U.S. Customs Service Enacts Final Rule on Affiliate Exception to Gray Market Goods Imports

By Peter S. Sloane

On March 26, 1999, an amendment to the regulations of the U.S. Customs Service governing gray market goods, known as the "affiliate exception," went into effect. The new rule permits the importation of gray market goods that are different from the domestic goods if labeled in accordance with a prescribed standard.

Section 42 of the Lanham U.S. Trademark Act of 1946 prohibits the importation of goods which copy or simulate the name or mark of any domestic manufacturer.[1] In 1972, however, Customs adopted the "affiliate exception," which rendered the protections of § 42 inapplicable where both the foreign and domestic trademark or trade name are owned by (i) the same person or business entity, (ii) parent and subsidiary companies or (iii) companies otherwise subject to common ownership or control.[2]

In 1993, the legality of the "affiliate exception" was reviewed by the U.S. Court of Appeals for the District of Columbia Circuit in *Lever Bros. Co. v. United States*.[3] In that case, Lever Brothers Company, a U.S. company, and its British affiliate both manufactured and sold deodorant soap under the trademark SHIELD and hand dishwashing liquid under the trademark SUNLIGHT. However, the two related companies manufactured and packaged their respective products differently to suit local tastes and circumstances. To prevent third parties from importing products manufactured by its British affiliate, Lever Brothers brought suit against the U.S. government, alleging that the unauthorized importation caused substantial confusion and deception among U.S. consumers about the nature and origin of the goods, in violation of § 42 of the Lanham Act.

In its defense, the U.S. Customs Service argued that § 42 applied only to imported goods bearing trademarks that "copy or simulate" the U.S. owner's marks. Customs urged that marks applied by foreign firms subject to common ownership and control with a domestic trademark owner are "genuine" regardless of whether the goods are identical. The court found this argument "fatally flawed" because "[t]rademarks applied to physically different foreign goods are not genuine from the viewpoint of the American consumer."[4] Quoting from an earlier decision, the court stated that "when identical trademarks have acquired different meanings in different countries, one who imports the foreign version to sell it under that trademark will (in the absence of some specially differentiating feature) cause the confusion Congress sought to avoid. The fact of affiliation between the producers in no way reduces the probability of that confusion. . . ."[5] Accordingly, the court held that § 42 precludes Customs from applying the "affiliate exception" when the domestic and foreign goods are physically and materially different.

In response to the ruling in *Lever Bros.*, Customs amended its rules to establish a "specially differentiating feature" requirement to avoid consumer confusion. Upon application of the U.S. trademark owner, Customs will restrict the importation of goods that are physically and materially different from the authorized U.S. goods, even if the domestic and foreign trademark owners are the same or related entities. However, the amended rules provide a safe harbor if the merchandise or packaging bears a conspicuous and legible label, displayed in close proximity to the trademark and designed to remain on the product until the first point of sale to a retail consumer in the United States, stating that "this product is not a product authorized by the U.S. trademark owner for importation and is physically and materially different from the authorized product."[6]

Whether or not the new label requirement is sufficient to avoid consumer confusion in the case of materially different imports is questionable. During the comment period following publication of the proposed rule, and before its enactment, one commentator stated that the courts have rejected the notion that disclaimers absolve infringing conduct.[7] Indeed, it seems open to debate whether the *Lever Bros.* discussion of a "specially differentiating feature" even authorized Customs to amend its rules to provide a disclaimer as an exception to the statutory prohibition against the importation of gray market goods established by § 42.

Endnotes

1. 15 U.S.C. § 1124.
2. 19 C.F.R. § 133.21(c).
3. 981 F.2d 1330, 25 U.S.P.Q.2d 1579 (D.C. Cir. 1993).
4. *Lever Bros.*, 981 F.2d at 1338.
5. *Id. (quoting Lever Bros. Co. v. United States*, 877 F.2d 101, 111 (D.C. Cir. 1989)).
6. 19 C.F.R. § 133.23(b).
7. *See Home Box Office, Inc. v. Showtime/The Movie Channel Inc.*, 832 F.2d 1311 (2d Cir. 1987) (rejecting claim that disclaimers are a favored way of alleviating substantial consumer confusion and imposing burden on infringer to prove proposed materials would significantly reduce the likelihood of confusion).

Peter S. Sloane, an associate at Ostrolenk, Faber, Gerb & Soffen, LLP, is co-chair of the Trademark Law Committee of the Intellectual Property Law Section. This article was originally published as a Trademark Committee Bulletin in May 1999.