods, manufactured abroad and legally imported into the U.S. for sale through competitive channels. Parallel imports may include, for examples: Japanese cameras, Irish crystal, French tires, French perfume, English china, Japanese televisions and other consumer electronics products, and Swiss and Japanese watches. Absent parallel importation, these products would be imported only through restricted distribution networks picked by the foreign manufacturer. Consumer prices on these goods would be high, at or near the foreign manufacturers' "suggested" resale prices. With parallel imports, however, there is price competition for these goods -- competition which enables American consumers to get the same reasonable prices offered to foreign consumers of these goods.

The parallel imports issue is quite simple: Should parallel imports continue to enter the United States? Certain foreign manufacturers, seeking to preserve high prices, have expended great time and monies to urge that this question be answered: "No.". However, the Treasury Department, the majority of courts, the Congress, and -- most important -- the American consuming public have resoundingly answered this question: "Yes." There are a wealth of reasons to support the view that parallel imports should be permitted to continue to enter the United States: (1) parallel imports have traditionally been encouraged by Congress and the Administration; (2) parallel imports are pro-competitive and in the American consumer's best interests; (3) permitting parallel imports is consistent with our foreign trading partners' policies; and (4) affected trademark holders are not injured by parallel imports.

We proceed to address each of these four points in greater detail below.

1. Congress and the Administration Have Traditionally Permitted Parallel Imports

The history of Congressional approval of parallel imports is long and involved. What emerges from a study of that history is that, on every occasion when the issue has been studied, Congress, as well as the Treasury Department, have concluded that parallel imports ought freely to enter this country.

The present legislation is justified, then, simply as an uncontroversial ratification of historical treatment of parallel imports. Such a ratification would end the recent wrangling on the subject -- wrangling initiated by foreign companies seeking to avoid price competition -- and would confirm, again, this nation's policy in favor of parallel imports.

a. Prior legislation

On at least six occasions in the last sixty five years, Congress has determined that parallel imports ought to be permitted entry into this country. Section 526 of the 1922 Tariff Act was Congress' first foray into this area. That statute, enacted as a response to the decision of the Court of Appeals of the Second Circuit in A. Bourjois & Co. v. Katzel, 275 F.539 (2nd Cir. 1921), prohibits the importation into the United States of certain trademarked merchandise but only where the trademark is owned by a corporation created or organized in the United States and domiciled in the United States. The legislation, in brief, permitted U.S. national trademark holders to prevent unauthorized importation of their goods into the country. The legislation was not intended to apply to foreign national trademark holders. Indeed, the legislative history of the 1922 Act, though scant, demonstrates a Congressional intent to permit entry of trademarked goods where the trademark is owned by a foreign company, a company not domiciled in the United States.[1]

1/ This distinction -- between U.S. national and foreign owners of U.S. trademarks -- is critical to the parallel imports debate. The distinction was clearly made in the early congressional study of the topic. For example, in response to a question from Senator Lenroot, an opponent of §526 of the 1922 Tariff Act, to
(Footnote 1 continued on next page)

Congress later re-enacted Section 526 in the Tariff Act of 1930, presumably fully conscious of 1923 Customs Regulations which limited protection under the statute to trademarks owned by American citizens. In 1954, 1959, 1978, and as recently as 1984, Congress again affirmed the legality of permitting parallel imports.[2]

In 1978, for example, Congress amended Section 526 of the Tariff Act. At that time, Congress was fully aware that Customs regulations did not provide import protection to foreign trademark holders, and, in fact permitted parallel imports. Congress deliberately chose to continue that policy, allowing free entry of parallel imports under the law. Customs Procedural Reform and Simplification Act, 92 Stat. 888 (1978).[3]

(Footnote 1 continued from previous page)
Senator McCumber, a sponsor of the legislation, Senator McCumber stated that a <u>foreign</u> manufacturer could not bar entry of trademarked items into this country under the bill:

> The mere fact of a foreigner having a trademark and registering that trademark in the United States, and selling the goods in the United States through an agency, of course, would not be affected by this provision. 62 Cong. Rec. 11605 (1922).

2/ <u>See</u>, <u>e.g.</u>, Registration and Protection of Trade-marks: Hearing on S.2540 before a Subcommittee of the Senate Committee on the Judiciary, 83rd Cong., 2d. Sess. 96 (1954); H.R. 7234, 86th Cong., 1st Sess. §§2, 3 (1959); Subcommittee on Trade of the Committee on Ways and Means, U.S. House of Representatives, Background Materials on H.R. 9220, the Proposed Customs Modernization Act of 1975, 94th Cong., 2d. Sess. 54 (1976); H.R. Rep. No. 625, 95th Cong., 1st Sess. 27 (1977).

3/ The House Report on that bill (H.R. Rep. No. 95-621 95th
(Footnote 3 continued on next page)

Most recently, in 1984, Congress enacted the Trademark Counterfeit Act of 1984, P. L. No. 98-473. In its Report on that bill, the Senate Judiciary Committee noted that that statute was not intended to curtail parallel imports:

> [The bill] does not include within its coverage so-called "Gray Market" goods -- i.e., authentic trademarked goods that have been obtained from overseas markets. Importation of such goods is legal under certain circumstances. For example, the Treasury Department has long interpreted Section 526 of the Tariff Act of 1930, 19 U.S.C. 1526, to permit the importation of such goods when foreign and domestic users of the trademark are affiliated through common ownership and control.

In light of this long-standing Congressional intent in this area, one might reasonably question why the present ratifying legislation is in fact needed. Senator Chafee, in his remarks introducing the legislation, provided that answer:

> ...A recent decision of the U.S. Court of Appeals for the District of Columbia Circuit, COPIAT v. U.S. (May 6, 1986), struck down these regulations on the basis of a narrow

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(Footnote 3 continued from previous page)
Cong., 1st Sess. 27 (1977)) stated that the provision:

> has been consistently interpreted by the United States Customs Service for the past 20 years as excluding from protection foreign-produced merchandise bearing a genuine trademark created, owned, and registered by a citizen of the United States if the foreign producer has been authorized by the American trademark owners to produce and sell abroad goods bearing the recorded trademark.

> reading of the legislative history behind Section 526 of the Tariff Acts of 1922 and 1930. ...Rehearing of the COPIAT decision will be sought, as well as Supreme Court review, but this process could take years and leave the matter highly uncertain in the interim. ...As a result, positive legislation is urgently needed now. The legislation which I introduce today makes clear current congressional intent in favor of parallel importation and avoids leaving it to the Supreme Court to divine what congressional intent was more than 50 years ago.

b. The Legislation is Consistent With Historical Customs Regulations

The first Customs regulations providing any detail on parallel imports were adopted in 1936. They provided that foreign manufactured goods which carried a trademark, owned in the foreign country by the same person who owns the American trademark, should not be excluded under Section 526 of the Tariff Act and could, in fact, freely enter the country. The 1936 regulations were included in subsequent revisions to Customs regulations in 1943 and 1947. On many occasions in the 1950's and 1960's, Customs officials continued to express the view that anyone can import merchandise manufactured abroad where the trademark was held by a foreign parent.

For example, in 1969, a Treasury Decision stated:

> The trademark or tradename on imported foreign-produced merchandise shall not be deemed to copy or simulate a registered trademark or tradename, if the foreign producer is the parent or subsidiary of the

> American owner or the firms are under a common control.

Treas. Dec. 69-12 (2), 3 Customs Bulletin 17 (1969).

In 1972, Customs issued the regulations that are presently in effect. The regulations, contained in 19 C.F.R. §133.21(c)(1) - (3), provide that import restrictions which apply to many trademarked goods do not apply in the case of trademarked imports when:

(1) Both the foreign and U.S. trademarks are owned by the same person or business entity;

(2) Both the foreign and domestic trademark owners are parent and subsidiary companies or otherwise subject to common ownership or control; or

(3) The articles of foreign manufacture bear a recorded trademark applied under authorization of the United States owner.

Nonetheless, despite the long historical certainty of Customs' endorsement of parallel imports, the present legislation in necessary, for Customs may now be wavering from its fifty-year-old position. Indeed, following the COPIAT decision, the Customs Service has commenced public inquiry on the advisability of the present regulations. 51 Fed. Reg. 22005 (June 17, 1986). The Customs Service, without identifying any particular jurisdictional basis for so doing, is considering adopting alternatives to the present regulations, alternatives which would call for either mandatory labelling, or mandatory demarking of trademarks, of parallel imports. In light of the historical Customs treatment of parallel imports -- treatment receiving express Congressional approval -- this new Customs inquiry should be abrogated by clarifying legislation.

c. Judicial Precedent Supports the Present Legislation

The majority of courts which have addressed §526 of the Tariff Act, and the validity of the present Customs regulations interpreting it, which permit parallel imports, have upheld the regulations.[4] Only one case, the recent COPIAT decision of the United States Court of Appeals for the District of Columbia, squarely holds that the regulations are invalid and that parallel imports should not enter the country. Even the cases upholding parallel imports, however, suggest that contemporary

4/ Parfums Stern, Inc. v. United States Customs Service, 575 F.Supp. 416 (S.D. Fla. 1983); Vivitar Corp. v. United States, 593 F.Supp. 420 (C.I.T. 1984), aff'd. 761 F.2d 1552 (Fed. Cir. 1985), cert. denied 106 S.Ct. 791 (1985); Coalition to Preserve the Integrity of American Trademarks v. United States, 598 F.Supp. 844 (D.D.C. 1984), rvsd ___ F.2d ___ (D.C. Cir. No. 84-5890, May 6, 1986); Olympus Corp. v. United States, No. CV-84-0920 (E.D.N.Y. August 22, 1985), aff'd. No. 85-6282 (2nd Cir. June 9, 1986).

Congressional endorsement of the historical treatment of parallel imports would be valuable.

Accordingly, because of the recent split in judicial precedent on this question, and the desirability of contemporary ratification of an important trade policy, the present legislation is needed. At the same time, the legislation will do no more than verify what the majority of the courts have already ruled: parallel imports are lawful.

2. S.2614 Benefits Consumers

The primary purpose for enacting S.2614 is to preserve price competition for foreign manufactured goods. Indeed, no one disputes that parallel imports permit vigorous price competition.

Senator Chafee, in his introductory remarks, noted that parallel imports are often sold to U.S. consumers at discounts of 25% to 40%. Absent parallel imports, foreign firms would be free to demand and get higher prices for their goods than anywhere else in the world -- often by as much as 30% to 40%. Senator Chafee offered particular examples of differences in prices between goods sold through "authorized" distribution chains and goods sold as parallel imports. The prepared testimony of James C. Tuttle, Assistant General Counsel for K-Mart Corporation, which NMRI endorses, further illustrates the dramatic price differences between "authorized" goods and parallel imports. Indeed, even the court in the COPIAT case explicitly acknowledged that consumer benefits are lost if the parallel import market is closed.

A further illustration of the benefits of parallel imports is seen by studying the particular markets where parallel imports are most prevalent. The majority of parallel imports are in product markets characterized by high levels of concentration, declining market shares by United States-based producers, and distinct market power of particular brand names. Such characteristics define markets which benefit from vigorous intra-brand price competition.

For example, some of the most often cited parallel imports products are cameras, perfumes, crystal, watches, and consumer electronics. In the photographic equipment and supplies market, "The 8 largest [companies] account for 85% of the total value of [domestic] industry shipments." Department of Commerce, U.S. Industrial Outlook 1986, p. 35-1. That statistic evidences a concentrated market, with insufficient number of producers to produce vigorous inter-brand price competition. Accordingly, intra-brand competition is necessary to insure that there are sufficient quantities of products available at reasonable prices.

Further, "Imports supply virtually all of the 35mm cameras for the U.S. market." (Id. p. 35-2). Thus, were exclusive distribution channels to be permitted by law, foreign camera manufacturers could enjoy monopoly/oligopoly profits -- they would be immune from intra-brand price competition.

Similarly, in the consumer electronics industry -- again a market characterized by high levels of parallel imports -- foreign imports are extremely important. The Commerce Department noted (id. at p. 45-9) that foreign-manufactured color televisions account for approximately 50% of U.S. sales and that foreign-manufactured radios account for approximately two- thirds of the U.S. market. Overall in the consumer electronics field, imports represent 63% of 1985 consumption.

If the door to parallel imports is closed, many of these foreign goods will enter the United States only through distribution channels mandated by foreign producers, free of the competition created by the parallel import market. As the Commerce Department found, "The consumer electronics industry is sensitive to changes in price ..." (Id. at p. 45-8). Accordingly, as a matter of elementary economics, if prices are raised, consumption will fall. That is, the availability of parallel imports creates intra-brand price competition and thereby reduces prices. Under supply and demand principles, reduced prices, in turn, permit consumers to buy more products -- more parallel imports or more products in other markets. Consumer welfare and the national economy are enhanced by greater consumption. This point requires a little further elaboration -- its import is obvious: competition causes lower prices; lower prices produce increased consumer benefits. The only persons who would benefit if parallel imports were eliminated would be foreign companies and their captive dealers who want to avoid competition.

Continued entry of parallel imports is important not only for price competition, but for other forms of competition as well. It is alleged by foreign-manufacturers, for example, that purchasers of parallel imports are deprived in many cases of the manufacturer's warranty. However, the evidence available demonstrates that discount retailers do in fact offer warranty, service, advertising, and other product promotion that is often superior to that offered by "approved" outlets. In short, they compete not only on price, but on other aspects of distribution.

In a series of interviews in the Antitrust Law and Economics Review (14 Antitrust Law and Economics Review No. 3 (1982) and 15 Antitrust Law and Economics Review No. 2 (1983)), several discounters recounted in great detail their methods of operation. For example, if a brand name good does not work or is not considered satisfactory to the consumer, NMRI members generally will accept the good in return, even where the manufacturer may not accept the good back from the seller or the consumer. E.g., 14 Antitrust Law and Economic Review, p. 85 (Interview with executive of a leading discount retailer: "...We don't have the frills but we have a satisfaction guaranteed policy, refunds without receipts, no questions asked and no accusations...").

Senator Chafee's remarks echo this testimony:

> "the purchaser of a parallel import can also look to the discount retailer from whom he purchased the product for warranty service ... in fact, most discount retailers offer even more extensive warranties than the manufacturers. Sales of parallel imports would not continue to rise year after year if consumers were being deceived or confused by buying from price-competitive sources."

3. Foreign Trading Partners' Policies Support This Legislation

The prevailing rule followed by our major trading partners is to permit parallel imports. Again, Senator Chafee hits the mark:

> Parallel markets are legal in Japan, France, Germany, and in every other country which is a major American trading partner. It would be entirely inappropriate for the U.S. Government to provide protection to foreign manufacturers whose own governments do not provide comparable protection for discriminatory pricing by American manufacturers.

Our foreign trading partners have thus recognized that consumer prices drop because of parallel import competition. Should this legislation not be enacted, and the COPIAT decision become the law, our citizens and our American manufacturers would lose benefits which foreign companies and foreign consumers now enjoy.

Indeed, the proponents of changes to traditional Customs law are essentially seeking restrictions in this country that their own nations do not provide to American manufacturers doing business abroad. See generally Takamatsu, Parallel Importation of Trademarked goods: A Comparative Analysis, 57 Wash. L. Rev. 433, (1982). See also The Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restricted Business Practices, U.N. Doc. TD/RBP/Conf/10/Rev. 1 (1980) (Principle D)(4) of the United Nations Conference on Trade and Development, stating as an international principle that parallel imports should be permitted). See also Schlieder, European Competition Policy, 50 Antitrust L.J. 647, 672-673 and n.101 (1982) ("The proprietor of the trademark right [in Europe] cannot prevent the import of protected products from another member state if they have been marketed there by him or with his consent").

In sum, the advocates of changes in Customs regulations are, in effect, asking that the United States protect restrictive distribution agreements that are not recognized by our trading partners. Were the United States to adopt such a contrary policy, it would abandon parity in international trade and would allow foreign manufacturers to carve up United States markets, even where United States companies do not enjoy comparable rights abroad.

4. <u>This Legislation Will Not Hurt Foreign Manufacturers</u>

Restricting sales of foreign-manufactured brand name goods to exclusive distributors anointed by foreign manufacturers is, in effect, a form of price maintenance. The advocates of change claim that restrictive distribution protects authorized retailers' profit margins and thereby permits those retailers to offer desired pre-sale and post-sale service. However, <u>legally-mandated</u> restrictive distribution -- <u>i.e.</u>, prohibitions on competition imposed by Congress or Customs -- is not necessary to serve the goals of the foreign manufacturer. Congress should not be in the business of legislating or policing restricted distribution schemes. Manufacturers have ample ability to achieve their goals through private means and consumers have ample protection under existing laws.

As one example, we refer to the Magnuson-Moss Warranty Act, specifically 15 U.S.C. §2302. As Senator Chafee noted:

> Finally, contrary to the foreign manufacturers' claims, there are no warranty or other consumer "deception" problems with parallel imports. The Magnuson-Moss Warranty Act requires manufacturers of consumer products sold in the United States to honor the written warranties they provide with their products unless they explicitly disclaim those warranties in writing.

In addition to rights and duties imposed under the Magnuson-Moss Act, foreign manufacturers have a whole host of other alternatives available to them to promote their views on parallel imports.

Many manufacturers have, for example, undertaken vigorous advertising campaigns, extolling the virtues of purchasing through authorized outlets. Consumers are, of course, free to accept or reject such advertising claims; consumers should be also free to purchase parallel imports through retail outlets of their choice.

Manufacturers may also request that their foreign distributors not resell the product to parallel importers. Manufacturers can try to enforce such contract rights to dry up the sources of parallel imports. That so many parallel imports continue to enter the United States would appear to be a testimonial to foreign manufacturers' desires to have increased production and sales -- regardless of the outlets selected by consumers.

Rather than rely on these and other existing options, however, foreign manufacturers, as evidenced by the COPIAT case and by the intense lobbying on this question, would prefer an easier course: the outright ban of parallel imports. That is not an appropriate course of action. Foreign manufacturers should be subject to competition, not immune from it.

S.2614, by keeping the door open to parallel imports, thereby rejects the proposal of foreign manufactures that restrictive distribution should be mandated by law.

Conclusion

For the above reasons, NMRI respectfully urges this Subcommittee, and the Senate as a whole, to enact S.2614, permitting "the continued importation of parallel imports in order to provide savings for United States consumers."

Respectfully submitted,

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July 29, 1986

COMMITTEE ON FINANCE
SUBCOMMITTEE ON INTERNATIONAL TRADE
UNITED STATES SENATE

COMMENTS ON S. 2614

FILED ON BEHALF OF
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COMMENTS OF ORIGINAL APPALACHIAN ARTWORKS, INC. AND COLECO INDUSTRIES, INC. ON S. 2614

These comments are submitted on behalf of Original Appalachian Artworks, Inc. ("OAA"), of Cleveland, Georgia and Coleco Corporation ("Coleco"), of West Hartford, Connecticut, in opposition to S. 2614, which seeks to amend Section 526 of the Tariff Act of 1930, as amended, 19 U.S.C. § 1526. S. 2614 would amend Section 526 to conform to the current Customs Service regulations which are intended to administer and enforce the statutory exclusion of so-called "gray market" goods from entry into the United States. Gray market goods are genuine trademarked goods manufactured overseas with the authority of the U.S. trademark owner for sale in foreign markets, but which are purchased overseas by U.S. importers and then imported into and sold in the United States without the authorization of the U.S. trademark owner.

Section 526, as originally enacted and presently constituted, prohibits the importation into the United States of (1) "any merchandise of foreign manufacture" which (2) bears a trademark owned by a citizen of, or by a corporation ... organized within the United States" unless (3) the "written consent" of the U.S. trademark owner to such importations is obtained, (4) when said trademark has been properly registered with the U.S. Patent and Trademark Office and recorded with the U.S. Customs Service. 19 U.S.C. § 1526(a). The present Customs Service regulations, however, allow merchandise of foreign manufacture bearing a trademark owned by a U.S. citizen or corporation to enter the United States without such written authorization in all but very limited circumstances, i.e., where the U.S. trademark owner is not related to the foreign manufacturer and has not authorized the foreign manufacturer to apply the mark.

The issue we wish to address in this statement, however, is not the validity of the Customs Service regulations which allow the entry of gray market goods into the United States in derogation of the intellectual property rights of U.S. trademark owners, but the wisdom of such a policy. It is our firm belief that the existence of the gray market does not benefit the U.S. economy, inasmuch as the sale of such goods (1) misleads and harms the consuming public, (2) harms intellectual property owners and their authorized distributors, and (3) allows gray marketeers to "free ride" on the goodwill associated with the mark.

OAA is the owner of the trademark "CABBAGE PATCH KIDS®," and the creator of the phemomenally successful "CABBAGE PATCH KIDS®" dolls, as well as "FURSKINS BEARS®" and "BUNNY BEES®."

OAA is a United States corporation headquartered in Cleveland, Georgia. Coleco, another United States corporation, has beengranted the exclusive right to manufacture, mass market and distribute "CABBAGE PATCH KIDS®" dolls in the United States and elsewhere. Both companies have been severely harmed by the unauthorized importation of gray market "CABBAGE PATCH KIDS®" dolls, which are manufactured overseas under license from Coleco. The harm suffered by these two companies has not only been pecuniary, but also to the goodwill associated with the "CABBAGE PATCH KIDS®" trademark built up by these two companies. Further, consumers who unwittingly purchased the gray market dolls found that they had not purchased the same product as the doll authorized for sale in the United States, but, as described below, something much less than what they believed they were purchasing.

Trademarks, and the protection afforded therefrom to trademark owners, serve two distinct but related purposes. According to the Senate Report accompanying the Lanham Trademark Act of 1946:

> One [purpose of the trademark] is to protect the public so that it may be confident that, in purchasing a product bearing a particular trademark which it favorably knows, it will get the product which it asks for and wants to get. Secondly, where the owner of a trademark has spent energy, time and money in presenting to the public the product, he is protected in his investment from its misappropriation by pirates and cheats. This is the well-established rule of law protecting both the public and the trademark owner. [S.Rep. No. 1333, 79th Cong., 2d Sess. 3 (1946)]

This dual purpose cannot be fully served unless owners, their licensees and legitimate distributors of U.S. trademarked products such as OAA and Coleco, and their customers, as well as members of the consuming public, are protected against the importation and sale of gray market goods. The experiences of OAA and Coleco provide a fine illustration of the problems caused by the sale of such goods in the United States.

OAA has expended substantial time, effort and dollars to create and maintain an exclusive licensing program on a worldwide basis with respect to "CABBAGE PATCH KIDS®" dolls, from which it derives a majority of its income. As such, it has a keen interest in ensuring that its licensees abide by the terms of their licensing agreements. As is common practice among licensors, OAA has granted certain licenses to numerous entities to manufacture and distribute its "CABBAGE PATCH

KIDS®" dolls, and other articles bearing the "CABBAGE PATCH KIDS®" trademark, in specified geographic markets, and in return for this right, these licensees agree to pay OAA certain sums of money. Included among these licensees is Coleco, which was granted the exclusive right to distribute "CABBAGE PATCH KIDS®" dolls within the United States. In return for this right, Coleco has paid OAA a substantial sum of money with the expectation that it alone would reap the benefits of sales of "CABBAGE PATCH KIDS®" dolls in the United States.

The massive influx of gray market "CABBAGE PATCH KIDS®" dolls imported into and sold in the Untied States over the past few years, without authorization of OAA, has placed OAA's entire licensing program in jeopardy by wreaking havoc among the legitimate expections of its licensees, expectations based upon having paid OAA substantial sums of money for the right to exclusively distribute the dolls in a specific territory. Due to the fact that OAA derives a majority of its income from its licensing agreements, its ability to keep its licensees satisfied is critical to the health of the company.1/ The unauthorized importation and sale of "CABBAGE PATCH KIDS®" dolls in the United States, in violation of the various licensing agreements entered into by OAA, clearly harms OAA's interests, and if it continues, may ultimately undermine its entire licensing program, and cause serious, if not fatal, harm to the company.

The continued unauthorized importation of "CABBAGE PATCH KIDS®" dolls not only poses a threat to the financial well-being of OAA, but also causes severe damage to the goodwill which OAA has made considerable effort to develop with the consuming public. This is a direct result of the fact that most "CABBAGE PATCH KIDS®" dolls imported without authorization into the United States are sold with "adoption" papers and "birth certificates" which are generally not in English, but in some foreign language. Further, there is no address in the United States to which to send these papers, whether in English or in a foreign language, for completion of the "adoption" process. Therefore, the "adoption" process, which is unique to "CABBAGE PATCH KIDS®" dolls, and one of the primary factors for their phenomenal success, cannot be carried out with gray market dolls.

1/It should be emphasized that it is not OAA's licensees which are the major source of diversion of "CABBAGE PATCH KIDS®" dolls to the United States market, but that the diversion occurs further down the chain of distribution. Where OAA has received evidence that any of its licensees are actively engaged in such activity, it has immediately taken steps to terminate said licensee.

Consumers, unfortunately, are not aware of this fact, until after they have purchased a gray market doll. The ill-will caused by not being able to carry out the "adoption" process (and not being able to even read the "adoption" papers and "birth certificate") is magnified by the fact that the ultimate recipients of these dolls are generally small children, who are less likely to understand, and more likely to suffer greater disappointment, than an adult. The purchaser of a doll imported without authorization (usually an adult) not only finds that he or she has purchased a doll with "adoption" papers and a birth certificate in a foreign language, and for which there is no address in the United States to which to send the adoption papers, but that he or she also must deal with the disappointed child. The resulting aggravation will necessarily cause ill-will, which will be directed against OAA and/or Coleco. Both companies have received hundreds, if not thousands, of letters from disappointed customers. This loss of goodwill, which in and of itself constitutes substantial injury to OAA and Coleco, also will negatively impact on sales of other "CABBAGE PATCH KIDS®" related items from which OAA derives substantial income.

Moreover, it should be noted that manufacturers licensed by OAA to manufacture and sell "CABBAGE PATCH KIDS®" dolls for sale outside the United States are not insured for such sales in the United States. In the unlikely event that a child somehow is injured by one of these dolls, the manufacturer would not have appropriate insurance coverage. Because the public associates OAA and/or Coleco with the "CABBAGE PATCH KIDS®" dolls, and would hold these companies responsible for any such injury, they would be placed in the position of having to assume full responsibility and liability (at potentially very great cost) in order to maintain the goodwill of the public, or to deny responsibility (a legally correct position) and appear to the public to be a callous, uncaring company. Either way, both OAA and Coleco would suffer serious injury -- financial and/or loss of goodwill -- from unauthorized imports in this manner.

Coleco also has, and continues to have, serious injury inflicted upon it every time a sale of a "CABBAGE PATCH KIDS®" doll imported without authorization occurs. Coleco is the licensee with the sole and exclusive right to sell "CABBAGE PATCH KIDS®" dolls in the United States; thus, every sale of an unauthorized doll is one less sale Coleco will make. Every additional sale of a "CABBAGE PATCH KIDS®" doll imported without authorization adds to this injury.

Gray marketeers attempt to portray the gray market as beneficial to U.S. consumers, allowing them to purchase genuine trademarked goods at prices below that which they could be purchased from authorized sources. They attempt to portray the existence of the gray market as a result of foreign-owned companies charging higher prices in the U.S. than in other markets around the world, taking advantage of the U.S. consumers. This clearly is not the case with "CABBAGE PATCH KIDS®" dolls, and in most other instances. We again emphasize that the gray market "CABBAGE PATCH KIDS®" dolls are not identical to the dolls authorized for sale in the United States, as the entire "fulfillment process" (i.e., adoption and birthday cards), the cost of which is included in the price of the U.S. dolls, is not available with gray market dolls.

Further, and perhaps more importantly, is the idea that U.S. consumers are somehow being cheated by being charged higher prices for the dolls than consumers in other world markets. The fact that "CABBAGE PATCH KIDS®" dolls sell in the United States at higher prices than in other markets is the result of one fact alone -- the cost of doing business in the United States is much greater than in other markets. This is true with most goods sold in the United States, but especially so in the toy industry. The amount of money which must be spent on promotional activities and advertising in the United States far exceeds the cost of these activities in other markets, and the higher U.S. price merely is a reflection of the higher cost of doing business.

For example, for almost any toy to be successful in the U.S. market today, substantial sums of money must be spent not only on television advertising (especially on Saturday morning), but also on creating entire cartoons and shows for television revolving around the product. In France, for instance, in contrast to the millions of dollars which are spent on such activities in the U.S. market by toy manufacturers, advertisements for toys are banned from television. Thus, a significant cost of doing business in the United States is not present in France, which enables "CABBAGE PATCH KIDS®" dolls in France to be sold at lower prices than dolls in the United States.

Gray marketeers go to France and purchase French dolls made for sale, and priced for sale, in the French market at lower prices than they could purchase dolls made for sale and priced in the U.S. market. However, in the case of "CABBAGE PATCH KIDS®," these savings have not been passed on to U.S. consumers, who generally pay the same price for a gray market "CABBAGE PATCH KIDS®" doll as for an authorized doll (although some instances have been reported when the gray market dolls have undersold, and at times oversold, the authorized dolls), but is kept by the gray marketeer as additional profit. Having borne none of the cost of developing, promoting and advertising the product, the gray marketeers reap tremendous profits from the efforts of others. This is "free riding" in its classic form.

The Senate Finance Committee Report accompanying the enactment of the Lanham Trademark Act made clear that one of the purposes behind this new Trademark Act was to ensure that U.S. trademark owners would reap the resulting benefits and goodwill resulting from their promotional efforts and maintaining high standards of quality on their products:

> Trademarks encourage the maintenance of quality by securing to the producer the benefit of the good reputation which excellence creates. To protect trademarks, therefore, is to protect the pulbic from deceit, to foster fair competition, and to secure to the business community the advantages of reputation and good will by preventing their diversion from those who have created them to those who have not. [S.Rep. No. 1333, *supra*, at 4.]

Gray marketeers "free ride" on the marketing efforts of U.S. trademark owners. U.S. trademark owners, licensees and authorized distributors expend great amounts of money, time and effort to build up brand name recognition to create a strong demand for their product. Usually years are involved in the development of a product, and millions of dollars are spent in advertising and promotion before a product becomes a success, if it becomes one at all. The time, effort and risk is borne by the trademark owner, and to a lesser extent his licenses and authorized distributors. For this, when a product becomes successful, there are great rewards to be reaped. Gray marketeers undertake none of those risks, or any of the start-up expenses associated with a product, but merely come in and reap the benefits of its popularity. Such a result was clearly not envisioned by the Congress when it enacted the Lanham Act in 1946, and likewise it should not be countenanced by Congress today.

Finally, we note another cost of the gray market which has become significant over the last three years -- that of litigation arising out of the sale of gray market goods. During this period many U.S. trademark (and copyright) owners have been forced to seek relief in the federal courts from the harm inflicted by gray market imports. OAA itself has initiated over 50 trademark infringement lawsuits in the federal courts relating to gray market "CABBAGE PATCH KIDS®" dolls, and has been successful in all of them. OAA has also instituted proceedings under Section 337 of the Tariff Act of 1930 (19 U.S.C. § 1337, directed against unfair practices in import trade) before the U.S. International Trade Commission against gray market importers of "CABBAGE PATCH KIDS®" dolls, and to date has been extremely successful in this effort also.

None of these proceedings would have been necessary had the Customs Service initially excluded these gray market dolls from entry into the United States. The costs of these legal proceedings, in terms of time, effort and dollars, is significant, especially when multiplied to account for such proceedings initiated by other U.S. trademark owners, and ultimately is passed on to the consumer. Further, the already overburdened federal judiciary is being needlessly burdened with a multitude of trademark infringement actions which would not be necessary if Section 526 were administered and enforced as intended, and enacted, by Congress.

For all of the above-stated reasons, we respectfully express our strongest opposition to S. 2614, and submit that its enactment into law would be extremely harmful to both U.S. business and U.S. consumers.

Post-Hearing Statement

of

Peter M. Thompson

Chief Executive Officer

of

The Paddington Corporation

Fort Lee, New Jersey

Gray Market Imports Hearing

Before the

Subcommittee on International Trade

U.S. Senate Committee on Finance

July 29, 1986

POST-HEARING STATEMENT

OF

PETER M. THOMPSON

On July 29, 1986, I appeared on a panel before the Subcommittee and presented oral testimony. I also submitted a Statement to the Subcommittee prior to my appearance.

I am submitting this post-hearing statement for the purpose of addressing some of the questions asked and concerns expressed by some members of the Subcommittee.

I wish to first reiterate my concurrence in the views expressed by the witness who appeared on behalf of COPIAT. The actions of those involved in the importation into the United States of gray market goods are unquestionably "free-riding" on the efforts of authorized importers who have spent millions of dollars creating consumer demand for the brand names of the products currently being undercut by gray market goods. Notwithstanding the protestations of the K Mart and 47th Street Photo witnesses, the advertising engaged in by them is "too little, too late." They did no advertising when the brand in question was unknown to the American public. It was only after the authorized importers had spent years and millions of dollars developing a consumer demand for their products that these gray marketers engaged in any advertising. Indeed, had not the authorized importers succeeded in building a brand awareness for their products, these gray marketers would not have even imported the products into the United States, let alone spent any money on advertising them.

What the gray marketers do in "free riding" on the economic backs of the authorized importers flies in the face of the letter and spirit of the United States Trademark laws. These laws have been carefully drafted and applied over the years to protect bona fide brand investments and to provide incentive to those who would legitimately nurture and develop the goodwill that accompanies a well-known brand. If you permit gray marketers to continue their free ride, then you ensure that eventually no new products will reach the consumer. Is this really what you intend?

My concern, however, extends beyond the issue of just gray market and its ramifications to the United States economy. As a vendor of ingestible products, i.e., beverage alcohol, I must also concern myself with the issue of public health and safety--as must you. If our government were not concerned with the health and safety of the public, why do we need the Federal Food Drug and Cosmetic Act or the Food and Drug Administration?

During the July 29 hearing some skepticism was expressed as to whether (1) the importation of gray market beverage alcohol, or indeed any ingestible product, really poses a potential health hazard and, if so (2) cannot such a potential hazard be avoided by law-enforcement measures.

Certainly, it is common knowledge that our Food and Drug Administration has banned products containing certain ingredients and additives, although such ingredients and additives are permitted in other countries. For instance, FDA has determined that Red Dye No. 2 is carcinogenic and has prohibited its presence in food products sold in the United States. However, across the border, in Canada, this same ingredient is permitted. There are numerous other examples such as this. Is the potential health hazard real if products containing illegal ingredients or additives enter the United States? The answer is obvious.

Can law enforcement authorities prevent the importation and distribution of such illegal products? The answer is "NO"! -- for the following reasons:

1. Unlike goods imported by authorized importers, gray market goods do not come from a single source. Although they may be produced by the same producer that sells to the authorized United States importer, gray market goods are not produced for the United States market, according to United States health standards. As such, although these goods are genuine in the sense that they are produced for sale in a particular country according to that country's standards, there is no way of knowing what country they were intended for and, therefore, what particular standards they were intended to meet. To complicate matters further, oftentimes gray marketers will consolidate cases of products, obtained from different countries, in a single shipment. Accordingly, it would be necessary for law enforcement agencies--the Bureau of Alcohol, Tobacco and Firearms ("BATF") in the case of beverage alcohol--to literally analyze a sample of each case of the gray market goods to determine whether the contents conform to United States standards. Even then, as the BATF will confirm, unless the particular laboratory possesses sophisticated equipment (which even ATF's laboratory does not in all cases), and the analyst knows specifically what ingredients and/or additives to look for, it is quite possible that the prohibited or offending substance will go undetected.

This is precisely what happened when the State of Washington submitted its chemical analysis of "Baileys Original Irish Cream" Liqueur to the BATF in support of its application for label approval. Washington State requested the laboratory at the University of Washington do the analyses. However, the University's equipment was not sophisticated enough to detect the presence of synthetic vanillin in the Baileys product. Washington State erroneously reported the contents of the gray market Baileys to the BATF and the latter issued label approval without requiring Washington State to label the product "Imitation". What if a a gray market product were imported containing Red Dye No. 2 or some other carcinogenic substance? Who would know until it was too late? The plain truth is that we cannot take the risk that sooner or later such will occur.

2. It is not practical to expect any regulatory agency to be able to adequately police the quality of ingestible products entering the United States. Responsibility for ensuring the public safety rests on the producer of the product and the importer--a responsibility which the producer and the <u>authorized</u> importer willingly undertake. These are the parties who have a considerable investment in the continued goodwill of the brand. Gray market importers, who have made no investment in building the brand, lack the incentive to stand behind the brand.

This latter fact is best exemplified by the actions of Washington State, who one would think to be a responsible importer. However, Washington State removes the back label from every bottle of Baileys that it imports. The back label contains the product quality code, placed on the back label by the producer at the insistence of the authorized importer. Thus, Washington State effectively prevents a recall of the specific production batch in the event a recall is necessary. If an importer of the repute of Washington State can be so irresponsible, what can be expected of a private party who has even less incentive to care about the public health and safety?

To those who would suggest that the potential health hazards are remote and problematical, I would only reply--are you prepared to expose a member of your family to the risk?

I believe that it is apparent to everyone who has examined this issue that it is exceedingly complex and has far-reaching consequences, both economic and as it affects the existing structure of United States trademark law. The general subject of gray market imports is presently under consideration by the Department of the Treasury and the precise issue encompassed by S.2614 will shortly be presented to the United States Supreme Court in the guise of the <u>COPIAT</u> and <u>Olympus</u> cases. It is respectfully suggested that, in view of the complex issues it presents and the lack of time until adjournment, within which to consider these issues, S.2614 be withdrawn from consideration by this Subcommittee. Alternatively, preliminary to any action being taken by this Subcommittee, the bill should be cross-referred to the Senate Judiciary Committee for consideration of its affect on existing trademark law, and to the Senate Commerce Committee for consideration of its consequences to the United States economy.

COMMENTS IN OPPOSITION
TO S. 2614
Submitted to the
Subcommittee on International Trade
Committee on Finance
United States Senate

Submitted by

Paul Plaia, Esq. and Alice Zalik, Esq.*

Witnesses testifying during the International Trade Subcommittee's July 29 hearing on S. 2614 did not provide any new arguments regarding importation of "gray market" merchandise. The accusations of retail price maintenance and free riding obscured the real question S. 2614 presents to the Congress. That question is: Should the Congress weaken the rights provided businesses which register trademarks in the United States so that some might buy certain luxury consumer goods at lower prices than they might otherwise have had to pay?

Before answering that question, Congress should consider carefully the comprehensive statutory scheme it created to protect trademarks in the United States. S. 2614, which was characterized at the hearing as a simple question of pricing, would make a profound change in U.S. trademark law, essentially saying that a trademark identifies a particular product but that a trademark's function as an indication of source is no longer relevant.

A. What Is a Trademark?

Congress has provided a comprehensive statutory scheme to govern the rights of the owner of a U.S. registered

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trademark. In section 45 of the Lanham Trademark Act of 1946, Congress defined a trademark as including

> -- any word, name, symbol, or device or any combination thereof adopted and used by a manufacturer or merchant to identify his goods, including a unique product, and distinguish them from those manufactured or sold by others and to indicate the source of the goods, even if that source is unknown. (emphasis added)

15 U.S.C. § 1127.

The Senate report on the Lanham Act says that trademarks serve two purposes:

> One is to protect the public so that it may be confident that, in purchasing a product bearing a particular trademark which it favorably knows, it will get the product which it asks for and wants to get. Secondly, where the owner of the trademark has spent energy, time and money in presenting to the public the product, he is protected in his investment from its misappropriation by pirates and cheats. (emphasis added)

S. Rep. No. 1333, 79th Cong., 2d Sess. 3 (1946).

Congress recognized that a merchant of trademarked goods, if it owns the right to the trademark in the United States, should be able to enforce those rights both against counterfeiters and those who infringe the trademark owner's rights. The legislative history clearly shows that Congress intended to protect the trademark owner's investment in promoting a product and maintaining its quality, by preventing others from selling products bearing the trademark without the trademark owner's authorization.

B. What Right Does a U.S. Trademark Owner Have?

Section 33(a) of the Lanham Act provides that, in an infringement action, a trademark registration issued by the U.S.

Patent and Trademark Office under the Lanham Act, or either of the earlier trademark acts,

> shall be prima facie evidence of registrant's exclusive right to use the registered mark in commerce on the goods or services specified in the registration . . . . (emphasis added)

15 U.S.C. § 1115(a).

Congress went further in Subsection 33(b). The U.S. registration of a trademark that has been used in commerce in the United States by the registrant for five years after registration and has become incontestible

> shall be conclusive evidence of the registrant's exclusive right to use the registered mark in commerce on or in connection with the goods or services specified . . . . (emphasis added)

15 U.S.C. § 1115(b).

Congress, therefore, recognized that a merchant which has registered a trademark with the U.S. Patent and Trademark Office has the exclusive right to use that trademark on the merchandise for which it is registered.

Congress took into account concurrent use of a trademark in the United States by more than one party, even authorizing the Commissioner of Patents and Trademarks to allow registration of marks for concurrent users if to do so does not cause confusion, mistake or deception. For concurrent use to be considered, however, each party must have used the trademark in commerce in the United States prior to the earliest filing for registration. See 15 U.S.C. §§ 1051(a)(1) and 1052(d).

C. How Are A Trademark Owner's Rights Protected When Imports are Involved?

In section 42 of the Lanham Act (which dates back to the 1890 Tariff Act), Congress provided that an imported article which copies or simulates a U.S. registered trademark recorded with the Customs Service shall not be entered into the United States. 15 U.S.C. § 1124. The Supreme Court interpreted section 27 of the 1905 Trademark Act, which was identical to section 42, in A. Bourjois and Company, Inc. v. Katzel, 260 U.S. 689

(1923). The Supreme Court found that so-called "genuine" goods imported into the United States by someone other than the registrant of the U.S. trademark infringed the rights of the U.S. registrant. The Court did not limit the scope of its decision to the particular situation faced by Bourjois.

Before the Supreme Court ruled in Bourjois, however, Congress passed another law governing imports of trademarked goods. That law, section 526 of the Tariff Act of 1922, 19 U.S.C. § 1526, was a trade law. It simply said that it is unlawful to import foreign produced merchandise bearing a trademark, registered with the U.S. Patent and Trademark Office and recorded with the Customs Service, unless written authorization of the trademark owner is produced at the time of importation. There is no mention of "copy or simulation" and, therefore, no requirement that infringement be shown. Congress intended that the Customs Service administer the law to the fullest extent since written authorization is to be produced with each shipment of trademarked goods "at the time of importation".

Congress included no exceptions either in 1922 or when it reenacted the provision as section 526 of the Tariff Act of 1930. Congressional debates both in 1922 and 1930 make it clear that Congress intended the law to be applied as written. See 62 Cong. Rec. 11,602 (1922) and 71 Cong. Rec. 3871 (1929).

In 1930, the Senate Finance Committee even attempted to eliminate imports for which the U.S. trademark owner had given written authorization and to add to the prohibition imports of merchandise patented in the United States. The debate shows that the supporters of the Finance Committee's amendment to the Smoot-Hawley bill wanted to ban imports altogether so that trademark and patent owners would have to manufacture their products in the United States. If Congress had contemplated a related party exception to the law, the Finance Committee's proposed amendment would not have accomplished the Committee's objective.

In 1954, 1959 and 1968, Congress rejected attempts to repeal or to amend section 526 to include exceptions like those contained in the Customs regulations1/ and in S. 2614. See S.

1/ The Customs Service's regulations allow importation of trademarked merchandise without the U.S. trademark owner's authorization if the merchandise was produced abroad by a company affiliated with the U.S. trademark owner or by a company licensed by the U.S. trademark owner to use the trademark. See 19 C.F.R. 133.21.

2540 and H.R. 9476, 83d Cong., 2d Sess. (1954); H.R. 7234, 86th Cong., 1st Sess. (1959); and S. 3713, 90th Cong., 2d Sess. (1968).

Supporters of the current legislation argue that Congress endorsed Customs' current practice by failing to state its disapproval of that practice in 1978 when Congress added an exception to the law which allowed individuals to bring trademarked goods coming under the law into the country for their personal use. That exception would be unnecessary for the most part if Congress had agreed with the Customs Service's regulations. Moreover, the supporters' argument assumes Congress is obligated to monitor each agency's regulations to make certain they conform with Congress' intent because failure to object makes the agency's inconsistent regulation the law of the land. Under the Constitution, an Executive Branch agency clearly cannot legislate.

With section 526 of the Tariff Act of 1930 and section 42 of the Lanham Trademark Act, Congress has provided a comprehensive statutory scheme for Customs' treatment of all imports of merchandise bearing a trademark. If the trademarked goods were produced abroad and the U.S. registered trademark is recorded with Customs, section 526 of the Tariff Act of 1930 applies. If the importer produces written authorization of the U.S. trademark owner, he should be permitted to import the goods. If the importer has no written authorization, Customs should refuse entry or seize the merchandise. If the trademark on the seized merchandise is found to be copied or simulated, section 42 of the Lanham Act applies and the goods should be dealt with accordingly. If the trademark on the seized merchandise is not a copy or a simulation, the goods should be dealt with as provided under section 526(b) and (c). Customs' exceptions have no basis in law and, therefore, should be revoked.

D. Should the Statutory Scheme Be Changed?

The Senate Finance Committee has before it S. 2614, which would incorporate Customs' exceptions into sections 526 and section 42. Should the bill be passed? The simple answer is no.

Congress recently passed legislation directing the U.S. Trade Representative to consult with foreign governments to improve the protection those countries give patents, copyrights and trademarks of U.S. citizens. See the Trade and Tariff Act of 1984, Pub.L. 98-573, Titles III and V. The legislation authorizes trade retaliation if those governments do not provide stronger protection. Passing S. 2614 would confirm other countries' beliefs, created in part by the manufacturing clause of the U.S. copyright law, that we manipulate our own intellectual property laws whenever it is of benefit to politically powerful economic interests here. If we wish other countries to protect the trademark rights of U.S. citizens in their markets, we must protect the rights of their nationals here.

Rather than assume that U.S. trademark owners with overseas affiliates or licensees established those relationships in order to manipulate prices in the U.S. market, the Finance Committee should recognize that business decisions to invest or license abroad are motivated by high tariffs and import restrictions, market reserve practices and differences in required product standards, as well as efficient and economic production and distribution of the product. The transfer of technology laws and investment laws of many countries would not allow license agreements or other business arrangements to restrict exports or limit distribution as some suggested at the Finance Committee's hearing. Since most trademark laws, including ours, require use in the country in order to maintain a trademark registration, a U.S. trademark owner hasn't the luxury of deciding not to sell its product in a country where investment or licensing will be necessary. Of course, if the U.S. trademark owner fails to register its trademark in a country, it has no protection since the U.S. registration provides no protection beyond our own borders. Passing S. 2614 would reward countries that restrict imports and impose conditions on investment and on the transfer of technology, by increasing their exports to the United States of the trademarked products involved.

The statement introducing "The Price Competitive Products Act of 1986" emphasizes savings that might result to U.S. consumers in some cases from "gray market" imports. The same argument could be made regarding other forms of intellectual property and probably will be if S. 2614 is passed. This emphasis on possible consumer savings, however, is completely at odds with the emphasis of other recent and pending trade legislation. For example, U.S. consumers save billions when foreign countries subsidize their exports to the United States yet Congress required that developing countries enter into a commitment to phase out their subsidies before they are entitled to an injury test in U.S. countervailing duty cases. Congress is considering changes to the countervailing duty and dumping laws to make relief easier to obtain, causing consumers to pay higher prices for some products in the United States. Textile quotas also mean U.S. consumers must pay higher prices for clothing, which is a necessity, not a luxury.

The United States is free to exclude "gray market" goods under GATT and under the Paris Convention. Since most "gray market" products are luxury consumer goods with numerous competitors, enforcing section 526 of the Tariff Act of 1930 will not eliminate price competition at all. Even intrabrand competition will continue since the U.S. antitrust laws can be used against those who would manipulate distribution to fix prices.

The introductory statement implies that demand for each trademarked product is inelastic and that interbrand competition does not exist. Neither implication is correct. The U.S. trade deficit will not be affected if section 526 is enforced as written since, if the price of a particular product increases, the number of those products sold will decrease as consumers choose competing but lower priced products. Many of those competing products, clothes, perfumes, cameras, electronic products, etc., are manufactured in the United States.

Accordingly, we believe that S. 2614, if enacted, would weaken the protection of trademarks under U.S. law, thereby decreasing investment in product differentiation and quality control. In the short run, some consumers will benefit from lower prices, but, in the long run, all consumers will suffer from a decline in quality and variety of available products.

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August 12, 1986

Re: S.2614 and the Hearing of July 29, 1986
<u>Concerning Parallel Importation</u>

Dear Senator Danforth:

Our client, Progress Trading Company ("Progress"), is a small, independently owned American importing company which helps bring low, competitive prices to the American consuming public. It does so through "parallel distribution"; purchasing Seiko watches abroad and distributing them in this country to companies which sell at those low prices. The ability to compete freely, which S.2614 will preserve, is essential to the very existence of Progress and of the many other small companies which, through parallel distribution, hold prices down.

The controversy here centers on whether price competition will be extinguished by strict control of distribution, not based on any question of whether the watches will come into this country, but on the matter of who will bring them in. Although price is what the fight is all about, the COPIAT allies, recognizing that their position on price is not an attractive one, touch only lightly on that and instead choose to focus on tangential areas, such as warranty, service, and allegedly damaged goods. But even as to those tangential areas, an examination of the facts demonstrates how wrong they are.

Two documents dealing with watches, provided to members of the Committee by COPIAT associates, require comment for a full understanding of the competitive circumstances. They are: the statement of Bernard Gassin of G-K-G, Inc., an "approved distributor," and the letter of July 21 of Robert Pliskin, the President of Seiko Time, Inc., addressed to Senator Chafee.

Mr. Gassin's statement claims superiority for the warranty provided by Seiko Time, Inc., which he calls "perhaps the best in the industry," and praises the service provided by Seiko Time, Inc. The statement also seeks to leave the impression that the Seiko watches handled by parallel distribution are generally inferior and in many instances, have been damaged. The facts are to the contrary.

We note first that the watches of parallel importers are of identical quality to those of Seiko Time, Inc. Hattori-Seiko of Japan, the manufacturer, does not run two production lines; one to make good watches and the other to make bad.

Generally, the importing and other companies in parallel distribution provide warranties with terms every bit as protective to the consumer as those in the Seiko Time warranty. Some purchasers of parallel products receive warranties valid for two years rather than one and with other more favorable terms. Furthermore, much of the service rendered by those in parallel distribution is provided more rapidly than the service provided by the "approved" distribution.

These matters of warranty, service and quality were subjects of affidavits filed in the District Court in the COPIAT case. Those affidavits, by Dan Rotta, President of Progress, and of Henry Goldsmith, the National Merchandise Manager of Montgomery Ward, who has had extensive experience as a purchaser of Seiko watches both through "approved channels" and from parallel distribution, are a part of the record, available for inspection.

The COPIAT allies in that litigation did not try to contradict any of the sworn statements of Messrs. Rotta and Goldsmith in those affidavits. They didn't for the obvious reason that they coundn't. No countering affidavits were offered to the Court and the statements of Messrs. Rotta and Goldsmith remained completely unchallenged in that highly contested case.

We invite attention to the following statements by Mr. Rotta:

> The watches imported by Progress are of identical quality to watches imported from the same manufacturer by Plaintiffs and others. The markings which Progress applies to such watches do not damage the watches nor in any way impair their operation or quality.
>
> Progress gives its own warranty for the watches it imports and maintains its own warranty repair facilities staffed by Progress employees and well stocked with an inventory of repair parts. Because of the location and staffing of Progress' warranty repair facility, the warranty service of Progress is provided more promptly than the service offered by subsidiaries of the foreign manufacturers.

We also invite attention to the statements of Mr. Goldsmith of Montgomery Ward, who speaks of his ten year involvement in "the purchase of substantial quantities of watches from Seiko Time, Inc." He says that ... Montgomery Ward was not satisfied with its dealings with the Seiko-controlled distribution...." and began buying from independent companies.

Mr. Goldsmith further states:

> Montgomery Ward found that those independent companies were equally satisfactory as sources of supply than the Seiko-controlled distribution and that warranty service provided by the independent companies was rendered as promptly and was otherwise satisfactory in every way.
>
> Montgomery Ward found further that the Seiko watches delivered by the independent companies were genuine, undamaged, and of excellent quality, identical in quality to the watches available through Seiko-controlled distribution.

Although such affidavits conclusively rebut the claims of the COPIAT allies in such matters as quality and service, the heart of this matter remains prices. Mr. Pliskin's letter states that Seiko watches are bought by Seiko Time for prices "as low or lower than the prices paid by authorized distributors around the world," and then states "this cost advantage is passed directly on to consumers." The implications here are clearly wrong. In no way do American consumers get the lowest prices through such distribution. Indeed, were there not such a great disparity between these "approved" prices and the prices prevailing overseas, Progress would not exist; the company would not ever have come into being. The fact is that the two-tier pricing practices, with the United States prices being much higher, have enabled Progress Trading and its customers to sell a broad range of Seiko watches at something like 30 to 40 percent less than the Seiko Time distribution.

Mr. Pliskin also says that Seiko Time Corporation "sells its watches to a variety of retail outlets including discount houses and catalog showrooms ..." but fails to state that the only reason Seiko Time, Inc. ever started making any such sales was because it was forced to by the competition of parallel importers, and that such sales are a recent phenomenon. Our information is that any substantial sales to catalog companies by Seiko Time, Inc. began only in February, 1985.

Mr. Pliskin has long fought bitterly against discounting, as evidenced by an interview with him published in the October 1983 issued of "Modern Jeweler" magazine, a complete copy of which is attached.

Please note the discussion of "dissatisfaction among ... jeweler customers" (of Seiko Time, Inc.) "when Seiko goods turn up in discount outlets" and how the interview contains, in effect, a long speech against low prices, including such statements as "grey markets hurt the jeweler by creating discount competition for them for Seiko goods."

While those opposing S.2614 make a point of trying to establish that the approved distribution is selling Seiko watches at a discount, any such discounts have been forced by parallel distribution and there appears to be no doubt at all that watch prices would go up immediately were the "spur of competition" provided by parallel distribution to dissappear.

But for the determination of the sponsors and allies of COPIAT to bring about the demise of price cutters, there would never have been the sustained campaign maintained for the last few years in arguments submitted to senators and congressmen, to the Treasury Department, the Customs Service and to the courts, International Trade Commission, and the White House. Their attempt to jack the prices back up has been lengthy, skillful, vigorous, and as Mr. Pliskin acknowledged in the attached interview, extremely expensive. In no way was this campaign conducted by people who look with any favor on discount houses or low prices.

Finally, we respectfully invite to the attention of the Subcommittee the fact that S.2614 is in the highest tradition of American free competition. That tradition has been embodied in our statutory law since July 2, 1890, when the Sherman Act became effective, and it is reflected by fifty years of practice by the Customs Service, now codified in the present regulations appearing at 19 C.F.R. §133.21.

This bill makes certain that this great tradition will be followed in the future as it has been in the past, with respect to the import and sale of trademarked goods.

Respectfully submitted,

Frank W. Gaines, Jr.

The Honorable John C. Danforth
Chairman
Subcommittee on International Trade
497 Senate Russell Office Building
Washington, D.C. 20510

FWG/ee

Attachments

SEIKO'S BATTLE AGAINST THE GREY MARKET

by Joe Thompson/MJ Editor

Seiko is appealing to jewelers to help it stop an industry threat

For Robert Pliskin, it is an awful irony.

For the past five years, since he took over as president of Seiko Time Corp., the American jeweler's best selling watch has been Seiko.

And yet, over the same span, the most annoying watch to American jewelers has been Seiko too.

The reason: the notorious grey market, the vast perfectly legal loophole in the free market system which allows companies to buy Seiko watches abroad, import them into the United States and sell them at discounted prices.

The result: for every three Seiko watches sold in the U.S. today by Seiko Time, a fourth is sold by a grey market importer, according to best industry estimates. That amounts to about $80 to $100 million that is siphoned from jewelry and department store sales each year.

Little wonder then that for five years jewelers have been selling Seikos with one hand and shaking their fist at Seiko Time with the other, urging the firm to control the distribution of its goods.

Seiko's side of the story

Now comes word that for nearly four of the five years, Seiko Time has waged a battle on several fronts to gain control of its goods. That battle by Seiko estimates has cost the company about $7 million.

The details of Seiko's grey market battle came from Seiko President Pliskin in an exclusive *Modern Jeweler* interview in his Fifth Ave., New York City office in early August. Elements of Seiko's campaign have been made public before. There was the "authorized Seiko dealer" program launched in 1980 and the firm's successful legal action last year against Alexander's, a New York City area department store chain. In that case a federal judge enjoined the store from using so-called "list prices" on foreign Seikos it sold to give the impression of substantial savings over Seikos sold for the U.S. market by authorized dealers.

Until now, though, Seiko has held its peace about other actions it has taken to combat what it considers illegitimate traffic in its goods. Those actions include:

- Long legal and lobbying efforts to win exclusive control of its trademark under U.S. law. Seiko Time has enlisted the aid of three major law firms in New York and Washington, D.C., which specialize in trademark law. The cost to the company has been "hundreds of thousands of dollars in legal fees," says Pliskin. Currently Seiko Time is unable to gain legal protection for its trademark because it is a subsidiary of a foreign company, Hattori Seiko Co. Ltd. of Japan.
- The closing of Seiko Time accounts who also deal with grey market importers. In the past two years, Seiko Time has dropped six such accounts, costing the company a hefty loss of $6 million annually, according to Pliskin. (The Seiko president revealed the names of the firms to *MJ* on the grounds that they not be published.) Says Pliskin, "We don't sell to people who buy from grey marketers."
- Formed, with companies in the photographic, watch, fragrance, tire and crystal industries, COPIAT, Coalition to Preserve the Integrity of American Trademarks. This association, formed earlier this year, assists owners of U.S. registered trademarks in preserving the integrity and quality of their goods in the U.S. market. Seiko Time Corp. Vice President and Secretary Ronald J. Thomas, an attorney, is a member of COPIAT's executive committee. The association is recruiting American companies to help fight for laws which protect trademark holders from abuses of trademarks by third party importers. One-time suggested membership dues are $3,500 for manufacturers and importers, $1,500 for retailers. COPIAT currently has 20 members.

Seiko President Pliskin

Legal victory on the line

Pliskin agreed to detail Seiko

Time's efforts to win protection of its trademark because the legal victory the firm has sought for three years is in jeopardy ... The legal issues are complicated, but essentially Seiko and other COPIAT founding members hurt by parallel imports want the U.S. Treasury Department to change a Customs Service regulation which denies their goods protection under U.S. law because of their foreign affiliations (see sidebar). They are convinced a change in the regulations would eliminate the grey market traffic for firms with registered trademarks since the trademarks would then be protected by law.

"After long and arduous toiling," as Pliskin puts it, Seiko and other firms convinced Customs officials to request a change in the regulations which would allow Seiko to register and protect its trademark.

The request was then sent to the Treasury Department which oversees Customs and implements the legal change. What happened next is disputed. Pliskin stated in a speech Aug. 1 at the New York Jewelers of America show that Assistant Secretary of the Treasury John M. Walker Jr. "advised us that he indeed would publish such a change of intent (in the *Federal Register*). This was some four or five months ago. To date this has not happened."

David Bates, an aide to Walker (who was on vacation and unavailable when *MJ* called), denied that Walker had agreed to publish a notice in the *Federal Register*, the first step in the process of changing the regulation. Walker "will make a decision on what to do with these proposed regulations very soon," Bates told *MJ*.

"The reason we haven't published it is that it is a matter of great economic impact and the agency needs to be certain about what it wants to do." As of *MJ*'s early September deadline, Walker was still considering the issue.

Nevertheless in late May, Walker seemed to be leaning toward a decision to change the 1972 Customs regulation. He wrote to Congressman Edwin B. Forsythe (R.-N.J.) that "in response to numerous petitions, we are considering publishing a Notice of Proposed Rulemaking in the *Federal Register* which would inform both United States trademark owners and importers of our intention to change our position

Seiko's sample letter for Jewelers

The following is a suggested letter drafted by Seiko Time Corp. for jewelers and others in the trade to use requesting government action against the flow of grey market goods into the U.S. It calls on federal officials to revise a Customs Service regulation which allows for grey market imports. Seiko Time urges jewelers to send this letter or a copy to your senators, congressmen and Assistant Secretary John M. Walker, Department of the Treasury, 15th Street and Pennsylvania Ave. N.W., Washington DC 20510.

Dear Sir:

Diversion (parallel distribution or grey market) by illegitimate importation and sale of goods bearing U.S. registered trademarks is a problem affecting virtually all aspects of American industry. Diverters, trading on the substantial financial investments, hard-won reputations and goodwill of legitimate trademark owners and distributors, often import and market products that were not produced by the manufacturer for consumption in the United States, and, as such, may be second-rated or discontinued products and, in some instances, products that actually may be harmful to the welfare of purchasers or not labeled in accordance with U.S. law.

Diversion severely disrupts the marketing and distribution mechanisms established by trademark owners and legitimate distributors to preserve the integrity of their trademarks, resulting in deception of the American consumer and constant diminution of those trademarks.

We respectfully request that you act immediately to issue a notice of proposed rule making that would allow for the revision of regulations at 19 C.F.R. Section 133.21, to allow Section 526 of the Tariff Act and Section 42 of the Lanham Act to be enforced with the will of Congress. Such enforcement would properly prohibit the importation and sale of so called diverted goods, regardless of the possible foreign affiliation of the U.S. registered trademark owner.

This change of practice is long overdue. Also, it is absolutely essential because it will provide consumers, jewelers and trademark owners alike with the full measure of the protection of law intended by Congress.

Sincerely yours,

on the matter. Of course, a final decision on the matter will not be made until comments have been received and evaluated."

Seiko asks for help

Walker's hesitation to announce Treasury's "intention to change our position on this matter" forced Pliskin to go public with details of Seiko's [illegible] efforts earlier than he wanted to. He knew Walker was being subjected to a strong lobbying effort by grey marketing importers who stand to lose much if the regulation which opened the door to parallel imports is revoked. Pliskin decided to appeal to the watch and jewelry trade for help.

The appeal came in his Aug. 1 speech at a watch seminar at the Jewelers of America show in New York City. There Seiko Time staff members handed out briefing papers for jewelers on the grey market problem and a sample letter they could send to Walker, their senators and representative urging repeal of the 1972 Customs regulation. (See sidebar.)

Pliskin was in a delicate spot. For his appeal to have any force, he had to convince his colleagues and customers that the grey market was in fact an industry problem, not simply a Seiko Time problem.

They needed little convincing. Pliskin soon received pledges of support from the Jewelers of America and the California Jewelers Association. Both associations urged their members to write Walker and their congressmen on behalf of the proposed change. The American Watch Association, long an opponent of grey market imports, also completely supports Seiko's efforts to change the regulation.

The letter writing campaign is being noticed in Washington. Treasury's David Bates told *MJ* "We have heard extensively from both sides on this issue. It is hotly contested."

Billions of dollars

Treasury's decision affects far more than the U.S. watch industry. The grey market is a multi-billion dollar business involving "almost any foreign product that is popular in America," according to Robert Rosenberg, an assistant U.S. attorney in Miami, a major port for grey market goods. "You name it and you can bet the grey market is handling it," Rosenberg told *The Miami News*.

COPIAT's position is that grey marketers are, in effect, free loaders. They make no investment of their own in a product but take advantage of the good name, good marketing, and goodwill built up over the years by trademark owners. "They are parasites," says Pliskin, "who contribute nothing to a trademark, who disrupt the marketplace, who use and abuse trademarks until eventually they are killed and then they move on to something else."

The damage they do hurts everyone in the distribution pipeline—the trademark owner, the authorized retailer and the consumer.

They damage Seiko Time in many ways, Pliskin points out. They take away business from the firm. They create dissatisfaction among its jeweler customers when Seiko goods turn up in discount outlets. They damage the image of the Seiko brand by placing the product in inappropriate retail outlets at deceptively low prices. Often they damage the product when they open it to mark it for passage through U.S. Customs.

Moreover, Pliskin notes, "they are not hurting a foreign company, they're hurting a U.S. company. We have 1,500 American employees, an enormous payroll and 30 locations in 17 states."

Damage to the jeweler

Grey marketers hurt the jeweler by creating discount competition

Why Seiko wants Section 133.21 changed

For more than 50 years, U.S. law has provided protections to importers who register their trademarks with the U.S. Customs Department. By so doing, the law forbids third parties (also called diverters because they divert product intended for other markets to the U.S.) to bring goods bearing registered trademarks into the country. Those protections are provided under Section 526 of the Tariff Act and Section 42 of the Lanham Act.

However, in 1972, the Customs Service promulgated regulations denying those protections to owners of U.S. registered trademarks in certain circumstances:

1) If the foreign and U.S. trademarks are owned by the same person;
2) If the foreign and domestic trademark owners are "subject to common ownership or control;"
3) If the U.S. trademark owner authorizes the manufacture of the product abroad.

These restrictions are found at 19 C.F.R. Section 133.21 of the Customs Service regulations.

From these 1972 regulations, the grey market was born. The regulations opened the door for third parties to purchase on foreign markets and import into the U.S. products with trademarks of foreign affiliated firms. American subsidiaries of foreign companies could no longer look for trademark protection under the Tariff and Lanham Acts.

Companies like Seiko Time, Michelin, Charles of the Ritz, Sony and others plagued by grey market importers maintain that the Customs regulations at 19 C.F.R. Section 132.21 violate the intent of Section 526 of the Tariff Act and Section 42 of the Lanham Act. They have appealed to the Customs Department and the U.S. Treasury Department to change the 1972 regulations.

That way, they could register their trademarks with Customs and put an end to the grey market traffic in their goods since third parties would be prohibited by law from importing products with their trademarks.

for [illegible] Seiko goods. These outlets sell [illegible] Seikos [illegible] goods at deep discounts [illegible] the jeweler's price. They also sour the jeweler's relationship with some customers who complain when they discover cheap Seikos selling in cheap outlets.

Last but not least, grey marketers hurt the consumer. Consumers buying grey market Seikos usually do not realize:

1) that they are not getting a Seiko warranty but one issued by Zalmon Corp. or Daltron Corp. or some other grey market importer;

2) that they are not getting a watch made for American distribution but one made for foreign markets;

3) that the watch has been tampered with and possibly damaged in order to mark it for passage through U.S. Customs. The procedure is to open the back and stamp the movement or module. That procedure, Seiko says, breaks a tiny gasket that seals the back, thus exposing grey market Seikos to excessive dust and moisture which can damage the movement. Watches imported by Seiko Time do not have to be opened since they are stamped at the factory.

Finally, the consumer often is attracted to grey market Seikos because of a low retail price. Such prices are deceptive, Seiko officials say. They maintain that the so called list prices which appear on grey market goods are fictitious since those models usually are not distributed in this country. Moreover, Seiko Time has found cases where models similar to pieces in its line carry a higher "discounted" price than its own list price. Pliskin showed *MJ* an advertisement for a discounted Seiko at $62.50. A similar model from Seiko Time carries a suggested retail of $59.50.

"At no time do consumers get a value," charges Pliskin, "and sometimes they pay more than if they purchase it from an authorized Seiko distributor."

Elsewhere on the grey market battlefront...

Seiko Time Corp. is not the only watch company fighting to protect its good name and trademark from the effects of grey marketers.

Rolex Watch U.S.A., New York City, found its watches being imported by third parties and discounted in unauthorized outlets at an alarming rate last year. Sales of grey market Rolexes were hurting Rolex jewelers economically and creating tension between the firm and its jewelers.

But because Rolex New York is a subsidiary of Watches Rolex Ltd. of Bienne, Switzerland, the Rolex trademark was ineligible for trademark protection under the Tariff Act and Lanham Act, which offers such protection to trademarks of American firms.

Rolex lawyers, however, found a legal way around the damaging foreign subsidiary loophole in the Customs regulations. In September 1982, Rolex's parent firm assigned the rights and title to the Rolex trademark to Rolex Watch U.S.A., a firm incorporated in the United States. Rolex Watch then registered the trademark with U.S. Customs. As a result, according to Customs regulations, no watches bearing Rolex trademarks or marks similar to Rolex trademarks can be admitted into the U.S. unless authorized by Rolex Watch U.S.A. (Rolex did grant a consent allowing travelers to bring two Rolex watches into the country for personal use and not for sale.)

Piaget Watch Corp., New York City, part of the North American Watch Corp. group, recently took legal action in federal courts against five firms selling illegally imported Piagets.

Piaget won a court approved stipulation from the New York department store chain, Alexander's, which agreed to stop advertising or selling unlawfully imported Piaget watches.

It has also started legal action in a Miami federal court against four parties allegedly dealing in illegally imported Piagets. They are: Herman Donnefeld & Geneva Watch Company, Janet Buchwald d/b/a/ Buchwald Seybold Jewelers, Meir Jungreis Enterprises Inc., and International Confirmers and Financiers No. 3 Inc. d/b/a Gemcraft II. Legal action is still pending in these four cases, but Piaget has obtained restraining orders against each firm prohibiting it from selling any Piaget watch which was imported illegally.

"Piaget Watch Corp. is determined to do whatever is legally possible to stamp out the sale of illegally imported Piaget watches," a company spokesperson said, "not only because it is illegal, but also because in the final analysis, the consumer suffers and millions of dollars in sales are drained off from the authorized retailers."

Perfectly legal

Grey marketers, for their part, argue that they are conducting perfectly legal businesses in the spirit of American free enterprise. They maintain that they are offering consumers a legitimate price alternative. They accuse trademark owners of gouging the American consumer with high prices and of trying to restrain free trade.

Grey marketers are not without their supporters in Washington. A COPIAT alert issued to members in July noted that "reportedly, Rep. Sam Gibbons, senior member of the House Ways & Means Committee, which authorizes Treasury funding, has ordered the Treasury not to move on this issue, promising that, if necessary, Congress will amend existing law to provide sanctuary to the diverters."

For this reason, Pliskin continues to urge jewelers and other segments of the trade to appeal to Assistant Secretary Walker and their congressmen to allow American subsidiaries of foreign firms to register and protect their trademarks.

"The control we're fighting for is control at the borders," Pliskin says. "We do not want a law change but the law administered as it was originally written. We want equity and integrity for our trademarks and we want the consumer protected against those that exploit us and him."

Statement

of

Elaine Laws

Brand Manager

of

Sambuca Romana International

Concerning

Gray Market Imports Hearing on S.2614

Before the

Subcommittee on International Trade

U.S. Senate Committee on Finance

July 29, 1986

STATEMENT

OF

ELAINE LAWS

I submit this statement, concerning gray market imports (S.2614), for inclusion in the printed record of the hearing held on July 29, 1986 before the Subcommittee or International Trade of the United States Senate Committee on Finance.

Sambuca Romana International is responsible for the production and marketing worldwide of Sambuca Romana Liqueur. The importation (or local manufacture under license where appropriate), local marketing and distribution of the Sambuca Romana brand are carried out in each country by an exclusive importer appointed by Sambuca Romana International under contract to service that market. Importers in each market have a clearly defined role to play in the marketing of the brand and this includes its advertising, promotion, selling, warehousing and distribution, all of which requires a substantial expenditure of money which must be recouped from the importer's margin.

Sambuca Romana International thoroughly opposes S2614 on the grounds that it is not in the best interests of U.S. consumers, and because it substantially reverses 60 years of trademark law designed to protect the investments made by trademark owners and importers.

The following points are relevant:

1. In the United States the distribution and sale of alcoholic liquor products is closely regulated by Federal and State law. A three tier system of distribution exists which ensures that importers/distillers, wholesalers and retailers operate in distinct bands with no common ownership. The gray market is an attempt to break down the three tier system.

2. The source of parallel imports is frequently a trader having no responsibility for or interest in the brand; this may result in the supply of deteriorated goods.

3. It is not true that the appointed importers are always (or even usually) subsidiaries of the brand owners or manufacturers of the goods.

4. The reason why parallel importers can undercut the price of appointed importers is that parallel importers free-ride on the distribution overhead and promotional costs of appointed

importers and do not offer the same pre-sales or post-sales service.

5. Experience in Europe and Japan indicates that parallel imports reduce not increase total trade in the affected brand. Parallel imports disturb the orderly marketing of a brand, and because retailers refrain from obtaining normal supplies even when parallel suppliers are out of stock, the brand's availability to the consumer is reduced.

6. Counterfeit labels are often used on genuine parallel goods in substitution for the original labels so as to prevent tracing of the source. In both Europe and Japan this has led to the use of counterfeit labels on spurious goods. There have been many examples of the connection between parallel traders and the distribution of counterfeit goods in these two markets.

7. Parallel goods are not necessarily identical to the United States market product. It is said that authorized and parallel goods are "manufactured in the same plant" and that "other than price the products are identical." Sambuca Romana is already and will, to a greater extent in the future, be manufactured under license in other than the prime production plant. Dependent on varying local restrictions and conditions, there may be different raw materials employed in the manufacture. If such a product is imported into the United States, it will not necessarily conform to United States health regulations; additionally, if it is brought in regardless, it may deceive the consumer and damage the reputation of the brand.

8. Alcoholic strength may differ in certain markets. The United States consumer may receive parallel goods at a different strength to that which he/she expects; the information on the labels is not necessarily noticed (especially with regular purchase) by the consumer in package stores, and it is even less likely to be seen under normal circumstances in pouring outlets.

It is to be hoped that these points illustrate certain of the danger areas involved in permitting the control and policing of an international brand such as Sambuca Romana to be removed from the brand owner and its accredited importers throughout the world.

66-541 O - 87 - 14

BEFORE THE

SENATE COMMITTEE ON FINANCE

COMMENTS OF

THE SCOTCH WHISKY ASSOCIATION

IN OPPOSITION TO

S.2614, GREY MARKET GOODS

(July 29, 1986 Hearing)

The Scotch Whisky Association
20 Atholl Crescent
Edinburgh, EH3 8HF, Scotland

Michael S. Kelly
Kenneth G. Weigel
Robert S. Schlossberg
Counsel for The Scotch
Whisky Association

OF COUNSEL

MORGAN, LEWIS & BOCKIUS
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Washington, D.C. 20036
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August 12, 1986

Summary of Contents: */

I. The Background to Parallel Trading

The description of parallel trading in the preamble to S.2614 is selective and misleading:

a. It is NOT true that parallel imports are always identical to the product to which U.S. consumers are accustomed.

b. The source of parallel imports is frequently a trader having no responsibility for or interest in the brand: this may result in the supply of deteriorated goods.

c. The majority of Scotch Whisky producers do not charge a higher price to appointed distributors in the U.S.A. than to appointed distributors elsewhere. The reason why parallel importers of Scotch Whisky can undercut the price of appointed distributors is that parallel importers free-ride on the promotional costs of appointed distributors and do not offer the same pre- or post-sales service.

II. Economic and Competition Policy Aspects

a. Experience in Europe and Japan shows that parallel imports of Scotch Whisky reduce, not increase, total trade in the affected brand.

b. S.2614 would be destructive of non-price inter-brand competition and fails to recognize the

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settled principles related to vertical restraints as espoused by the U.S. Supreme Court in Continental T.V. Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977) ("GTE Sylvania").

III. Parallel Imports Facilitate the Distribution of Counterfeit Goods

a. It is more difficult for appointed distributors to police the market.

b. Counterfeit labels are used on genuine parallel goods in substitute for the original labels so as to prevent tracing of the source. In both Europe and Japan this has led to the use of counterfeit labels on spurious goods.

c. There have been many examples of the connection between parallel traders and the distribution of counterfeit goods in Europe and Japan.

d. Eastern Bloc countries have been a source of both genuine parallel goods and counterfeit goods.

I. INTRODUCTION: THE BACKGROUND TO PARALLEL TRADE

The preamble to S.2614 sets out a brief description of parallel imports. The circumstances described may be true in relation to some such parallel imports. The description is, however, selective and relates only to the circumstances in which parallel imports may be thought to be most nearly justified. In particular:

a. It is said that authorized and parallel imported products "are manufactured in the same plant" (second paragraph) and that "other than price the products are identical" (third paragraph). However:

(i) Although Scotch Whisky can only be produced in Scotland, a number of famous alcoholic beverages are manufactured under license in different countries throughout the world. Local restrictions may impose different quality standards, specifications and even different raw materials. If such a product is imported into the U.S.A. consumers may be deceived, and the reputation of the brand injured.

(ii) Even where goods the subject of parallel import were originally of the same kind and quality as those imported by the appointed distributor they may have been available at lower price to entrepreneurial middlemen because of deterioration. (Please see examples in Appendix).

(iii) Although Scotch Whisky producers ensure the same quality of their brands throughout the world, the alcoholic strength differs in different markets. A parallel import may be at 40% volume whereas the U.S. consumer is accustomed to the brand at 43% volume. Thus, the parallel import gives the consumer 7% less. A warning on the label of this lower alcohol content is unlikely to be an adequate safeguard: such warnings are rarely read in supermarkets and cannot be seen in the normal circumstances of purchase by the drink in bars.

b. The statement in the third paragraph that parallel importers in the U.S.A. "purchase the goods from foreign authorized distributors" is also inaccurate so far as spirituous beverages are concerned. It implies that the goods are purchased from a trader having some responsibility for the brand. In practice, the U.S. importers purchase from entrepreneurial middlemen in Europe or elsewhere who have no responsibility or interest in the brand, such as the importing agencies of countries in the Eastern Bloc. This is one of the reasons why parallel imports of Scotch Whisky facilitate the distribution of counterfeit goods (please see section III below).

c. It is also said in the third paragraph that there are "two routes by which genuine trademarked goods are brought to U.S. consumers: through the U.S. authorized distributor owned or controlled by the foreign manufacturer or through independent U.S. importers who purchase the goods from foreign authorized distributors." This ignores the many brands that are imported by an appointed distributor who is not controlled by the foreign manufacturer and who is motivated by strong inter-brand competition to ensure that he obtains the goods from the foreign producer at the keenest possible price.

d. The further statement (in the fifth paragraph) that "foreign manufacturers see the U.S. as a wealthy market where they can demand - and get - a higher price for their goods than elsewhere in the world" also gives an untrue picture so far as Scotch Whisky is concerned. The majority of the producers of the leading selling brands of Scotch Whisky in the U.S.A. have confirmed that their prices to U.S. distributors are identical to, or virtually identical to, their prices to distributors throughout the rest of the world. The slight variation in price stems not from an attempt to obtain higher profits, but from currency fluctuations which influence prices to U.S. distributors who purchase Scotch Whisky on a dollar price basis. For the majority of those brands the U.S. price in sterling terms is currently (at L = $1.49) marginally below the world price. So far as these spirituous beverages are concerned the reason why parallel importers are able to undercut the prices of appointed distributors is not that they buy more cheaply or that they take a lower profit, but that the appointed distributor has an obligation both to invest in advertising and promotion and to undertake a wide range of services which are necessary to uphold the reputation of the brand and which constitute important forms of non-price competition.

II. ECONOMIC AND COMPETITION POLICY ASPECTS

a. It is sometimes argued that parallel imports reduce the retail price of a product and that producers ought therefore to be in favor of them. It is even asserted that secretly they are. It is not so. Experience with parallel imports of Scotch Whisky in Europe and Japan has shown clearly that the brands most afflicted lose market share and, in Japan at least, that parallel imports lead to a reduction in total sales of Scotch Whisky. On reflection, this is not surprising in view of the fact that promotion and non-price competition is reduced and that doubts and confusion are created in regard to the authenticity of the product (by the appearance on the market of different qualities with different labels, including counterfeit labels, and sometimes counterfeits of the product itself: please see section III below). Equally important is the fact that parallel traders make offers they cannot fulfill: as a result rumours abound of the availability of a brand at a low price. These rumours make traders unwilling to buy at a higher price for fear of being undercut by their competitors. A common consequence of parallel imports in Europe has been that retailers refrain from obtaining supplies even when the brand is out of stock. The availability of the brand to consumers is thereby reduced.

b. It is manifestly not for a foreign trade association to determine U.S. economic or competition policy. However, the principles established by the Supreme Court in GTE Sylvania clearly reflect the view that vertical restraints are, provided that there is adequate inter-brand competition, efficiency enhancing and pro-competitive. There are over 250 competing brands of Scotch Whisky in the U.S.A. some of which are imported in bottle and some of which are bottled in the U.S.A., some of which are heavily promoted and some of which compete almost exclusively on a price basis. These vary in retail price from about \$8.00 to \$11.59 a bottle (750 ml) for "standard" brands and up to as high as \$20.00 to \$21.00 for "special deluxe" or "malt" brands. */ The U.S. consumer therefore, has a wide choice, and in particular the option to buy the cheapest or to pay a little extra for a brand with an international reputation for consistent quality and a corresponding reputation for good service to customers in all respects. There is both price and non-price competition. It is against this background that the benefit to consumers of parallel imports which inevitably lead to a reduction of non-price competition needs to be

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*/ Superpremium brands are priced at around \$15.98 per bottle, while those brands bottled in the U.S. range from \$5.99 to \$7.99 per bottle. Source: Beverage Media (August Prices).

judged. It is, therefore, suggested that the philosophy which underlies S.2614 is inconsistent with GTE Sylvania to the extent that the Supreme Court recognized that vertical restraints designed to ensure quality control and to protect consumers in a market with strong inter-brand competition are pro-competitive in nature.

III. PARALLEL IMPORTS FACILITATE COUNTERFEITING

Scotch Whisky is a product which offers lucrative opportunities for fraud. Whisky from some distilleries is better than whisky from others. Older whiskies are more expensive than younger ones. Plain alcohol is very cheap. Methanol is even cheaper. It is extremely profitable to sell inferior (spurious) products under the counterfeit labels of famous brands. The health risks of fraud in relation to alcohol liquors have been demonstrated by the Austrian and Italian wine scandals.

a. In Europe such frauds have been facilitated by the development of parallel imports. There are a number of reasons:

(i) In the absence of a parallel trading circuit, the main difficulty of counterfeitors is to get their products into the established distribution channels. Any attempt to do so is likely to be discovered almost at once by the sole distributor and prompt legal action taken. The existence of a parallel circuit, and the fact that retailers become accustomed to receiving offers from unknown sources, remove that difficulty.

(ii) Parallel importers of genuine whisky pave the way for such frauds by the practice of using counterfeit labels on genuine goods to prevent the source being traced.

(iii) It is one of the duties of sole distributors to police the market for counterfeit labels. It can be readily appreciated how difficult this becomes -- and how easy it is to peddle counterfeit whisky -- as a result of the simultaneous existence on the market of:

(a) the brand imported by the sole distributor;

(b) parallel imports of the genuine brand from various sources bearing differing genuine labels (each brand is sold under dozens of slightly different labels because of the special statutory requirements of different markets);

(c) parallel imports of the genuine brand bearing counterfeit labels; and,

(d) spurious whisky bearing counterfeit labels.

(iv) Parallel importers obtain their supplies from entrepreneurial middlemen. Those middlemen in turn obtain supplies from sources such as duty free traders and purchasing agencies of Eastern Bloc countries. Such sources of supply are evanescent. The goods often pass through several hands before reaching the parallel importer.

Because of the uncertain character of supplies, middlemen are often required to put up a performance bond to guarantee the availability of the goods. However, traders who have set up successful selling channels are reluctant to admit an inability to procure supplies and often enter into a contract to sell goods without ensuring that they can procure them. Such traders are particularly vulnerable to counterfeit goods because the financial penalty if they do not produce the brand makes them reluctant to enquire too closely about the source of the goods they are offered.

b. The explanation of the way in which parallel trading facilities counterfeiting is not merely theoretical. Although brand owners are naturally loath to publicize the fact that counterfeiting has taken place, The Distillers Company plc has agreed to include examples in its submission to the Committee.

It is important to stress the role of Eastern Bloc countries as a source of supply for parallel imports of Scotch Whisky, as well as counterfeit imports of Scotch Whisky. Brand owners are torn between the need to be among the first to penetrate Eastern Bloc special outlets for tourists and privileged purchasers and the risk that the goods will be misused in deals to obtain hard currency. Control is extremely difficult.

IV. SUMMARY

a. So far as Scotch Whisky is concerned it is expenditure by appointed distributors on promotion and non-price competition and NOT discriminatory pricing by manufacturers which makes parallel importing profitable.

b. Parallel imports reduce non-price and inter-brand competition. S.2614 is therefore inconsistent with the recognition by the United States Supreme Court in GTE Sylvania that a manufacturer should be able to impose vertical restrictions in markets where factors such as those raised by parallel imports are present.

c. There is conclusive evidence in Europe that parallel imports of Scotch Whisky facilitate the distribution of counterfeit goods. Eastern Bloc countries have been a source for both.

d. In view of the particular danger of counterfeiting in the alcoholic drink trade and the health risks involved and, in view of the strong inter-brand competition which exists in this market sector, it seems evident that parallel imports are contrary to the consumer interest and that S.2614 is undesirable so far as these goods are concerned.

APPENDIX

Examples of the sale and the attempted sale by parallel traders of deteriorated goods.

1. In 1980 legal proceedings were instituted in Tokyo against a parallel importer of a consignment of King George IV Scotch Whisky which had originally been sold to a customer in Laos in 1973. As a result of storage in unsuitable conditions and particularly in high temperatures during the intervening period, the whisky had been reduced in alcoholic strength (so that the indication of strength on the label was inaccurate); the volume of the contents of the bottles had fallen as a result of leakage and evaporation (so that the statement of contents on the label was no longer accurate) and most important of all the flavour of the whisky had been badly affected by the storage conditions.

2. In October, 1981 four containers holding some 4,000 cases of famous brands of Scotch Whisky fell into the sea outside Limasol Harbour from the Greek vessel Fasis II.

The containers were subsequently salvaged. Sea water and possibly other liquid had entered the bottles. The quality of the whisky had been seriously impaired.

The whisky was owned by a parallel trader who was shipping it to a parallel importer in Egypt. The goods had not been insured. The trader endeavoured to reship the goods despite their condition and legal proceedings had to be instituted in Cyprus to prevent him from reshipping the goods.

U.S. Department of Justice
Washington, DC 20530

Exhibit A
To Registration Statement
Under the Foreign Agents Registration Act of 1938, as amended

OMB No. 1105-0003
Approval Expires Oct. 31, 1986

Furnish this exhibit for EACH foreign principal listed in an initial statement and for EACH additional foreign principal acquired subsequently.

1. Name and address of registrant
Morgan, Lewis & Bockius
1800 M Street, N.W.
Washington, D.C. 20036

2. Registration No.
3794

3. Name of foreign principal
Scotch Whisky Association

4. Principal address of foreign principal
20 Atholl Crescent
Edinburgh, EH3 8HF
Scotland

5. Indicate whether your foreign principal is one of the following type:

☐ Foreign government

☐ Foreign political party

☒ Foreign or ☐ domestic organization: If either, check one of the following:

☐ Partnership ☐ Committee

☐ Corporation ☐ Voluntary group

☒ Association ☐ Other (specify) ____

☐ Individual—State his nationality ____

6. If the foreign principal is a foreign government, state:

a) Branch or agency represented by the registrant.

b) Name and title of official with whom registrant deals.

N/A

7. If the foreign principal is a foreign political party, state: N/A

a) Principal address

b) Name and title of official with whom the registrant deals.

c) Principal aim

8. If the foreign principal is not a foreign government or a foreign political party,

a) State the nature of the business or activity of this foreign principal

Members of the Scotch Whisky Association are distillers, blenders and owners of a proprietary brand or brands, brokers and exporters of Scotch Whisky. One of the Association's objectives is to protect and promote the interests of the Scotch Whisky trade generally in all its world markets.

b) Is this foreign principal

Owned by a foreign government, foreign political party, or other foreign principal .... Yes ☐ No ☒

Directed by a foreign government, foreign political party, or other foreign principal .... Yes ☐ No ☒

Controlled by a foreign government, foreign political party, or other foreign principal .... Yes ☐ No ☒

Financed by a foreign government, foreign political party, or other foreign principal .... Yes ☐ No ☒

Subsidized in whole by a foreign government, foreign political party, or other foreign principal .... Yes ☐ No ☒

Subsidized in part by a foreign government, foreign political party, or other foreign principal .... Yes ☐ No ☒

9. Explain fully all items answered "Yes" in Item 8(b). *(If additional space is needed, a full insert page may be used.)*

N/A

10. If the foreign principal is an organization and is not owned or controlled by a foreign government, foreign political party or other foreign principal, state who owns and controls it.

It is owned and controlled by its members.

Date of Exhibit A	Name and Title	Signature
June 7, 1986	Joseph P. Griffin, Partner	Joseph P. Griffin

U.S. Department of Justice
Washington, DC 20530

Exhibit B
To Registration Statement
Under the Foreign Agents Registration Act of 1938, as amended

OMB No. 1105-0007
Approval Expires Nov. 30, 1986

INSTRUCTIONS: A registrant must furnish as an Exhibit B copies of each written agreement and the terms and conditions of each oral agreement with his foreign principal, including all modifications of such agreements; or, where no contract exists, a full statement of all the circumstances, by reason of which the registrant is acting as an agent of a foreign principal. This form shall be filed in duplicate for each foreign principal named in the registration statement and must be signed by or on behalf of the registrant.

Name of Registrant	Name of Foreign Principal
Morgan, Lewis & Bockius	Scotch Whisky Association

Check Appropriate Boxes:

1. ☐ The agreement between the registrant and the above-named foreign principal is a formal written contract. If this box is checked, attach two copies of the contract to this exhibit.

2. ☐ There is no formal written contract between the registrant and foreign principal. The agreement with the above-named foreign principal has resulted from an exchange of correspondence. If this box is checked, attach two copies of all pertinent correspondence, including a copy of any initial proposal which has been adopted by reference in such correspondence.

3. ☒ The agreement or understanding between the registrant and foreign principal is the result of neither a formal written contract nor an exchange of correspondence between the parties. If this box is checked, give a complete description below of the terms and conditions of the oral agreement or understanding, its duration, the fees and the expenses, if any, to be received.

The Registrant will represent the Foreign Principal for an indefinite period of time for its normal hourly charges, plus will receive reimbursement for all of the costs it incurrs in rendering such services. We cannot now estimate the number of hours which will be required.

4. Describe fully the nature and method of performance of the above indicated agreement or understanding.

The Registrant agrees to meet and speak with U.S. Government officials to discuss action by the U.S. to reduce barriers to the importation of distilled spirits into Japan. Such barriers include the Japanese taxation and import duty systems. The Registrant on occasion, will prepare and disseminate papers providing factual background on Japan's barriers to such imports and its position as to how these barriers should be revised and will seek implementation of these goals by U.S. officials.

5. Describe fully the activities the registrant engages in or proposes to engage in on behalf of the above foreign principal.

The Registrant will promote the implementation of policies by the U.S. Government in its relationship with Japan to achieve the goals of the Foreign Principal concerning elimination of Japan's barriers to imports of distilled spirits. Registrant will promote these interests by meeting and speaking with relevant U.S. Government personnel and providing written materials to such persons.

6. Will the activities on behalf of the above foreign principal include political activities as defined in Section 1(o) of the Act?[1]
Yes ☒ No ☐

If yes, describe all such political activities indicating, among other things, the relations, interests or policies to be influenced together with the means to be employed to achieve this purpose.

Our activities may include the promotion of adoption of certain policies by the United States in its relationship with Japan as to Japan's barriers to imports of distilled spirits.

Date of Exhibit B	Name and Title	Signature
June 7, 1986	Joseph P. Griffin Partner, Morgan, Lewis & Bockius	

[1] Political activity as defined in Section 1(o) of the Act means the dissemination of political propaganda and any other activity which the person engaging therein believes will, or which he intends to, prevail upon, indoctrinate, convert, induce, persuade, or in any other way influence any agency or official of the Government of the United States or any section of the public within the United States with reference to formulating, adopting, or changing the domestic or foreign policies of the United States or with reference to the political or public interests, policies, or relations of a government of a foreign country or a foreign political party.

IN THE MATTER OF PARALLEL IMPORTS AND US SENATE FINANCE COMMITTEE HEARING OF 29 JULY 1986 RE S2614

SUBMISSION BY PETER F GOODCHILD

ON BEHALF OF

TANQUERAY GORDON & COMPANY LIMITED

1 Tanqueray Gordon & Company Limited (Gordon) is the proprietor of GORDON'S DRY GIN, the world's largest selling brand of gin and its subsidiary, Charles Tanqueray & Company Limited, is the proprietor of TANQUERAY GIN, the largest selling imported gin in the USA.

2 Gordon manufactures gin in the UK which is exported to at least 147 countries around the world. GORDON'S GIN is also manufactured either under licence or by subsidiaries in 7 other countries of the world including the USA.

3 The proliferation of parallel trading would consititute a serious impediment to international brands of alcoholic drinks.

International brands such as GORDON'S GIN are sold in over 180 countries of the world. The economic and competitive conditions in these markets vary enormously. Many of them have extortionate import duties designed to protect locally produced alcoholic drinks. Since imported liquors cannot compete on price with local liquors because of tax discrimination they have no choice but to compete on the basis of substantial promotion of a reputation for high quality. The cost of promotion in some markets is greater than the manufacturer's selling price of the product. This promotional cost must be borne by the appointed importer, not the manufacturer, since it is otherwise subject to high ad valorem import duties in markets such as Japan.

Because of the huge differences in economic and competitive conditions and the levels of promotional expenditure required it is inevitable that there will be differences in the selling prices of sole importers in different countries of the world.

In some countries competitive conditions permit low promotional costs and low distribution costs (eg Belgium where as much as 70% of sales of alcoholic liquors are made through as few as 5 retail chains). In other countries heavy promotion may be necessary to counterbalance discriminatory duties or pre- and after-sales service and other forms of non-price competition may be demanded by consumers and consequently essential for the long-term success of a brand. If entrepreneurs are able to buy in the former and sell in the latter it will follow inevitably that brands will no longer be able to compete throughout the entire world. Producers will have to select markets which are reasonably similar and either ignore the others or sell different brands.

The theory that brand promotion is undesirable and that the only acceptable form of competition is price competition is surely discredited.

Parallel traders present themselves as crusaders on behalf of the consumer against international price cartels. In a trade such as the alcoholic beverages trade where there is already fierce inter-brand competition they are nothing of the kind. They are simply traders who have found a route to profit which is easier than building up good will in their own brands. That would not matter so much if they were not at the same time destructive. Unfortunately, they are potential destroyers of international brands and represent yet another addition to the increasing obstacles to international trade.

4 The consequences of parallel trading can be damaging even in relation to a product made in a single plant and sold in indentical quality throughout the world. That, however, is not always and cannot always be the case.

TANQUERAY GIN is made to a single formula. But in France penal taxation of spirits compared with wine and beer has lead to its sale at 40% vol compared with 47% vol in the USA. A US customer buying a parallel import of TANQUERAY at 40% vol who wished to maintain the same consumption strength after adding his chosen mixer would get some 15% fewer drinks from the bottle.

GORDON'S GIN is produced in the USA in accordance with the strict US requirements established for "distilled" gin. All the spirit must be distilled in the presence of the flavouring botanicals. In other markets of the world the description "distilled gin" can lawfully be used in relation to mixtures of such a product with neutral spirit. In order to be competitive Gordon uses such production methods in the UK for many export markets.

In some countries of the world it is or has been unlawful to use cereal spirit for the production of gin or not economically viable to do so. In order to compete at all in such markets Gordon has been forced to produce GORDON'S GIN sometimes from molasses spirit and sometimes from wine spirit. If gins of those kinds were imported into the USA consumers would be deceived and the reputation of GORDON'S GIN injured.

Hitherto the proprietors of international brands have endeavoured to overcome the obstacles of protectionist import barriers by licensing local production. One of the consequences of wide-spread parallel trading would be to discourage or prevent this practice. European and US companies would effectively be prevented from promoting their international brands in some parts of the world. International trade would be impeded. In fact this has already happened in the case of Gordon: a factor in a decision to discontinue production of GORDON'S GIN under licence in a Central American country was the introduction of a law in that country which would have made it impossible to prevent parallel exports.

5 Submissions on behalf of the parallel traders point out that parallel imports are encouraged in certain other countries. Particular emphasis has been placed upon the competition laws of the European Community. This is a totally false comparison. The object of the Treaty of Rome was to create a single market. The concept was that trade between France, Germany and Italy should be trade within a single market in the same way as is trade between New York, Illinois and California. The whole purpose of the Treaty of Rome is to harmonise economic and trading conditions. The integration of the former sovereign states into a single market makes it important to prevent the erection of new barriers at the old national frontiers. This, however, has nothing to do with trade between one international market and another; and in particular nothing to do with the import into the USA of products originally sold or manufactured in totally different economic conditions elsewhere in the world. There is no comparison between trade <u>within</u> the Common Market and trade <u>between</u> the USA and other sovereign states.

6 Unrestricted grey imports threaten the appointed importers ability to promote the brand . To compete with the parallel importer he must reduce his price. To reduce his price he must reduce non-price competition. The loss would be felt in advertising agencies and other industries serving such forms of competition. It would also be felt by consumers. Consumers can currently choose between many competing promoted and non-promoted brands. Many prefer the quality guarantee of the former. In a market reduced to price competition they wuld be deprived of that choice.

7 Gordon therefore believes that S2614 is an undesirable measure which, if enacted, would impede and reduce international trade, thwart inter-brand competition within the USA and reduce consumer choice.

Statement

of

Peter Cox

Managing Director

of

Twelve Islands Shipping Co. Ltd.

Concerning

Gray Market Imports Hearing on S.2614

Before the

Subcommittee on International Trade

U.S. Senate Committee on Finance

July 29, 1986

STATEMENT

OF

PETER COX

I submit this statement, concerning gray market imports (S.2614), for inclusion in the printed record of the hearing held on July 29, 1986 before the Subcommittee or International Trade of the United States Senate Committee on Finance.

Twelve Islands Shipping Co. Ltd. is responsible for the production and marketing worldwide of Malibu coconut rum liqueur. The company operates in virtually every country and, therefore, has extensive experience of international marketing. The importation (or local manufacture under license where appropriate), local marketing and distribution of the Malibu brand are carried out in each country by an exclusive importer appointed by Twelve Islands Shipping Co. Ltd. under contract to service that market. Importers/licensees in each market have a clearly defined role to play in the marketing of the brand and this includes its advertising, promotion, selling, warehousing and distribution, all of which requires a substantial expenditure of money which must be recouped from the importer's margin.

Twelve Islands Shipping Co. Ltd. thoroughly opposes S2614 on the grounds that it is not in the best interests of U.S. consumers, and because it substantially reverses 60 years of trademark law designed to protect the investments made by trademark owners and importers.

The following points are relevant:

1. In the United States the distribution and sale of alcoholic liquor products is closely regulated by Federal and State law. A three tier system of distribution exists which ensures that importers/distillers, wholesalers and retailers operate in distinct bands with no common ownership. The gray market is an attempt to break down the three tier system.

2. The source of parallel imports is frequently a trader having no responsibility for or interest in the brand; this may result in the supply of deteriorated goods.

3. It is not true that the appointed importers/licensees are always (or even usually) subsidiaries of the brand owners or manufacturers of the goods.

4. The reason why parallel importers can undercut the price of appointed importers is that parallel importers free-ride

on the distribution overhead and promotional costs of appointed importers/licensees and do not offer the same pre-sales or post-sales service.

5. Experience in Europe and Japan indicates that parallel imports reduce not increase total trade in the affected brand. Parallel imports disturb the orderly marketing of a brand, and because retailers refrain from obtaining normal supplies even when parallel suppliers are out of stock, the brand's availability to the consumer is reduced.

6. Counterfeit labels are often used on genuine parallel goods in substitution for the original labels so as to prevent tracing of the source. In both Europe and Japan this has led to the use of counterfeit labels on spurious goods. There have been many examples of the connection between parallel traders and the distribution of counterfeit goods in Europe and Japan.

7. Parallel goods are not necessarily identical to the United States market product. It is said that authorized and parallel goods are "manufactured in the same plant" and that "other than price the products are identical." Malibu is already manufactured under license in certain countries. Dependent upon varying local restrictions, regulatory requirements and conditions, there may be different quality standards and even different raw materials employed in the manufacture. If such a product is imported into the United States, it will not necessarily conform to United States health regulations; additionally, if it is brought in regardless, it may deceive the consumer and damage the reputation of the brand.

8. Alcoholic strength may differ in certain markets. The United States consumer may receive parallel goods at a different strength to that which he/she expects; the information on the labels is not necessarily noticed (especially with regular purchase) by the consumer in package stores, and it is even less likely to be seen under normal circumstances in pouring outlets.

It is to be hoped that these points illustrate certain of the danger areas involved in permitting the control and policing of an international brand such as Malibu to be removed from the brand owner and its accredited importers throughout the world.

Duncan, Allen and Mitchell

<u>United States Senate</u>
<u>Committee on Finance</u>

<u>Statement in Opposition to S.2614</u>

Submitted on behalf of Vilore Foods Company Inc.
By
Leslie Alan Glick
Duncan, Allen & Mitchell
Washington, D.C., Counsel

This statement is submitted pursuant to the notice issued July 1, 1986 (PR 86-058) soliciting testimony and written statements concerning S.2614 introduced by Senator Chafee. S.2614 would incorporate into law certain customs regulations relating to the importation of trademarked articles entering through unauthorized channels (grey market imports). These regulations have recently been declared invalid by the United States Court of Appeals for the District of Columbia in <u>COPIAT</u> v <u>United States</u>, 7 ITRD 2249, decided on May 6, 1986. The <u>COPIAT decision</u> found that certain regulations issued by Customs that narrowed the protection provided by Section 526 of the Tariff Act of 1930 were invalid as being inconsistent with both the clear language of Section 592 and the legislative history. These customs regulations restricted the protection provided by Section 592 under certain circumstances. Senator Chafee's bill would accomplish little more than put into the statute what the Court of Appeals for the District of Columbia has ruled was not intended to be there, at least by the original draftsman of Section 592. While Congress can always amend the law if it sees fit, we believe such an amendment is inappropriate at this time for the following reasons:

1) <u>The issue is currently subject to further judicial review and action by the Congress at this time is both premature and an unwarranted intervention into the purview of the Judicial Branch.</u>

The United States has requested a rehearing of the <u>COPIAT</u> case. In addition, approximately one month after the <u>COPIAT</u> decision, the Court of Appeals for the Second Circuit in <u>Olympus Corp.</u> v <u>United States</u> 7 ITRD 2423 (June 9, 1986), reached an opposite conclusion on the question decided by the District of Columbia Court of Appeals in <u>COPIAT</u>. However, even in the <u>Olympus</u> case, the Court of Appeals for the Second Circuit found the Customs regulations to be "of questionable wisdom" (7 ITRD at 2428), and cited an earlier decision of the District Court in Osawa & Co. v B & H Photo 589F Supp 1163 (S.D.N.Y. 1984) that found the customs regulations in question "unsound". Thus, even the majority of the Second Circuit did not approve of the regulations that S.2614 would incorporate into law. The court merely found them a valid exercise of Customs authority. Judge Winter vigorously dissented from even this conclusion. Thus, it is likely, due to the conflict of the Circuit Courts, that the Supreme Court will ultimately review and determine this issue. This is the correct legal path to follow. Senator Chafee's bill S.2614 is attempting to short circuit due process by legislating the exact issue before the Court before the Supreme Court can hear and adjudicate the issue. There is sufficient opportunity for Senator Chafee to reintroduce his bill if the COPIAT decision is upheld by the Supreme Court. Until such time, it is premature.

2) S.2614 is an unwarranted denigration of protection to U.S. trademark holders, and is not in the interests of public policy.

The purpose of Section 526 is to protect the rights of U.S. trademark holders against unauthorized imports. Often a foreign company that has registered a U.S. trademark has spent years and great sums of money building up good will and product image and quality in the U.S. To permit importation from unauthorized sources of trademarked goods, although legal in their country of origin, whose quality or even composition may not be identical, can seriously injure the U.S. importers and distributors. It should not matter at all whether the U.S. importer is in any way related to the foreign exporter. The trademark owner has an absolute right, if not a duty, to protect his good will and product image. U.S. consumers are buying the trademarked good because, to a large extent, they know there is an organization in the United States to back-up the trademark. This is almost always true in the case of authorized importers. Grey market importers, in the case of Mexican products, often truck the products over the border with no real office or official distributor in the U.S. Sometimes, no one is responsible for quality control or to answer complaints. If problems do arise, customers go to the authorized importer or his agents who in turn may be held liable for poor quality or contamination caused by unauthorized grey market importers' storage or handling techniques.

Vilore Foods is an importer of food products from Mexico, subject to FDA and other regulations. It is the authorized importer for several major Mexican brands. Imports of these brands by unauthorized sources diminishes quality control, and could lead to FDA rejections of both the legitimate and grey market imports if contaminated products are found and placed on the so-called "blocked list". We therefore request that, at least in the case of trademarks for food products, an absolute ban on grey markets imports be maintained and that the Congress not take any action which would disturb the court decision in COPIAT v United States, which declared invalid Section 133.21 of the Customs regulations. Congress should not interfere with the wisdom of two Courts of Appeals that found these regulations invalid or "of questionable wisdom". At the very least, no congressional action should be taken until the Supreme Court has acted on this matter.

Before the

SENATE FINANCE COMMITTEE

INTERNATIONAL TRADE SUBCOMMITTEE

Statement of

ABRAHAM TUNICK

WASHINGTON COUNSEL

On Behalf of

WINE AND SPIRITS WHOLESALERS OF AMERICA, INC.

July 29, 1986

Mr. Chairman, members of the Subcommittee, my name is Abraham Tunick, Washington Counsel for Wine and Spirits Wholesalers of America, the national trade association of wine and spirits distributors doing business in 44 states, the District of Columbia, Puerto Rico and the U.S. Virgin Islands. Our members account for almost 90 percent of the wine and spirits sold to the retail trade in states where such products can be sold by private enterprise under license.

I appreciate the opportunity to express our views and strong opposition to S.2614. This bill would reverse eighty years of trademark law and prohibit trademark owners from taking judicial action against infringers where gray market goods are concerned. In addition, it codifies a discredited and narrow reading of the tariff laws provision dealing with gray market goods.

At the outset let me clarify the interest of our members on this issue. The imported alchohol beverages shipped to the United States through the grey market bear the same trademarks as the alcohol beverages sold by our members who are the designated distributors.

As such, we are vitally concerned with the preservation of the integrity of the trademarks and authenticity of the products. The gray market destroys this integrity.

Although other witnesses will address the trademark issue, I believe that the following excerpt from the Senate committee report that accompanied the Lanham Act, articulates two distinct purposes which are served by trademark protection:

> "One is to protect the public so that it may be confident that, in purchasing a product bearing a particular trade-mark which it favorably knows, it will get the product which it asks for and wants to get. Secondly, where the owner of the trade-mark has spent energy, time, and money in presenting to the public the product, he is protected in his investment from its misappropriation by pirates and cheats. This is the well-established rule of law protecting both the public and the trade-mark owner." S. Rep. No. 1333, 79th Cong., 2d Sess. 3 (1946).

Other witnesses will also respond to some of the erroneous assumptions contained in Senator Chafee's introductory statement. But, fundamentally the issue is that the gray market, through the sale of beverages which frequently, due to a variety of factors -- shipping and handling, foreign formulations, etc. -- is less good than the legitimate product, destroys the goodwil in our members' trademarks and deceives the consumer.

Alcohol beverages, are ingestible commodities and therefore assurance of product integrity and authenticity should require the highest degree of scrutiny. The alcohol beverages being shipped to the U.S. through the grey market are formulated and packaged for consumption in foreign markets. Indeed some have been found to contain ingedients prohibited by federal law.

If the present trend in the sharp increase in the volume of grey market imports continues, the incentive for counterfeit becomes a serious reality.

Finally, we submit that S.2614 preempts the function of the judiciary prior to a final determination of the validity of Customs regulations implementing Section 526 of the Tariff Act and, thus, subverts and frustrates the judicial process.

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