In the Matter of

CERTAIN SOFT SCULPTURE DOLLS POPULARLY KNOWN AS "CABBAGE PATCH KIDS," RELATED LITERATURE AND PACKAGING THEREFOR

Investigation No. 337-TA-231

USITC PUBLICATION 1923

NOVEMBER 1986

United States International Trade Commission / Washington, DC 20436

UNITED STATES INTERNATIONAL TRADE COMMISSION

COMMISSIONERS

Susan Liebeler, Chairman
Anne E. Brunsdale, Vice Chairman
Paula Stern
Alfred E. Eckes
Seeley G. Lodwick
David B. Rohr

Prepared principally by the Office of Industries

Erland Heginbotham, Director

Address all communications to
Kenneth R. Mason, Secretary to the Commission
United States International Trade Commission
Washington, DC 20436

UNITED STATES INTERNATIONAL TRADE COMMISSION
Washington, D.C. 20436

In the Matter of	Investigation No. 337-TA-231
CERTAIN SOFT SCULPTURE DOLLS, POPULARLY KNOWN AS "CABBAGE PATCH KIDS," RELATED LITERATURE AND PACKAGING THEREFOR	

NOTICE OF ISSUANCE OF GENERAL EXCLUSION ORDER

AGENCY: U.S. International Trade Commission.

ACTION: Determination of violation of section 337 of the Tariff Act of 1930 and issuance of a general exclusion order.

AUTHORITY: 19 U.S.C. § 1337.

SUMMARY: The Commission has determined that a general exclusion order pursuant to section 337(d) of the Tariff Act of 1930 (19 U.S.C. § 1337(d)) is the appropriate remedy for the violations of section 337 found to exist in the above-captioned investigation; that the public interest considerations enumerated in section 337(d) do not preclude the issuance of such an order; and that the amount of the bond during the Presidential review period shall be 165 percent of the entered value of the imported articles.

FOR FURTHER INFORMATION CONTACT: Stephen A. McLaughlin, Esq., Office of the General Counsel, U.S. International Trade Commission, telephone 202-523-0421.

SUPPLEMENTARY INFORMATION: On July 11, 1986, the presiding administrative law judge (ALJ) issued an initial determination (ID) finding that there is a violation of section 337 in the unauthorized importation into and sale in the United States of certain soft sculpture dolls, popularly known as "Cabbage Patch Kids". On August 28, 1986, the Commission determined to review those portions of the ID relating to the country of origin marking requirements, the scope of the domestic industry, and the effect or tendency to substantially injure a domestic industry. No other issues were reviewed and the remainder of the ALJ's ID was thereby adopted by the Commission. 51 F.R. 31,731 (Sept. 4, 1986). The Commission requested written comments on the issues under review and on the issues of remedy, the public interest, and bonding. Submissions were received from complainants Original Appalachian Artworks, Inc. and Coleco Industries, Inc. and the Commission investigative attorney, but not from any respondent.

This action is taken under the authority of section 337 of the Tariff Act of 1930 (19 U.S.C. § 1337) and sections 210.54-.56 of the Commission's Rules of Practice and Procedure (19 C.F.R. §§ 210.54-.56).

Notice of this investigation was published in the Federal Register on November 7, 1985 (50 F.R. 46,368).

Copies of the Commission's Action and Order, the nonconfidential version of the ALJ's ID, and all other nonconfidential documents filed in connection with this investigation are available for inspection during official business hours (8:45 a.m. to 5:15 p.m.) in the Office of the Secretary, U.S. International Trade Commission, 701 E Street NW., Washington, D.C. 20436, telephone 202-523-0471. Hearing impaired individuals may obtain information on this matter by contacting the Commission's TDD terminal at 202-724-0002.

By order of the Commission.

Kenneth R. Mason
Secretary

Issued: November 7, 1986

UNITED STATES INTERNATIONAL TRADE COMMISSION
Washington, D.C. 20436

In the Matter of CERTAIN SOFT SCULPTURE DOLLS, POPULARLY KNOWN AS "CABBAGE PATCH KIDS," RELATED LITERATURE AND PACKAGING THEREFOR	Investigation No. 337-TA-231

COMMISSION ACTION AND ORDER

Background

A complaint was filed with the Commission on October 1, 1985, by Original Appalachian Artworks, Inc. and Coleco Industries, Inc. alleging unfair acts and methods of competition in the importation and sale of certain soft sculpture dolls, popularly known as "Cabbage Patch Kids", related literature and packaging therefor. The Commission on October 31, 1985, voted to institute the above-captioned investigation to determine whether there is a violation of section 337 of the Tariff Act of 1930 (19 U.S.C. § 1337) in the importation or sale of certain soft sculpture dolls, popularly known as "Cabbage Patch Kids", related literature and packaging therefor by reason of (1) infringement of U.S. Copyright Reg. Nos. VA 35-804, VA 141-801, TX 1-254-777, TX 1-254-778, and TX 1-261-526; (2) failure to mark the country of origin on such unlawfully imported dolls and their packaging in violation of 19 U.S.C. § 1304; and (3) violation of 17 U.S.C. § 601(a) (the Manufacturing Clause). It was alleged that the effect or tendency of these unfair acts and

unfair methods of competition was to destroy or substantially injure an industry, efficiently and economically operated, in the United States. Named as respondents were John and Jane Doe Murrell d/b/a Murrell Marketing, Japan Instruments Corp., Sav-On-Drugs, Inc., Osco Drugs, Inc., and Household Merchandising, Inc. On January 3, 1986, Calila, Inc. and International Panasound Ltd. were added as respondents by amendment of the complaint. The Commission's notice of investigation was published in the Federal Register on November 7, 1985. (50 F.R. 46,368).

On July 11, 1986, the presiding administative law judge (ALJ) issued an initial determination that there was a violation of section 337 in the importation and sale of certain soft sculpture dolls, popularly known as "Cabbage Patch Kids". Specifically, the ALJ found that (1) the copyrights at issue were valid and infringed by the respondents and that such infringement was an unfair act under section 337; (2) there was no violation of 19 U.S.C. § 1304 for failure to mark the unlawful imports with their country of origin and, even if they were a violation, it did not constitute an unfair act under section 337; and (3) there was no violation of 17 U.S.C. § 601(a), commonly known as the "Manufacturing Clause." The ALJ then determined that the unfair acts had the effect and tendency to substantially injure a domestic industry. In making this determination the ALJ included complainants' licensing activity within the scope of the domestic industry and included operating profits in his value-added computation for the purpose of determining the existence of a domestic industry.

On August 28, 1986, the Commission published in the Federal Register notice of its decision to review certain issues raised by the ALJ's initial determination. These issues were:

(1) Whether respondents' unauthorized imports violate the country of origin marking statute (19 U.S.C. § 1304) and, if so, whether such violation constitutes an unfair act under section 337.

(2) Whether the ALJ's determination of the scope of the domestic industry was correct. In this regard, the Commission was especially interested in (a) whether licensing activity in combination with production activity can constitute a domestic industry under section 337 and (b) whether operating profits are properly included in a value-added computation for the purpose of determining whether there is a domestic industry under section 337.

(3) Whether the unfair acts of respondents have the effect of substantially injuring the relevant domestic industry. The Commission was particularly interested iin the question of whether substantial injury can be found during a period when there is no idle domestic capacity and when imported product sold for higher prices than domestic products.

(4) Whether the unfair acts of respondents have the tendency to substantially injure the domestic industry.

No other issues were reviewed and the remainder of the ALJ's initial determination was thereby adopted by the Commission. The Commission's notice of review requested written comments on the issues under review and on the issues of remedy, the public interest, and bonding. Submissions were received from complainants and the Commission investigative attorney (IA), but not from any respondent.

Action

Having reviewed the record in this investigation, including the written submissions submitted in response to the Commission's notice of review, the Commission has determined that there is a violation of section 337. The Commission has also determined that the appropriate remedy in this investigation is a general exclusion order prohibiting the importation of unauthorized "Cabbage Patch Kids" dolls into the United States, that the

public interest factors enumerated in section 337(d) (19 U.S.C. § 1337(d)) do not preclude issuance of such an exclusion order, and that the bond during the Presidential review period should be in the amount of 165 percent of the entered value of the imported articles.

Order

Accordingly, it is hereby ORDERED THAT—

1. Foreign soft sculpture dolls popularly known as "Cabbage Patch Kids," related birth certificates and adoption papers, and packaging therefor, including but not limited to such models as the 16-inch Cabbage Patch Kids; 14-inch Preemies; 16-inch Twins; 16-inch World Travelers; 16-inch Cornsilk Kids; 14-inch Preemie Twins; 16-inch Clowns; 16-inch Astronauts; 16-inch Allstars; and 12-inch Babies, that infringe Original Appalachian Artworks, Inc.'s (OAA's) copyrights, U.S. Copyright Registration Nos. VA-35-804, VA 141-801, TX 1-254-777, TX 1-254-778, and TX 1-261-526, are excluded from entry into the United States until the expiration of all of the aforesaid copyrights, except (1) as provided in paragraph 2 of this order or (2) under license from or with the permission of OAA;

2. The products ordered to be excluded in paragraph 1 above are entitled to entry into the United States under bond in the amount of 165 percent of the entered value of the subject articles, from the day after this order is received by the President pursuant to subsection (g) of section 337 of the Tariff Act of 1930, until such time as the President notifies the Commission that he approves or disapproves this action, but, in any event, no later than 60 days after the date of such receipt;

3. Notice of this Action and Order shall be published in the Federal Register;

4. A copy of this Action and Order and of the Commission Opinions issued in connection therewith shall be served upon each party of record in this investigation and upon the Department of Health and Human Services, the Department of Justice, the Federal Trade Commission, and the Secretary of Treasury; and

5. The Commission may amend this Order in accordance with the procedure described in 19 C.F.R. § 211.57.

By order of the Commission.

Kenneth R. Mason
Secretary

Issued: November 7, 1986

CERTAIN SOFT SCULPTURE DOLLS, POPULARTLY KNOWN AS "CABBAGE PATCH KIDS," RELATED LITERATURE AND PACKAGING THEREFOR

Inv. No. 337-TA-231

Certificate of Service

I, Kenneth R. Mason, hereby certify that the attached NOTICE OF ISSUANCE OF GENERAL EXCLUSION ORDER, was served Deborah S. Strauss, Esq., and upon the following parties by first class mail, and air mail where necessary, on November 7, 1986.

Kenneth R. Mason, Secretary
U.S. International Trade Commission
701 E Street, N.W.
Washington, D.C. 20436

FOR COMPLAINANT: ORIGINAL APPALACHIAN ARTWORKS, INC.; COLECO INDUSTRIES, INC.

Steven P. Kersner, Esq.; Donald S. Stein, Esq.;
Denise T. DiPersio, Esq.
BROWNSTEIN, ZEIDMAN AND SCHOMER
1401 New York Avenue, N.W.
Suite 900
Washington, D.C. 20005

William H. Needle, Esq.
LAW OFFICE OF WILLIAM H. NEEDLE, P.C.
The Carnegie Building
Suite 400
133 Carnegie Way, N.W.
Atlanta, GA 30303

Stanley F. Birch, Esq.
VAUGHAN, PHEARS, ROACH, DAVIS & MURPHY
Suite 1500
One Ravinia Drive
Atlanta, Georgia 30346

FOR RESPONDENTS: Sav-On-Drugs, Inc.; Osco Drug, Inc.

Bruce Aitken, Esq.; Edward R. Easton
BUSBY, REHM AND LEONARD, P.C.
1330 Connecticut Avenue, N.W.
Suite 200
Washington, D.C. 20036

con't

CERTIFICATE OF SERVICE - page 2

FOR RESPONDENTS: John and Jane Doe Murrell; Japan Instruments Corp.

Daniel G. Rooney
SHAUB & ROONEY
12121 Wilshire Blvd.
Suite 816
Los Angeles, CA 90025

Household Merchandising, Inc.
(Ben Franklin Division)
1700 Wolf Road
Des Plaines, Illinois 60016

Calila, Inc.
8075 Third Street
Suite 406
Los Angeles, California 90048

International Panasound, Ltd.
1377 Avenue Of The Americas
New York, New York 10019

GOVERNMENT AGENCIES:

Mr. Charles S. Stark
Antitrust Div./U.S. Dept. of Justice
Room 7115, Main Justice
Pennsylvania Avenue & Tenth Street, N.W.
Washington, D.C. 20530

Edward F. Glynn, Jr., Esq.
Asst. Dir. for Int'l Antitrust
Federal Trade Commission
Room 502-4, Logan Building
Washington, D.C. 20580

Darrel J. Grinstead, Esq.
Dept. of Health & Human Services
Room 5362, North Building
330 Independence Avenue, S.W.
Washington, D.C. 20201

Michael T. Schmitz
Chief Counsel
U.S. Customs Service
1301 Constitution Avenue, N.W.
Washington, D.C. 20229

In the Matter of CERTAIN SOFT SCULPTURE DOLLS, POPULARLY KNOWN AS "CABBAGE PATCH KIDS," RELATED LITERATURE AND PACKAGING THEREFOR	Investigation No. 337-TA-231

VIEWS OF THE COMMISSION

I. INTRODUCTION

This investigation arose out of a complaint filed on October 1, 1985, by Original Appalachian Artworks, Inc. (OAA) and Coleco Industries, Inc. (Coleco). The complainants alleged unfair methods of competition and unfair acts in the importation and sale of certain Cabbage Patch Kids dolls (CPK dolls), together with the related literature and packaging. The unfair acts alleged were infringement of various OAA copyrights, failure to mark the country of origin, and violation of 17 U.S.C. § 601(a), commonly known as the "Manufacturing Clause."

On October 31, 1985, the Commission voted to institute an investigation based upon the allegations in the complaint. Named as respondents were John and Jane Doe Murrell d/b/a Murrell Marketing, Japan Instruments Corp., Sav-On-Drugs, Inc. (Sav-On), Osco Drugs, Inc. (Osco), and Household Merchandising, Inc. On January 3, 1986, Calila, Inc. and International Panasound Ltd. (IPL) were added as respondents by amendment of the complaint when complainants' motion to amend was granted in an initial determination

(ID) issued by the presiding administrative law judge (ALJ). The Commission issued notice of its determination not to review this ID on February 3, 1986. 1/

Settlement agreements were entered into between complainants and Osco, Sav-On, IPL, and Calila. Those respondents were terminated from the investigation on the basis of the settlement agreements. The remaining respondents (Murrell Marketing, Japan Instruments, and Household Merchandising) did not participate in the investigation.

On March 10, 1986, complainants filed a motion for summary determination as to all issues in the investigation. The Commission investigative attorney (IA) filed a response substantially in support of that motion. No respondent submitted any evidence in opposition to that motion. Briefs were submitted and oral argument was heard by the ALJ on April 14 and 15, 1986. No appearances were made on behalf of any of the respondents. The ALJ granted complainants' motion for summary determination in an ID issued July 11, 1986, finding that there is a violation of section 337 in the unauthorized importation or sale of CPK dolls and their related literature and packaging. 2/

The ALJ held that:

> (1) the unauthorized importation of CPK dolls by respondents and other third parties violated Coleco's exclusive right of distribution in the United States and therefore infringed the 801 and 804 copyrights under 17 U.S.C. § 602(a) (ID at 79-90);

1/ 51 Fed. Reg. 5267 (Feb. 12, 1986).

2/ ID at 73.

(2) the unauthorized importation of foreign birth certificates, adoption papers, and packaging by respondents and other third parties constituted infringement of the 777, 778, and 526 copyrights under 17 U.S.C. § 602(a) (ID at 91-92);

(3) the alleged violation of the Manufacturing Clause (17 U.S.C. § 601(a)) was not an unfair act within the meaning of section 337 (ID at 92-97);

(4) complainants have not shown that the accused CPK dolls violated the country of origin marking requirement (19 U.S.C. § 1304) as a matter of law (ID at 97-99);

(5) the alleged failure to comply with the country of origin marking requirement did not constitute an unfair act or unfair method of competition under section 337 (ID at 99-100);

(6) the relevant domestic industry comprised (a) the licensing program for complainant OAA's copyrights; (b) licensee Coleco's domestic production of CPK dolls and related literature and packaging; and (c) Coleco's post-sale fulfillment process (ID at 102-13);

(7) the domestic industry was efficiently and economically operated (ID at 114-15);

(8) the domestic industry was substantially injured, based in part upon sales of unauthorized imports when there was no idle domestic production capacity and the fact that gray market dolls sold for higher prices than complainants' dolls (ID at 117-20); and

(9) respondents' unfair acts had the tendency to substantially injure the domestic industry because gray market imports were likely to continue in the future (ID at 120-24).

On September 4, 1986, the Commission determined on its own motion to review the following issues:

(1) Whether respondents' unauthorized imports violated the country of origin marking statute (19 U.S.C. § 1304) and, if so, whether such violation constituted an unfair act under section 337;

(2) Whether the ALJ's determination of the scope of the domestic industry was correct, focusing on (a) whether licensing activity in combination with production activity can constitute a domestic industry under section 337 and (b) whether operating profits are properly included in a value-added computation for the purpose of determining whether there is a domestic industry under section 337;

(3) Whether the unfair acts of respondents had the effect of substantially injuring the relevant domestic industry, focusing on whether substantial injury can be found during a period when there was no idle domestic capacity and when imported products were sold for higher prices than domestic products; and

(4) Whether the unfair acts of respondents have the tendency to substantially injure the domestic industry. 3/

Complainants and the IA filed briefs on the issues under review and on remedy, the public interest, and bonding.

By limiting review to these issues, the Commission has adopted those (unreviewed) portions of the ID concerning copyright validity and infringement, the Manufacturing Clause, importation and sale, and efficient and economic operation of a domestic industry.

II. DETERMINATIONS

We have determined that:

1. Imported CPK dolls which are the subject of this investigation are not properly marked with their country of origin in violation of 19 U.S.C. §

3/ Commission Decision to Review Portions of an Initial Determination Finding a Violation of Section 337 of the Tariff Act of 1930, 51 Fed. Reg. 31731 (September 4, 1986).

1304(a) ("section 304(a)") and that such violation constitutes an unfair act under section 337. 4/ 5/

2. There is a domestic industry producing CPK dolls, related literature, and packaging for the CPK dolls, given the nature and significance of the complainants' domestic activities.

a. The licensing activities of complainants are not part of the relevant domestic industry. 6/ 7/

b. Profit should not be included in a value-added computation in deciding whether a domestic industry exists. 8/ 9/

3. The domestic industry is substantially injured by the unfair acts of respondents.

4. The unfair acts of respondents tend to substantially injure the domestic industry.

4/ Commissioner Rohr does not join in this finding. In view of his finding of a violation of section 337 in the infringement of the copyrights in question in this investigation, he does not find it necessary to reach the issue of whether a violation of the marking statute standing alone would be a violation of section 337.

5/ Commissioner Lodwick does not join in this finding. In view of his finding of a violation of section 337 in the infringement of the copyrights in question in this investigation he does not find it necessary to reach the issues of whether respondents violated the country of origin marking statute (19 U.S.C. § 1304) and, if so, whether such violation constituted an unfair act under section 337.

6/ Chairman Liebeler and Vice Chairman Brunsdale do not agree with this conclusion. See Additional Views of Chairman Liebeler and Vice Chairman Brunsdale, infra.

7/ Commissioner Lodwick, in view of his finding that there is sufficient evidence of a domestic industry without including complainant's licensing activities, finds it unnecessary to reach this issue, and does not join in this finding.

5. A general exclusion order prohibiting importation of unauthorized CPK dolls is the appropriate remedy.

6. The public interest factors do not prohibit the issuance of a general exclusion order.

7. A bond of 165 percent of the entered value of the unauthorized imports of CPK dolls will be required during the Presidential review period.

III. DISCUSSION

1. Country of Origin Marking [10/] [11/]

Section 304(a) of the Tariff Act of 1930 (19 U.S.C. § 1304(a)) provides that every article of foreign origin imported into the United States, or its container as provided in section 304(b) (19 U.S.C. § 1304(b)),——

> shall be marked in a conspicuous place as legibly, indelibly, and permanently as the nature of the article (or container) will permit in such manner as to indicate to the ultimate purchaser in the United States the English name of the country of origin of the article.

The imported CPK dolls were marked with the country of origin on the back of the doll's neck or on a tag stitched to the doll underneath its clothing.

8/ Chairman Liebeler and Vice Chairman Brunsdale do not agree with this conclusion. See Additional Views of Chairman Liebeler and Vice Chairman Brunsdale, infra.

9/ In view of his finding that there is sufficient evidence of a domestic industry without including profit in the value-added computation, Commissioner Lodwick finds it unnecessary to reach this issue, and does not join in this finding.

10/ Chairman Liebeler and Vice Chairman Brunsdale do not agree with the conclusion reached by the Commission. See Additional Views of Chairman Liebeler and Vice Chairman Brunsdale, infra.

11/ Commissioner Rohr does not join in this portion of the opinion. See note 4, supra.

The ALJ found that the unauthorized imported dolls arrived in the United States in display packages ready for retail sale. None of the imported packages identified the country of origin of the doll. Finally, the ALJ held that the doll's country of origin marking was not visible unless the doll was removed from its packaging and examined. The ALJ, however, did not specifically determine whether the dolls themselves were marked in a conspicuous place. 12/

Since the unauthorized imported dolls were marked with the country of origin, the ALJ declined to rule that such markings were not in compliance with the marking statute. 13/ Moreover, the ALJ held that the failure to mark the packaging would only be a violation of section 304(b) if the CPK dolls themselves were excepted from markings pursuant to Customs rule 134.24(d)(2) (19 C.F.R. § 134.24(d)(2)). No evidence was introduced showing that the CPK dolls themselves were excepted from the marking requirements. 14/ Finally, the ALJ determined that, even if the imported dolls failed to comply with the statutory requirements for country of origin marking, such failure did not constitute an unfair act for purposes of section 337. 15/

The ALJ analyzed Commission precedent regarding country of origin marking and concluded that failure to mark country of origin constitutes an unfair act

---

12/ ID at 90.

13/ ID at 99.

14/ Id.

15/ Id.

if there is also a finding that the public prefers products of domestic origin or is confused as to the source of a particular product. 16/ The ALJ held that such was not the case in this investigation because Coleco's "domestic" CPK dolls are manufactured in the Far East. 17/ Furthermore, since respondents' imported CPK dolls were shipped in packages that were either wholly in a foreign language or in both English and a foreign language, there was no evidence that purchasers bought these unauthorized imports in the belief that they were domestically produced. 18/

Both complainants and the IA argued before the ALJ, and in their submissions on review, that the country of origin marking on unauthorized imports was inadequate to satisfy the requirements of section 304(a). The IA also argued that the unauthorized imports violated section 304(b), which requires marking the country of origin on packaging of certain products that are normally sold without being opened by the ultimate purchaser and that are excepted from marking on the product itself. 19/

Both complainants and the IA also insisted that failure to mark the country of origin, in and of itself, constituted an unfair act under section

---

16/ ID at 100. Certain Swivel Hooks and Mountings Brackets, Inv. No. 337-TA-53, Recommended Determination at 4, adopted by Commission 107 U.S.P.Q. 669, 670 (1979).

17/ ID at 100. Although complainant OAA's CPK dolls are made in the United States, they are larger than the CPK dolls mass-produced by its licensees and do not have hard plastic faces. Therefore they are not likely to be confused with the CPK dolls produced by co-complainant/licensee Coleco and the foreign licensees.

18/ Id.

19/ Brief of the IA on Issues on Review at 8.

337. [20/] They maintained that the ALJ had confused the injury requirement of section 337 with proof of an unfair act. In their view, complainants need not demonstrate confusion of the consumer or preference for a domestically-produced product. Failure to properly mark the country of origin is enough.

We have determined that the evidence of record clearly demonstrated a violation of section 304(a) in that the unauthorized imports were not conspicuously marked with their country of origin. The ALJ's factual findings clearly demonstrate that the ultimate purchaser in the United States would have been unable to determine the country of origin of the unauthorized imports at the time of purchase. The only country of origin marking on the unauthorized imports was not visible unless the doll and the related literature were removed from their package. The ultimate purchaser should not be required to open the package, remove the literature and the doll, which was secured to the packaging making removal difficult, and examine them to determine their country of origin.

Section 304(b) is not pertinent. Country of origin marking on the package is required only if the product is excepted from the marking requirement of section 304(a). There was no evidence that the unauthorized imports were excepted from section 304(a).

After reviewing Commission precedent, we have determined that a violation of section 304, coupled with some evidence of either consumer confusion as a

---

20/ Brief of Complainants on Issues on Review at 6-9; Brief of the IA on Issues on Review at 10-14.

result of the failure to mark conspicuously the country of origin or a consumer preference for a domestically produced item, constitutes an unfair act under section 337. Recent determinations by the Commission and by the ALJs support the view that "it is inappropriate to elevate [a] technical violation [of section 304], standing alone, to an unfair method of competition within the meaning of Section 337." Certain Trolley Wheel Assemblies, Inv. No. 337-TA-161, Initial Determination at 54-55 (1984) (not reviewed). See also, Certain Kukui Nut Jewelry and Parts Thereof, Inv. No. 337-TA-229, Initial Determination (July 30, 1986) (not reviewed); Certain Caulking Guns, Inv. No. 337-TA-139, Initial Determination (1983) (not reviewed); Certain Miniature Plug-In Blade Fuses, Inv. No. 337-TA-114, Commission Opinion at 30-31, note 145 (1982). The only apparent inconsistency in this line of precedent is the unreviewed portion of the ID in Certain Alkaline Batteries, Inv. No. 337-TA-165, Initial Determination at 9 (July 10, 1984), wherein the ALJ stated that "[f]ailure to disclose the country of origin pursuant to 19 U.S.C. § 1304 constitutes an unfair act under § 337." The single reference in Alkaline Batteries, however, provides an insufficient basis for deviating from the otherwise consistent line of decisions noted above. The statement in Alkaline Batteries regarding violations of section 304 was dicta since the ALJ determined that there was no violation of section 304 in that case. In contrast, the other decisions, particularly Trolley Wheels, decided this issue directly by holding that, notwithstanding a violation of section 304, there was no evidence of consumer confusion and, therefore, no unfair act under section 337.

Potential consumers of certain products, such as those in Trolley Wheels, are so few and their knowledge of the products is so sophisticated that country of origin marking is superfluous. However, potential consumers of mass-produced goods may need the country of origin marking in order to avoid confusion as to the source of goods. This can be especially important where, as in this investigation, the product contains "literature" that is a key factor in consumer demand for the product.

Given the evidence in the record regarding consumer dissatisfaction with unauthorized imports because of the inability to complete the adoption process [21/] and the absence of any evidence to the contrary, we have determined that the violation of section 304(a) has resulted in consumer confusion. Thus the violation of section 304(a) in the importation of the CPK dolls and related literature subject to this investigation constituted an unfair act under section 337. [22/]

2. Domestic Industry

The notice of review, stated that the Commission was especially interested in two domestic industry issues: (1) whether licensing activity in

---

21/ See CX 17.

22/ Contrary to the position taken by the IA in his reply brief, we do not believe that it is appropriate to trace injury to each unfair act separately. Reply Brief of the IA at 2. The Commission should first determine whether unfair acts in violation of section 337 exist and then determine whether those unfair acts have the effect or tendency to substantially injure an efficiently and economically operated domestic industry.

combination with production activity can constitute a domestic industry under section 337 and (2) whether operating profits are properly included in a U.S. value-added computation for the purpose of determining the existence of a domestic industry. 23/ 24/

The ALJ began his analysis of the domestic industry by noting that, in copyright cases, the relevant domestic industry is defined as the domestic operations of complainant devoted to the exploitation of the copyright in issue. 25/ Certain Products with Gremlin Character Depictions, Inv. No. 337-TA-201, at 13 (1986) (Gremlins). The ALJ then analyzed the activities of complainants OAA and Coleco to determine the scope of the domestic industry.

The ALJ concluded that OAA's U.S. production of soft sculpture CPK dolls under the 804 copyright (i.e., the original dolls) was part of the domestic industry even though those dolls did not compete directly with the smaller CPK dolls made by Coleco and imported by respondents. The inclusion of OAA was significant because OAA's CPK dolls are manufactured in the United States;

23/ Neither complainants nor the IA relied on these two factors to establish a domestic industry in the proceedings below. Both insisted that a domestic industry exists regardless of whether licensing activity and operating profits are included in the domestic industry analysis.

24/ Chairman Liebeler and Vice Chairman Brunsdale do not reach the issues of whether complainants' profit and licensing activities should be included in the domestic industry in this investigation. Neither the parties nor the IA relied on these activities to establish a domestic industry. We do not agree with the general conclusions reached by the majority concerning the inclusion of licensing and profit in the domestic industry. See Additional Views of Chairman Liebeler and Vice Chairman Brunsdale, infra.

25/ ID at 102.

their domestic value added was 100 percent. The ALJ noted that the Commission had determined in Gremlins that direct competition was not a limiting factor on the scope of the domestic industry, although it might affect the injury analysis. 26/ Since OAA's larger dolls were covered by a copyright that was infringed by the imported CPK dolls, the ALJ included OAA's production under the 804 copyright in the domestic industry. 27/

The ALJ also included co-complainant Coleco's U.S. operations within the scope of the domestic industry. Coleco's operations consisted of product development, development of the matrixing rules, 28/ quality control, inspection, and repair of CPK dolls once they entered the United States, addition of accessories, fulfillment houses that provided the birth certificates and adoption papers and processed them, and sales and administrative expenses. 29/

Next the ALJ noted that, while the Commission had rejected in Gremlins the idea that licensing activity per se could be considered a domestic industry, it specifically left open the question of whether licensing activity combined with production activity could constitute a domestic industry. 30/ In Gremlins, the Commission stated:

26/ ID at 103-04.

27/ Id.

28/ For a discussion of the matrixing rules, see text at 16, supra.

29/ ID at 105-08.

30/ ID at 104.

> Further treatment of the issue of combining licensing activities and production activities must await another investigation in which the parties have adequately raised the issue and developed the factual record before the Commission.

Gremlins at 11. In this investigation, the ALJ held that the scope of the domestic industry included both production of the CPK dolls and the licensing activities related to those dolls. The ALJ also noted that complainant OAA retained final approval of all licensing agreements, employed five people for its licensing functions, and derived royalty revenue approaching what it earned from sales of its own CPK dolls and related products. 31/

Applying the "nature and significance" test for domestic activities pursuant to Schaper Mfg. Co. v. U.S.I.T.C., 717 F.2d 1368 (Fed. Cir. 1983), the ALJ proceeded to compute the value added by domestic activities. While noting that CPK dolls were actually assembled in the Far East, the ALJ concluded that the value added by complainants' domestic operations was significant enough to constitute a domestic industry. 32/ The ALJ determined that the U.S. value added for Coleco's CPK dolls was well over half of the total value, including within that computation the licensing activity of OAA and its agent and operating profit, but not including sales and administrative expenses. 33/ In including operating profit in his computation, over the objection of both complainants and the IA, the ALJ

31/ ID at 104-05.

32/ ID at 108-13.

33/ ID at 112-13.

observed that it had been argued that such a decision was inconsistent with Commission precedent. 34/ If operating profit had been excluded, along with sales and administrative expenses, the domestic value added was approximately 50 percent. 35/

Complainants' licensing activities and operating profit should not have been included in the domestic industry analysis. The U.S. Court of Appeals for the Federal Circuit stated in Schaper that design or licensing activities cannot be considered part of the domestic industry because they did not involve either manufacture, production, or servicing of the subject goods. Schaper, 717 F.2d at 1371. Moreover, inclusion of operating profit in the value-added analysis has been rejected by the Federal Circuit and the Commission. Schaper, 717 F.2d 1371-73; Certain Modular Structural Systems, Inv. No. 337-TA-164 (1984). Both complainants and the IA recognized this and did not argue to the ALJ that licensing activities or operating profit should be included within the scope of the domestic industry.

The inclusion of domestic licensing activity and operating profit in considering the existence of a domestic industry was, however, harmless error since there was sufficient evidence of a domestic industry even when those factors are excluded. An evaluation of the nature and significance of complainants' domestic activities, including the value added by those activities, demonstrates that a domestic industry exists. OAA actually

---

34/ ID at 112.

35/ Id.

manufactured its dolls in the United States; the domestic value added for those dolls was 100 percent. Coleco, while importing dolls from the Far East, did extensive quality control, testing, repair, and assembly in the United States. Coleco has two domestic pack out/quality control facilities. One in Amsterdam, New York, the other in Tustin, California. At these facilities the dolls are inspected, cleaned, tested for metal content, groomed, inserted in their packages (which are produced in the United States), secured, and the "adoption papers" and "birth certificates" (also entirely of U.S. manufacture) are inserted.

Coleco's matrixing system is also performed in the United States. As a result of this matrix system, individual CPK dolls appear to consumers to be unique. Matrixing is a complex design, manufacturing, packaging, and distribution concept that has contributed to the commercial success of the CPK doll. Matrix rules for each style of CPK doll control the head sizes, hair color, eye color, skin color, and clothing on each doll. At the production level, matrixing ensures the widest possible variety of CPK dolls are produced. At the distribution level, matrixing also ensures that each retailer receives the widest possible variety of CPK dolls. FF 149-153.

Further, the packaging, "adoption papers" and "birth certificates" (all of which were covered by the copyrights that respondents have infringed) 36/

36/ In Schaper, the Federal Circuit excluded from the scope of the domestic industry the production of various accessories added after importation to the toy trucks because those accessories, unlike the packaging and adoption papers in this case, were not covered by the property rights that were infringed. 717 F.2d at 1371.

were produced in the United States and the post-sale fulfillment process, [37/] a key factor in the commercial success of the doll, occurred in the United States. [38/]

The domestic value added to Coleco's CPK dolls, exclusive of sales and administrative costs, is roughly equal to the value added in Certain Cube Puzzles, Inv. No. 337-TA-112 (1982). [39/] More importantly, however, the domestic activities in the current investigation are more significant than the packaging and repair that occurred in that case. Some of the CPK dolls were actually manufactured in the United States. Further, the post-sale fulfillment process and the matrixing system for distribution occurred in the United States.

In light of the foregoing discussion, we have reversed that portion of the ID that included licensing activity and operating profit within the scope of the domestic industry, but we have adopted the ALJ's conclusion that there was a domestic industry in the United States.

37/ Id. at 16. Coleco's adoption program for CPK dolls is carried out by three "fulfillment houses" under contract to Coleco. The fulfillment houses provide the birth certificate and adoption application that are included in the box with each CPK doll. When a purchaser fills in the application, it is returned to one of the fulfillment houses where an adoption certificate is prepared and mailed to the purchaser. One year later, a birthday card is also sent. FF 170-171.

38/ ID at 102-13.

39/ Commissioner Stern notes that she dissented from the finding that a domestic industry existed in Certain Cube Puzzles. Her finding of the existence of a domestic industry in this investigation is therefore based on the nature and significance of the complainants' domestic activities.

3. Substantial Injury

The ALJ determined that the importation of unauthorized gray market CPK dolls had the effect of substantially injuring the domestic industry. First, the ALJ properly noted that injury requires proof separate and independent from evidence of the unfair act. He then evaluated the effect of gray market imports on the domestic industry. Although complainant OAA was included within the scope of the domestic industry, its CPK dolls were not competitive with respondents' imports and, therefore, it was largely unaffected by those imports, especially since it received royalties from their sale that did not differ from the royalties it would have received from co-complainant/licensee Coleco. 40/.

The ALJ's analysis of Coleco's production of CPK dolls showed that Coleco was financially healthy. Gross profits increased from 1983 to 1985. Although operating profits declined in 1985, the ratio of operating profits to net sales was high. Coleco's price increased and it was operating at full capacity through mid-1985 and was unable to meet demand until the second half of that year. 41/

The ALJ held that some of the consumers who were unable to buy a CPK doll from Coleco prior to mid-1985 would have waited to purchase authorized dolls if gray market imports had not been available. Therefore there were lost sales during this time that could be considered injurious to

---

40/ ID at 117.

41/ ID at 117-18.

complainants. 42/ Moreover, since mid-1985, Coleco was able to satisfy demand and was still losing sales to unauthorized imports. Since June 1985, unauthorized imports began to undersell Coleco's CPK dolls despite strong demand. 43/ The ALJ observed that Coleco did obtain a royalty on the initial sale of unauthorized CPK dolls but this royalty was small in comparison to its profit margin on direct sales. 44/

We have adopted the ALJ's determination of substantial injury in full. The evidence of massive levels of imports and harm to goodwill and business reputation supported a determination of substantial injury. Moreover, there was also evidence indicating that unauthorized imports have continued at high levels, despite the domestic industry's ability to meet demand, and have begun to undersell the domestic product.

As copyright holders, complainants possessed the exclusive right to distribute copies of CPK dolls in the United States. Every sale of an infringing article was a sale that should have gone to complainants, and once made by respondents, was irretrievably lost. Bally/Midway Mfg. Co. v USITC, 714 F.2d 1117, 1124 (Fed. Cir. 1983). While complainants' supply could not have met demand prior to 1985 and imports may not have been underselling complainants' dolls prior to that time, the enormous volume of unauthorized imports through 1985 provided a basis for calculating significant lost sales

---

42/ ID at 119-20.

43/ Id.

44/ Id.

and lost profits. There was also evidence of damage to complainants' goodwill and reputation: complainants' distribution and matrixing schemes were disrupted; quality standards of unauthorized imports were often lacking; and numerous purchasers of unauthorized imports had complained to complainants when they were unable to complete the adoption process for their dolls. Since mid-1985 the domestic industry has been fully capable of meeting domestic demand yet has continued to lose sales to unauthorized imports. Moreover, these imports were now underselling the domestic product by significant margins. 45/

4. Tendency to substantially injure

The ALJ also concluded that respondents' unfair acts had the tendency to substantially injure the domestic industry. Complainants supported this determination by arguing that the record contained evidence indicating that production of CPK dolls abroad was continuing, although at lower levels than previously, and that importation through unauthorized channels was economically profitable and likely to continue. 46/

The evidence of record indicated that unauthorized imports were fueled by strong U.S. demand coupled with weak foreign demand, overproduction by foreign

---

45/ Chairman Liebeler and Vice Chairman Brunsdale do not believe that evidence of underselling is relevant in determining whether an industry that is meeting demand is injured by an unfair practice under section 337. See Certain Unitary Electromagnetic Flowmeters, Inv. No. 337-TA-230, at 14-15 n. 38.

46/ Brief of Complainants on Issues on Review at 35-37.

licensees, a shortage of CPK dolls in the United States, and favorable currency exchange rates. 47/ While the ALJ agreed with the IA that demand in the United States was likely to decline, he did not agree that imports would cease. 48/ Given the significant price differential between some foreign market prices ($12 to $20) and domestic prices ($26.50), unauthorized imports were likely to continue, although some foreign licensees have been terminated and the price differential in certain countries has become so small as to eliminate unauthorized imports originating in those countries. 49/

The determination of this issue was primarily a factual one. The IA did not contest complainants' legal argument regarding tendency to substantially injure, but expressed reservations regarding whether imports of unauthorized CPK dolls are likely in the future. We have determined that there was sufficient evidence to conclude that unauthorized imports would continue in the future, although at lower levels. The ALJ's determination was, therefore, adopted.

5. Remedy

To remedy a violation of section 337, the Commission may issue a cease and desist order directed at particular parties or a limited or general exclusion order directed at particular products and/or component parts. A

47/ ID at 122.

48/ ID at 123-24.

49/ Id.

cease and desist order is an in personam remedy which can be avoided by shifting importation or sales to one who is not subject to the Commission's in personam jurisdiction. The Commission normally issues general, as opposed to limited, exclusion orders when the property right in question might readily be infringed or the unfair act might readily be committed by foreign manufacturers who are not parties to the Commission investigation. It is recognized that such broad orders have the potential to disrupt legitimate trade, but complainant should not be compelled to file numerous complaints to obtain complete relief. That would be a waste of resources for complainant and the Commission.

In balancing complainant's interest in obtaining complete protection with the inherent potential of general exclusion order to disrupt trade, the Commission has required that, before issuing a general exclusion order, complainant must prove a wide-spread pattern of unauthorized use of the copyright or commission of unfair acts and certain business conditions from which one might reasonably infer that other parties may attempt to enter the market. Paint Spray Pumps, 216 U.S.P.Q. at 473. Relevant factors on widespread unauthorized use include—

> (1) a Commission determination of unauthorized importation into the United States of infringing articles by numerous foreign manufacturers;
>
> (2) the pendency of foreign infringement suits based upon foreign copyrights which correspond to the domestic copyright in issue; or
>
> (3) other evidence which demonstrates a history of unauthorized foreign use of the copyright in issue.

Evidence on appropriate business conditions includes—

(1) an established demand for the product in the U.S. market and conditions of the world market;

(2) the availability of marketing and distribution networks in the United States for potential foreign manufacturers;

(3) the cost of foreign entrepreneurs of building a facility capable of producing the copyrighted article;

(4) the number of foreign manufacturers whose facilities could be retooled to produce the articles; or

(5) the cost of foreign manufacturers of retooling their facility to produce the articles.

There has been in excess of 300,000 unauthorized imports of CPK dolls sold in the United States. Moreover, the evidence of a wide variety of unauthorized distribution channels makes piecemeal enforcement of complainants' copyrights difficult. Demand for CPK dolls remains strong. It is relatively easy to become an importer of CPK dolls; special equipment or facilities is not necessary. Furthermore, although some of complainants' foreign licenses have been terminated, overseas production is continuing in the Far East.

We have determined that the issuance of a general exclusion order is the appropriate remedy and will not disrupt legitimate trade. We do not believe that a more limited remedy, such as cease and desist orders or labeling requirements, is appropriate. As in Alkaline Batteries, complainants are entitled to the profits derived from U.S. sales of the product subject to investigation by virtue of their exclusive right to U.S. sales. Sales of unauthorized imports, in addition to causing financial injury, have injured complainants' goodwill and reputation. The record contains evidence of lower

quality standards for the unauthorized imports as well as consumer confusion and dissatisfaction. Purchasers have encountered difficulty in completing the "adoption" process for the unauthorized imports and have blamed complainants for such difficulties. Moreover, complainants' distribution procedures, which have been designed to ensure that retailers were supplied with the widest possible variety of dolls, have been disrupted by unauthorized imports which were often not subjected to the same procedures. Thus, as in Alkaline Batteries, respondents have taken a free ride on complainants' distribution system and goodwill.

A general exclusion order is readily enforceable. 50/ Customs is already on the alert for counterfeit CPK dolls. If a general exclusion order were issued it might actually simplify Customs' task by denying entry to all CPK dolls imported by anyone other than complainants. Further, unauthorized imports are readily distinguishable from Coleco's dolls since they are packaged in retail-ready boxes while Coleco's dolls are shipped in bulk. 51/

6. The Public Interest

Section 337 provides that the Commission shall issue a remedy unless, after considering the effect of such remedy upon (1) the public health and

---

50/ The list of specific types of dolls in the exclusion order was provided for ease of enforcement by the Customs Service. All the dolls listed are covered by the copyrights at issue and are produced overseas.

51/ The IA conferred with Customs Service officials regarding the subject imports and those officials indicated that it would be feasible to enforce a general exclusion order. Brief of the IA on Remedy, the Public Interest, and Bonding at 18, n. 11.

welfare, (2) competitive conditions in the U.S. economy, (3) the U.S. production of articles that are like or directly competitive with those which are the subject of the investigation, and (4) U.S. consumers, it finds that a remedy should not be issued. This provision was added by the Trade Act of 1974. The legislative history indicates that the public interest factors are to be the overriding considerations in the administration of the statute. S. Rep. No. 1298, 93rd Cong., 2d Sess. 193 (1974).

The evidence of record indicated that complainants have enough capacity to satisfy domestic demand for CPK dolls. Both complainants and the IA insisted that a general exclusion order would actually benefit U.S. consumers by ensuring a high quality product and the availability of products that met U.S. health and safety standards. Furthermore consumers would be able to complete the "adoption" process and avoid the confusion and disappointment that often resulted from the purchase of unauthorized imports. We have determined that the issuance of a general exclusion order would not impair the public interest.

7. Bonding

The legislative history of section 337 and Commission rule 210.58(a)(3) provide that the amount of the bond during the Presidential review period is to be set at an amount which would offset any competitive advantage resulting from the unfair method of competition enjoyed by the party benefiting from the importation. S. Rep. No. 1298, 93rd Cong., 2d Sess. 198 (1974).

Complainants have submitted evidence of a $10.00 price offered to an unauthorized importer of CPK dolls and suggested that the bond be calculated

based on the difference between that offer and Coleco's wholesale price of $26.50. The IA recommended that the bond be based on the difference between Coleco's wholesale price and the lowest price offered by a respondent and disclosed by the record before the ALJ —$17.92 offered by Calila, Inc. in late 1985. We concurred with the complainants' reasoning and have determined that a bond of 165 percent is appropriate during the Presidential review period. Such a bond is based upon the difference between the Coleco's price and the lowest offered price for unauthorized imports. The offer was submitted as Exhibit 2 to Complainant's Brief on Remedy, the Public Interest, and Bonding. 52/ The 165 percent figure more accurately reflects the current market price of unauthorized imports. The figure relied upon by the IA dates from late 1985 and did not take into account the recent downward price trend of unauthorized imports. Since the bonding requirement operates prospectively, we have determined that the most recent pricing data, if reliable, should be used. A review of Exhibit 2 reveals a firm offer for CPK imports of $10.00 per doll.

52/ While submission of evidence outside the evidentiary record made by the ALJ is not allowed if it relates to the issues on review (i.e., the existence of a violation of section 337), it is allowed insofar as it relates to remedy, the public interest, and bonding.

ADDITIONAL VIEWS OF CHAIRMAN LIEBELER AND VICE CHAIRMAN BRUNSDALE
Certain Soft Sculpture Dolls,
Popularly Known as "Cabbage Patch Kids,"
Related Literature and Packaging Therefor
Investigation No. 337-TA-231

We are in substantial agreement with the Commission majority in this case. In fact, we do not reach a different result from that of the majority on any of the issues presented. We do, however, have a slightly different interpretation of the relationship between the country of origin marking requirements and section 337, which we address first. We then briefly discuss whether licensing and profit should be included in the definition of the domestic industry.

Country of Origin Marking

Section 304(a) of the Tariff Act of 1930 provides that every article of foreign manufacture imported into the United States

> shall be marked in a conspicuous place as legibly, indelibly, and permanently as the nature of the article (or container) will permit in such a manner as to indicate to the ultimate purchaser in the United States the English name of the country of origin of the article.[1]

---

[1] 19 U.S.C. sec. 1304(a) (1982).

We agree with the Commission majority that the record demonstrates that the unauthorized imports are not conspicuously marked with the country of origin in violation of section 304(a). We do not, however, necessarily agree that in addition to a violation of section 304(a) either consumer confusion or consumer preference for the domestically produced product must be shown to prove an unfair act under section 337. Instead, we believe the better position is the one suggested by complainants and the Commission Investigative Attorney (IA) that a failure to mark the country of origin constitutes an unfair act.[2] Such an interpretation we believe would be consistent with the statutory scheme of section 337, which requires both that there be an unfair act and that the unfair act substantially injure a domestic industry. If consumers did not have a preference for the domestic article, then there would be no injury from the improper marking. On the other hand, to require a showing of confusion or preference for the domestic article would be to include within the unfair act requirement a portion of the injury

---

[2] Brief of Complainants on Issues on Review at 6-9; Brief of the IA on Issues on Review at 10-14.

test.[3] Moreover, we do not believe that complainants' interpretation would lead to an influx of complainants seeking relief for technical violations of the marking statutes because the injury standard is not reduced by making a violation of section 304 an unfair act.

We would also agree that an examination of the record in this case establishes that imports of "Cabbage Patch Kids" (CPK) dolls in violation of section 304 have the effect of substantially injuring the domestic industry. The record shows that an important attribute of the commercial success of CPK dolls is that purchasers of CPK dolls can fill out a form that comes with their doll, mail it to one of three U.S. companies under contract to Coleco as fulfillment houses, and receive an English language birth certificate or adoption paper.[4] The evidence indicates that numerous purchasers of improperly marked dolls were unable

---

[3] We are aware that there is Commission precedent in the form of unreviewed initial determinations (IDs) of the Administrative Law Judges (ALJs) on both sides of the question, as well as the Commission opinion in Certain Miniature Plug In Blade Fuses, Inv. No. 337-TA-114, at 30-31 n. 145 (1982). See Commission Opinion, supra, at 11-12. While we have discussed this issue we find it unnecessary to resolve it in reaching our determination in this case.

[4] See Findings of Fact 170-71.

to complete the adoption process.[5]

Domestic Industry: Licensing and Profit

The complainants in this case have asked the Commission to find a domestic industry without including the licensing activity of complainant Original Appalachian Artworks, Inc. (OAA) and without including the profits of OAA or Coleco Industries, Inc. (Coleco). We agree with the majority that the domestic activities of OAA and Coleco, without examining profits or OAA's licensing, are sufficient to establish a domestic industry. We therefore decline to consider whether profits or licensing should be included in this case. Nevertheless, because we believe that both profits and licensing are properly included in the definition of the domestic industry in many instances, we set forth here some general comments on these issues.

With respect to profit, it must be recognized that profit is not a windfall from heaven but the return on an investment. A commercially successful article must not only be manufactured,

---

[5] See Complainants' Exhibit 17.

but it also must be first invented, then promoted, and its quality must be maintained. Investments in R&D, advertising, and quality control are like the investments in the physical plant used in the production process in that they continue to produce benefits long after they are made. The return on all these kinds of investments are in an accounting sense profit. Therefore, in order to determine properly the total domestic value added by domestic activities, we must include both the value added by manufacturing and the value added by R&D, advertising, quality control, and other similar activities.[6]

However, when the domestic firm that owns the intellectual property right being infringed produces abroad using a subsidiary, then profit has to be allocated between the domestic and foreign segments according to the contribution each makes to the project.[7] Where the domestic firm does not own the foreign

---

6 See Klett, The U.S. Tariff Act: Section 337, Off-shore Assembly and the "Domestic Industry," 20 J. World Trade L. 294, 302-05 (1986); R. Feinberg, The Interpretation of Injury under Section 337, 9-15, 33 (May 1986) (study produced under contract to the ITC) (not reviewed by the ITC).

7 This allocation should not necessarily correspond to the allocations made by the parent and subsidiary on their

(Footnote continued on next page)

producer, or vice versa, then the profit earned by the foreign segment is included in the transfer price. Thus, all profit earned on the domestic producer's sale of the product is a return on domestic investment. The entire profit should then be included in the value-added calculation.

With respect to licensing, Chairman Liebeler has recently stated her views on whether the activities of a domestic licensee can be part of a domestic industry for the purposes of section 337.[8] We believe that whether licensing activities should be included within the domestic industry depends on the nature and the significance of those activities. When those activities are substantial and involve operations such as market research, promotion, and quality control, they are properly included and can constitute an industry by themselves.[9] We do not read

---

(Footnote continued from previous page)
records. Their allocation may be influenced by tax and accounting concerns.

[8] Certain Products with Gremlin Character Depictions, Inv. No. 337-TA-201, USITC Pub. 1815, 3-18 (1985) (Dissenting Views of Vice Chairman Liebeler).

[9] Id.

Schaper[10] to preclude us from finding a domestic industry based on licensing without production; under Schaper a licensee can be part of a domestic industry when it is engaged in servicing or selling the items.[11] Finally, we note that a distinction should probably be drawn between licensing foreign producers to make an item for sale in the U.S. and for sale abroad. It may be that only the former activities could be injured by unfair imports.

---

10 Schaper Manufacturing Co. v. U.S.I.T.C., 917 F.2d 1368, 1371 (Fed. Cir. 1983).

11 Id.

OFFICE OF THE SECRETARY

UNITED STATES INTERNATIONAL TRADE COMMISSION

WASHINGTON, D.C. 20436

The President
The White House
Washington, D.C. 20500

Dear Mr. President:

The United States International Trade Commission has conducted an investigation (No. 337-TA-229) under section 337 of the Tariff Act of 1930 (19 U.S.C. § 1337) to determine whether certain respondents are engaging in unfair methods of competition and unfair acts in the importation of Certain Cabbage Patch Kids Dolls into the United States. The Commission previously transmitted to you, in accordance with the provisions of subsection 337(g) of the Tariff Act of 1930, copies of the Commission's Action and Order. Enclosed is a copy of the Commission's opinion in support of the actions taken in this investigation.

Sincerely,

Kenneth R. Mason
Secretary

Enclosure

cc: Honorable Clayton Yeutter
U.S. Trade Representative

OFFICE OF THE SECRETARY

UNITED STATES INTERNATIONAL TRADE COMMISSION

WASHINGTON, D.C. 20436

Honorable James Baker
Secretary of the Treasury
Washington, D.C. 20220

Dear Mr. Secretary:

The United States International Trade Commission has conducted an investigation (No. 337-TA-229) under section 337 of the Tariff Act of 1930 (19 U.S.C. § 1337) to determine whether certain respondents are engaging in unfair methods of competition and unfair acts in the importation of Certain Cabbage Patch Kids Dolls into the United States. The Commission previously transmitted to you, in accordance with the provisions of subsection 337(g) of the Tariff Act of 1930, copies of the Commission's Action and Order. Enclosed is a copy of the Commission's opinion in support of the actions taken in this investigation.

Sincerely,

Kenneth R. Mason
Secretary

Enclosure

cc: Mr. Louis Alfano
Commercial compliance Division
U.S. Customs Service
1301 Constitution Avenue, N.W.
Washington, D.C. 20229

[BRACKETED]

BUSINESS CONFIDENTIAL

UNITED STATES INTERNATIONAL TRADE COMMISSION
Washington, D.C.

In the Matter of	)	
	)	
CERTAIN SOFT SCULPTURE DOLLS POPULARLY KNOWN AS "CABBAGE PATCH KIDS," RELATED LITERATURE AND PACKAGING THEREFOR	)	Investigation No. 337-TA-231

INITIAL DETERMINATION

John J. Mathias, Administrative Law Judge

Pursuant to the Notice of Investigation in this matter (50 Fed. Reg. 46368, November 7, 1985), this is the Administrative Law Judge's Initial Determination under Rule 210.53(c) of the Rules of Practice and Procedure of this Commission. (19 C.F.R. 210.53(c)).

The Administrative Law Judge hereby determines that there is a violation of Section 337 of the Tariff Act of 1930, as amended (19 U.S.C. § 1337, hereafter Section 337), in the importation of certain soft sculpture dolls, popularly known as "Cabbage Patch Kids," together with their related literature and packaging into the United States, or in their sale. The complaint herein alleges that such importation or sale constitutes unfair methods of competition and unfair acts by reason of alleged: (1) infringement of U.S. Copyright Registration No. VA 35-804; (2) infringement of U.S. Copyright Registration No. VA 141-801; (3) infringement of U.S. Copyright Registration No. TX 1-254-777; (4) infringement of U.S.C. Copyright Registration No. TX 1-254-778; (5) infringement of U.S. Copyright Registration No. 1-261-526; (6) failure to properly mark the country of origin on such

dolls and their packaging; and (7) violation of 17 U.S.C. § 601(a). It is further alleged that the effect or tendency of such unfair methods of competition and unfair acts is to destroy or substantially injure an industry, efficiently and economically operated, in the United States.

APPEARANCES

FOR COMPLAINANTS: Original Appalachian Artworks, Inc.
Coleco Industries, Inc.

Steven P. Kersner
Donald S. Stein
Denise T. DiPersio
BROWNSTEIN ZEIDMAN AND SCHOMER

William H. Needle
LAW OFFICE OF WILLIAM H. NEEDLE, P.C.

Stanley F. Birch
VAUGHAN, PHEARS, ROACH, DAVIS & MURPHY

For the Commission Investigative Staff:

Robert D. Litowitz
Deborah S. Strauss

TABLE OF CONTENTS

TABLE OF CONTENTS - (con't)

TABLE OF CONTENTS - (con't)

PROCEDURAL HISTORY

On October 1, 1985, a complaint and motion for temporary relief were filed pursuant to Section 337 of the Tariff Act of 1930 (19 U.S.C. § 1337) on behalf of Original Appalachian Artworks, Inc. (OAA), Highway 75 South, Cleveland, Georgia 30528, and Coleco Industries, Inc. (Coleco) 999 Quaker Lane South, West Hartford, Connecticut 06110. A supplement to the complaint was filed on October 21, 1985. The complaint as supplemented alleges unfair methods of competition and unfair acts in the importation into the United States, of certain soft sculpture dolls, popularly known as "Cabbage Patch Kids," together with related literature and packaging, or in their sale, by reason of alleged: (1) infringement of U.S. Copyright Registion No. VA 35-804; (2) infringement of U.S. Copyright Registion No. VA 141-801; (3) infringement of U.S. Copyright Registration No. TX 1-254-777; (4) infringement of U.S. Copyright Registration No. TX 1-254-778; (5) infringement of U.S. Copyright Registration No. TX 1-261-526; (6) failure to properly mark the country of origin on such dolls and their packaging; and (7) violation of 17 U.S.C. § 601(a). The effect or tendency of the foregoing unfair methods of competition and unfair acts is alleged to be to destroy or substantially injure an industry, efficiently and economically operated, in the United States.

The complainants requested the Commission to institute an investigation, conduct temporary relief proceedings, and issue a temporary exclusion order. After a full investigation, the complainants requested the Commission to issue a permanent exclusion order and permanent cease and desist orders.

Upon consideration of the complaint, the Commission ordered, on October 31, 1985, that an investigation be instituted to determine whether there is a violation of subsection (a) of Section 337, as alleged in the complaint. Pursuant to Rule 210.24(e) (19 C.F.R. § 210.24(e)) complainants' motion for temporary relief under subsections (e) and (f) of Section 337 was forwarded to the Administrative Law Judge for an initial determination pursuant to Rule 210.53(b) of the Commission's Rules. (19 C.F.R. § 210.53(b)). The notice of institution of this investigation was published in the Federal Register on November 7, 1985 (50 Fed. Reg. 46368).

The following five parties were named as respondents in the Notice of Investigation:

John and Jane Doe Murrell
d/b/a Murrell Marketing
17900 South Central Parkway
Tukwila, Washington 98118

Japan Instruments Corp.
6360 Van Nuys Boulevard
Suite 5
Van Nuys, California 91401

Sav-On-Drugs, Inc.
1500 S. Anaheim Boulevard
Anaheim, California 92805

Osco Drugs, Inc.
1818 Swift Drive
Oak Brook, Illinois 60521

Household Merchandising, Inc.
(Ben Franklin Division)
1700 Wolf Road
Des Plaines, Illinois 60016

Deborah S. Strauss, Esq. and Robert D. Litowitz, Esq., Office of Unfair Import Investigations, were named as Commission investigative attorneys, party

to this investigation. Judge John J. Mathias was designated as the Administrative Law Judge to preside over the investigation.

A response to the complaint was filed on behalf of respondents Osco Drug, Inc. (Osco) and Sav-On-Drugs, Inc. (Sav-On) on December 13, 1986. No other respondents formally entered an appearance or responded to the complaint and notice of investigation. By notice filed December 12, 1985, respondents John and Jane Doe Murrell d/b/a Murrell Marketing (Murrell) and Japan Instruments Corp. (JIC) informed the Commission of their intention not to participate in this investigation.

A preliminary conference was held before Administrative Law Judge Mathias on December 4, 1985 pursuant to notice issued November 5, 1985. Appearances were made on behalf of complainants, respondents Osco and Sav-On and the Commission investigative staff. On December 9, 1985, complainants withdrew their motion for temporary relief in favor of proceeding on a schedule for expedited permanent relief, as discussed at the Preliminary Conference.

Order No. 9, issued January 3, 1986, was an initial determination granting complainants' motion to amend the complaint and notice of investigation to join the following two parties as respondents:

Calila, Inc.
8075 Third Street
Suite 406
Los Angeles, California 90048

International Panasound Ltd.
1377 Avenue of the Americas
New York, New York 10019

The Commission issued a notice of its decision not to review this initial determination on February 3, 1986. (51 Fed. Reg. 5267, February 12, 1986). The amended complaint was served on these newly joined respondents by the Commission Secretary on February 3, 1986. Respondents Calila, Inc. (Calila) and International Panasound Ltd. (IPL) did not formally enter an appearance or respond to the amended complaint and notice of investigation.

Order No. 10, issued January 24, 1986, was an initial determination finding respondents Murrell, JIC and Household Merchandising, Inc. (HMI) in default. On March 3, 1986 the Commission issued a Notice of Commission Determination Not To Review Initial Determination Finding Four Respondents in Default and Imposing Procedural Sanctions. (51 Fed. Reg. 8572, March 12, 1986).

Order No. 12, issued February 13, 1986 partially granted complainants' motion for sanctions against Murrell and JIC, and provided that these respondents could not introduce into evidence or otherwise rely upon documents, testimony or other material in support of their position in this investigation, and further that they would not be heard to object to the use of secondary evidence to show what withheld testimony, documents or other evidence would have shown.

Order No. 17, issued April 25, 1986, was an initial determination granting the joint motion to terminate this investigation as to respondents Osco and Sav-On on the basis of a settlement agreement. The Commission issued a notice of its decision not to review this initial determination on May 29, 1986.

(51 Fed. Reg. 20360, June 4, 1986). Similarly, Order No. 18, issued May 7, 1986, was an initial determination granting complainants' motion to terminate this investigation as to respondent IPL on the basis of a settlement agreement. The Commission's notice of its decision not to review this initial determination was issued on June 11, 1986. (51 Fed. Reg. 22145, June 18, 1986). Complainants' motion to terminate respondent Calila, also based on a settlement agreement, was granted by Order No. 19, issued June 2, 1986. A notice of the Commission's decision not to review this initial determination was issued on June 30, 1986. (51 Fed. Reg. 24949, July 9, 1986).

On March 10, 1986, complainants filed a motion for summary determination as to all issues in this investigation. (Motion Docket No. 231-12). This motion was accompanied by a supporting memorandum, depositions and exhibits. Complainants assert, on the strength of the documents and testimony of record, and pursuant to Rule 210.50 (19 C.F.R. § 210.50) that there are no genuine issues of material fact, and that they are entitled to a summary determination in their favor as a matter of law. The Commission investigative staff has filed a memorandum in response to Motion 231-12, together with additional exhibits, substantially in support of this motion. No respondent has submitted a response or any additional evidence in response to complainants' motion.

Order No. 16, issued March 31, 1986 ordered the submission of briefs and additional evidence on certain issues raised in Motion 231-12, and set the matter for oral argument. Testimony from two witnesses and oral argument were heard before Administrative Law Judge John J. Mathias on April 14-15, 1986.

Appearances were made on behalf of complainants and the Commission investigative staff. No appearances were made on behalf of any respondent.

Following the hearing and oral argument in this matter, complainants and the Commission investigative staff filed posthearing briefs and proposed findings of fact. Complainants also submitted certain additional documents at the request of the Administrative Law Judge.

On May 22, 1986, the Commission investigative attorney moved to re-open the record to receive as SX 17 the "Answers and Objections of Complainant Original Appalachian Artworks to First Set of Interrogatories of the Commission Investigative Staff." (Motion Docket No. 231-15). Complainants do not oppose this motion. Motion 231-15 is granted, and SX 17 is received.

The issues have been briefed and the matter is now ready for decision. This initial determination is based on the entire record of this proceeding, including the complaint and exhibits appended thereto, responses to the complaint, complainants' motion for summary determination, together with all depositions, exhibits and testimony in support thereof, the staff's memorandum and exhibits submitted in response to this motion, the arguments presented in briefs and at the oral argument, and all submissions filed after the hearing and oral argument. I have also taken into account my observation of the witnesses who appeared before me, and their demeanor. Proposed findings not herein adopted, either in the form submitted or in substance, are rejected either as not supported by the evidence or as involving immaterial matters.

The findings of fact include references to supporting evidentiary items in the record. Such references are intended to serve as guides to the testimony and exhibits supporting the findings of fact. They do not necessarily represent complete summaries of the evidence supporting each finding.

* * * *

The following abbrevations are used in this Initial Determination:

Tr. - Official Transcript, usually preceded by the witness' name and followed by the referenced page(s);
CX - Complainants' Exhibit, followed by its number and the referenced page(s);
CPX - Complainants' Physical Exhibit;
SX - Staff Counsel's Exhibit, followed by its number and the referenced page(s);
CF - Complainants' Proposed Finding;
SF - Staff Counsel's Proposed Finding;
CB - Complainants' Post Hearing Brief;
SB - Staff Counsel's Post Hearing Brief;
CRB - Complainants' Post Hearing Reply Brief
FF - Finding of Fact

FINDINGS OF FACT

I. JURISDICTION

1. The Commission Secretary served the complaint and notice of investigation on each respondent in this investigation. The Commission's records indicate that the complaint and notice of investigation were actually received by respondents Osco Drug, Inc. (Osco), Household Merchandising, Inc. (Ben Franklin Division), John and Jane Doe Murrell, d/b/a Murrell Marketing (Murrell), and Japan Instruments Corp. (JIC). In addition, respondents Osco and Sav-On Drugs, Inc. (Sav-On) filed a response to the complaint and notice of investigation, and respondents Murrell and JIC filed a notice of nonparticipation in this investigation. (Notice of Investigation, served November 4, 1985; ALJX 1; Response to Complaint and to Notice of Investigation by Osco and Sav-On, filed December 13, 1985; Notice of Non-Participation by Japan Instruments Corp. and Murrell Marketing, filed December 12, 1985).

II. PARTIES

2. Original Appalachian Artworks, Inc. (OAA), a Georgia corporation, has its principal place of business at Highway 75 South, Cleveland, Georgia 30528. OAA manufactures and markets various soft sculpture products, including Cabbage Patch Kids dolls (CPK dolls) to the gift trade in the United States. OAA has been marketing these dolls under the registered trademark "Cabbage Patch Kids" since July 1982. OAA also licenses certain of its products to other companies. (Needle, Tr. 5, 31-32; Amended Complaint, ¶ 11; CPX 13, Tolhurst Dep., at 98-99; CF 1; SF A3).

3. In addition to CPK dolls, OAA sells soft sculpture bears, called Furskins, and Bunnybees, stuffed animals which are part bunny, part bee, in the United States. "Bunnybees pollinate the cabbage patch in which CPK babies are born." (Needle, Tr. 5; CF 2).

4. Coleco Industries, Inc. (Coleco) a Connecticut corporation, has its principal place of business at 999 Quaker Lane South, West Hartford, Connecticut 06110. Coleco designs, manufactures, and markets toys and entertainment products in the United States. (Amended Complaint, ¶ 4; CX 85, at 1-2; CF 3).

5. Coleco manufactures and sells CPK dolls and accessories under license from OAA granted on August 8, 1982. Coleco also manufactures and sells a small amount of consumer electronics. (CPX 14, Schwefel Dep., at 18-21; SF A5).

6. Coleco Canada Ltd. is a wholly owned subsidiary of Coleco which is responsible for marketing and distributing Coleco products, including CPK dolls, in Canada. In some cases, Coleco Canada may also export certain Coleco products to other markets. (Kahn, Tr. 104-05).

7. Coleco Far East Ltd. is Coleco's manufacturing control operation based in Hong Kong, which is responsible for supervising and controlling Coleco's Far East manufacturing contractors, including those that manufacture CPK dolls. (Kahn, Tr. 104-06).

8. is an agent of Coleco in the Far East devoted exclusively to acting as Coleco's liaison and quality control organization in the Far East. All of Coleco's communications with its Far East vendors are handled through and it is responsibility to oversee production of CPK dolls by Coleco's Far East vendors, as well as to conduct quality control and handle shipping of Coleco's CPK dolls. (CPK 16, Reiner Dep., at 10-18; CPX 15, Zelman Dep., at 82, 91-92, 105; Kahn, Tr. 105).

9. John Murrell is the sole proprietor of Murrell Marketing (Murrell) which has its principal place of business at 8714-141st Court N.E., Redmond, Washington 98052. Murrell is also the sole proprietor of The Stuffed Zoo and Ashley's Toys, 17900 South Central Parkway, Tukwila, Washington 98188. Murrell has purchased and sold CPK dolls originating in Japan from a distributor, SMC, in the United States. (CPX 18, Murrell Dep., at 2, 6, 12-14, 17-19, 32-36; CF 7).

10. Japan Instruments Corp. (JIC) has its principal place of business at 6360 Van Nuys Boulevard, Suite 5, Van Nuys, California 91401. JIC has imported and distributed CPK dolls in the United States through its U.S. representative, Mike Moffat. (CX 21, at 30313, 30315; ALJX 1 at 2; CX 19, ¶¶ 4-5; CF 8).

11. Osco Drug, Inc. (Osco) has its principal place of business at 1818 Swift Drive, Oak Brook, Illinois 60521. Osco has distributed and sold imported CPK dolls in the United States. Osco has entered into a settlement agreement with complainants and has been terminated as a respondent in this

investigation. (Osco and Sav-On Response To Complaint, ¶ 8; CX 22, at 1-3; Order No. 17; see Procedural History, supra).

12. Sav-On-Drugs, Inc. (Sav-On) had a principal place of business at 1500 Anaheim Blvd., Anaheim, California 92805. As of February 1986, Sav-On merged with Osco and is now doing business as Osco Drug, Inc. Sav-On has distributed and sold imported CPK dolls in the United States. Sav-On has entered into a settlement agreement with complainants and has been terminated as a respondent in this investigation. (Osco and Sav-On Response To Complaint, ¶ 9; CX 22, at 1-3; Order No. 17; see Procedural History, supra).

13. Household Merchandising, Inc. (HMI), through its Ben Franklin Division, has purchased imported CPK dolls from Westhampton Group, Inc. in the United States. Ben Franklin Stores has a place of business at 1700 Wolf Road, Des Plaines, Illinois 60016. (CX 23, at 30488).

14. Calila, Inc. (Calila) has its principal place of business at 8075 Third Street, Suite 406, Los Angeles, California 90048. Calila has imported into and sold CPK dolls in the United States. Calila has entered into a settlement agreement with complainants, and has been terminated as a respondent in this investigation. (CX 24, at 1-12; CPX 19, De Vreese Dep., at 9, 22, 26; Order No. 19; see Procedural History, supra).

15. International Panasound Ltd. (IPL) has its principal place of business at 1377 Avenue of the Americas, New York, New York 10019. IPL has sold imported CPK dolls in the United States. IPL has entered into a

settlement agreement with complainants and has been terminated as a respondent in this investigation. (CX 25, 26; Order No. 18; see Procedural History, supra).

III. PRODUCTS IN ISSUE

16. The products in issue in this investigation, for which OAA has obtained copyright registrations, are soft sculpture dolls, popularly known as "Cabbage Patch Kids," related literature, comprised of adoption papers and birth certificates, and packaging for the dolls. (Complaint, ¶¶ 12-13, 20-22; CX 1, 5, 7-11; CPX 5; SF A14).

17. Complainant OAA has manufactured and sold soft sculpture dolls to the public since 1977. These dolls were originally sold under the name "The Little People" but have been marketed under the name Cabbage Patch Kids since July 1982. (CPX 15, Zelman Dep., at 35; SF A15).

18. The dolls that OAA manufactures and sells are 22 inches tall and are formed entirely out of soft materials. (Needle, Tr. 7-8; CPX 23; CPX 15, Zelman Dep., at 35; SF A16).

19. The CPK dolls that complainant Coleco is licensed by OAA to manufacture have the same overall appearance as the dolls manufactured by OAA, but differ in that Coleco's dolls have a molded plastic head and are smaller. Coleco's CPK doll is 16 inches tall and its "Preemie" CPK doll is 14 inches tall. (Needle, Tr. 11-13; CPX 5-8; SF A17).

20. Coleco's CPK dolls are sold with copyrighted "adoption papers" and "birth certificates." A purchaser of a Coleco doll who sends in these papers receives a birth certificate noting the doll's "adoption" and "date of birth." (Complaint, ¶ 20; CX 7-10; SF A18).

21. Coleco sells its CPK dolls in packaging which features original text and artwork. OAA has secured copyright registration for this packaging. (CX 11; CPX 1; SF A19).

IV. UNFAIR ACTS

A. Infringement of Complainant OAA's Copyrights

1. Copyright Ownership

22. Complainant OAA is the owner of each of the five copyrights at issue in this investigation. OAA has obtained certificates of copyright registration from the United States Copyright Office for each of these copyrights which include:

1. Registration No. VA 35-804, for the "Little People" soft sculpture doll;
2. Registration No. 141-801, for the derivative work "Cabbage Patch Kids" soft sculpture doll;
3. Registration No. TX 1-254-777, for the "Cabbage Patch Kids" Official Adoption Papers;
4. Registration No. TX 1-254-778, for the "Cabbage Patch Kids" Birth Certificate;

5. Registration No. TX 1-261-526, for the package for the "Cabbage Patch Kids" dolls.

(CX 1, 5, 9-11; SF C1).

23. Registration No. VA 35-804 ("the 804 copyright") bears an effective date of registration of June 1, 1979. The application for this registration was prepared by Xavier Roberts, creator of the CPK dolls and Chairman of OAA, and Linda Allen, a former employee of OAA. (Needle, Tr. 6-7; CPX 12, Roberts Dep., at 25-26; CX 1; SF C2).

24. The subject matter of the 804 copyright pertains to OAA's original design for soft sculpture dolls. (CPX 12, Roberts Dep., at 25; CPX 13, Tolhurst Dep., at 42-43; SF C3).

25. The date of first publication of the subject matter of the 804 copyright is shown in the copyright registration as February 18, 1978. (CX 1; SF C4).

26. The matter of the 804 copyright is described as "The Little People Soft Sculpture, Style-Bald, Baby Land General Babies. (CX 1; SF C5).

27. Although the subject of the 804 copyright is described as bald soft sculpture dolls, the 804 copyright covers all varieties of soft sculpture CPK dolls produced and sold by OAA, including dolls with hair. (Needle, Tr. 8; SF C6).

28. OAA filed applications with the United States Copyright Office to register as derivative works at least six variations on the hairstyles of OAA's original soft sculpture CPK dolls. The Copyright Office returned these applications because the variations for which registrations were sought did not reflect sufficient originality to warrant separate copyright registrations. The Copyright Office indicated that the 804 copyright covers all CPK soft sculpture dolls, irrespective of hairstyle. (Needle, Tr. 9; CPX 12, Roberts Dep., at 28; SF C7).

29. Complainants' Physical Exhibit 23 is an original OAA soft sculpture CPK doll. (Needle, Tr. 8; CPX 23; SF C8).

30. OAA manufactures and sells a smaller version of its soft sculpture CPK doll. This smaller version, known as the "Preemie," is also within the scope of the 804 copyright. (Needle, Tr. 9; CPX 6; SF C9).

31. The validity of the 804 copyright has been affirmed by the United States District Court for the Northern District of Georgia and by the United States Court of Appeals for the Eleventh Circuit, Original Appalachian Artworks, Inc. v. Toy Loft, 489 F. Supp. 174 (N.D. Ga. 1980), aff'd 684 F.2d 821 (11th Cir. 1982). The district court found original authorship in the stitching of the hands, knees, feet and face, and other features of OAA's soft sculpture CPK doll (exemplified by CPX 23). (CX 13; Needle, Tr. 34; SF C11).

32. The initial owner of the 804 copyright, Xavier Roberts, assigned ownership of this copyright to complainant OAA. A copy of the assignment of this copyright has been duly recorded in the Copyright Office. (CX 2; SF C12).

33. Registration No. VA 141-801 ("the 801 copyright") bears an effective date of registration of December 13, 1983. The application for this registration was prepared by William Needle, Esq., General Counsel of OAA. OAA is the original and present owner of the 801 copyright. (CX 5; Needle, Tr. 4, SF C13).

34. The subject matter of the 801 copyright was first published, according to the copyright registration, on September 30, 1982. (CX 5; SF C14).

35. The 801 copyright is directed to the doll manufactured and sold by Coleco under license from OAA. (Needle, Tr. 10; CPX 13, Tolhurst Dep., at 45; SF C15).

36. The subject matter of the 801 copyright was prepared for OAA by employees of both OAA and Coleco as a work for hire. (Needle, Tr. 36-37; CF 126).

37. The 801 copyright is a derivative work made for hire which is based upon the 804 copyright. The original material in which copyright is claimed is described in the 801 registration as "forming the face of plastic and the proportion, form, contour, configuration and conformation of the work in view of the original effort required in reducing the work with great exactness into a smaller scale." (CX 5; Needle, Tr. 11, 38-39; SF C16).

38. Complainants' Physical Exhibit 5 is a doll manufactured by Coleco. It is representative of the subject matter of the 801 copyright. (CPX 5; Needle, Tr. 11; SF C17).

39. All CPK dolls, as well as the birth certificates and adoption papers, sold by Coleco bear a copyright notice. On the Coleco CPK doll, itself, this notice is engraved on the back of the neck, and also appears on a tag stitched to the doll. (Needle, Tr. 43; CX 7, 8; CPX 1).

40. All CPK dolls manufactured for Coleco or by other foreign licensees intended for sale outside the United States bear a copyright notice on the doll and on the package. (SX 12-14, ¶ 8; CX 87, ¶ 8; CPX 2-4, 9-11).

41. Xavier Roberts, the creator of CPK dolls, and Chairman of OAA, approved all aspects of Coleco's designs of CPK dolls, including advertising, packaging, clothing, the papers, and the dolls themselves, before these dolls were sold by Coleco in the mass market. (Needle, Tr. 37; CPX 12, Roberts Dep., at 4, 47-50; CPX 15; Zelman Dep., 43-46; CF 129).

42. All CPK dolls manufactured by Coleco are covered by the 801 and 804 copyrights because each Coleco CPK doll, regardless of hairstyle, color or facial expression, incorporates the original features which are the subject of these copyrights. (Needle, Tr. 8-9, 12, 35; SF C18).

43. Complainants' Physical Exhibit 8 is a CPK doll sold under the designation "World Travelers." Coleco's World Travelers dolls are basically

identical to Coleco's 16 inch CPK dolls except that World Travelers are packaged in suitcase-style boxes and may be accompanied by different accessories. World Travelers are covered under the 801 and 804 copyrights. (Needle, Tr. 14; CPX 8; SF C19).

44. Complainants' Physical Exhibit 7 is a package containing CPK Twins. CPK Twins are two 16 inch CPK dolls sold together in the same retail package. CPK Twins are covered under the 801 and 804 copyrights. (Needle, Tr. 14-15; CPX 7; SF C20).

45. Corn Silk CPK dolls are CPK dolls with hair that is capable of being styled. Corn Silk dolls are substantially the same in appearance as the 16 inch CPK doll and are covered under the 801 and 804 copyrights. (Needle, Tr. 15-16; SF C21).

46. OAA does not produce any CPK dolls within the scope of the 801 copyright. (Needle, Tr. 72; CF 137).

47. Registration No. TX 1-254-777 ("the 777 copyright") bears an effective date of registration of January 26, 1984. OAA is the original and present owner of the 777 copyright. (CX 9; SF C22).

48. The 777 copyright pertains to Coleco's CPK Official Adoption Papers, which the copyright registration indicates was first published May 13, 1983. (CX 9; SF C23).

49. The 777 copyright is a derivative work which consists of the compilation, selection, and arrangement of the text and artwork of the original adoption papers that were first prepared by OAA in connection with OAA's version of the CPK dolls. (Needle, Tr. 97; CX 9; SF C24).

50. OAA's original version of the adoption papers are the subject of Copyright Registration No. TX 456-509. (CX 9; Needle, Tr. 43-44; SF C25).

51. Complainants' Exhibit 7 is a sample of Coleco's CPK adoption certificate. It is representative of the work which is the subject of the 777 copyright. Coleco's adoption certificate bears a notice of OAA's copyright claim. (CX 7; SF C26).

52. The Coleco version of the CPK adoption papers differs from the OAA version in the following respects: the Coleco version is smaller that OAA's; the Coleco version is a single page document while the OAA version is printed in triplicate; and the borders on the respective versions are different, as are the texts of the two versions. (Needle, Tr. 96-97; CPX 15, Zelman Dep., at 67; SF C27).

53. Registration No. TX 1-254-778 ("the 778 copyright") bears an effective date of registration of January 26, 1984. The 778 copyright pertains to Coleco's version of the "Baby Land General Birth Certificate," which according to the copyright registration was first published May 13, 1983. OAA is the original and present owner of the 778 copyright. (CX 10; SF C28).

54. The 778 copyright is a derivative work which consists of the compilation, selection and arrangement of the text and art work of the birth certificate that was prepared by OAA in connection with the original OAA version of CPK dolls. The original OAA birth certificate is the subject of United States Copyright Registration No. TX 456-506. (CX 10; Needle, Tr. 95-97; SF C29).

55. The Coleco version of the CPK birth certificate differs from the OAA version in the following respects: the Coleco version is smaller than OAA's, the border on the Coleco version features two-dimensional pictures of CPK dolls, while the OAA version does not; and the texts of the two versions are not identical. (Needle, Tr. 45, 96; CPX 15, Zelman Dep., at 67; SF C29).

56. Complainants' Exhibit 8 is a sample of the birth certificate which accompanies Coleco's CPK dolls, and is therefore representative of the work which is the subject of the 778 registration. This birth certificate is marked with a notice of OAA's copyright. (CX 8, 10; Needle, Tr. 44; SF C30).

57. Registration No. TX 1-261-526 ("the 526 copyright") pertains to Coleco's package for CPK dolls, first published, according to the copyright registration, September 30, 1982. The 526 copyright bears an effective date of registration of January 30, 1984. OAA is the original and present owner of the 526 copyright. (CX 11; SF C31).

58. There was no previous packaging for the original OAA CPK doll; thus the '526 copyright covers Coleco's package for its CPK dolls. These

packages are marked with a notice of OAA's copyright claim. (Needle, Tr. 44; CX 11; CPX 5).

59. Each of the copyright registrations at issue identify the author -- Xavier Roberts in the case of the 804 copyright, and OAA in the remaining registrations -- as a citizen of the United States. (CX 1, 5, 9-11, at Item 2).

2. Relationship Between Complainants OAA and Coleco

60. Schlaifer Nance & Co. (SNC) is OAA's exclusive licensing agent for Cabbage Patch Kids products, except for OAA's original CPK dolls.

(Needle, Tr. 19-21; CX 4; CF 144).

61. was responsible for causing to be a licensee of OAA with regard to the CPK property. (Needle, Tr. 22-23; CX 3, at 1; CF 146).

62. OAA licensed to Coleco its trademarks in CPK dolls, as well as the visual representations of the dolls. OAA also authorized Coleco to make copies of OAA's copyrighted works in CPK dolls. Whatever works are done by Coleco with respect to CPK dolls are works for hire owned by OAA. (CPX 13, Tolhurst Dep., at 44-45; CX 3; CF 147).

63. Under the agreement with received the right to make a derivative work of the original subject matter known as CPK dolls. OAA owns

the copyrights in the original as well as in the derivative works. (Needle, Tr. 23-24; CX 1, 3, 5; CF 149).

64. first entered into a license agreement with for CPK products on August 8, 1982. This agreement granted an license to manufacture, sell and distribute CPK products. Under the terms of this license, agreed to pay a royalty of (CX 3, August 1982 Agreement; Needle, Tr. 22-24).

65. On January 5, 1984, and on behalf of updated the August 1982 agreement by setting out the terms of a "worldwide third party licensing program." This 1984 agreement had the effect of so as to allow for separate licenses to third parties in certain countries to manufacture and sell CPK dolls. The reason for this later agreement was that by 1984,

(CX 3, 1984 Agreement; Needle, Tr. 24-25, 51-52, 56).

66. Under the terms of the January 1984 agreement, on behalf of was to enter into agreements with the third party licensees. had the right to approve the products and product categories to be manufactured and sold by the third party licensees. Although could not enter into a third party license agreement, it could seek out and solicit licensees on behalf of Final approval from was required before a license agreement could be entered into. Royalties on all third party licenses were (CX 3, 1984 Agreement, ¶ 4; Needle, Tr. 52-56; CPX 16, Reiner Dep., at 109-10).

67. Coleco has entered into contracts with approximately seven manufacturers, or "vendors" in the Far East who manufacture CPK dolls for Coleco in accordance with Coleco's requirements. The CPK dolls manufactured by Coleco's Far East contractors are destined for sale in the United States,

C These contractors manufacture according to Coleco's matrix and quantity requirements, and are subject to Coleco's quality control inspection. (CPX 16, Reiner Dep., at 39-42; CPX 15, Zelman Dep., at 71-74).

68. On September 10, 1985, Coleco notified SNC that it was exercising its option to renew its CPK agreement for an additional three-year term. (CX 3, letter of September 10, 1985; Needle, Tr. 22).

3. OAA's Third Party Licensees

C 69. During 1983-1984, on behalf of entered into twelve third party license agreements. Although the terms of each of these agreements are substantially the same, and authorize each licensee to manufacture, sell and distribute CPK dolls in a specified territory, only four licensees actually manufactured CPK dolls. The manufacturing licensees, and their territories, were as follows:

Licensed Territory

C
C

C
C

C
C

C
C

(SX 12, 14; CX 87; Needle, Tr. 25; CPX 13, Tolhurst Dep., at 93; CPX 16, Reiner Dep., at 107-08).

70. OAA's foreign licensees who were or are selling and distributing CPK dolls in their licensed territories are as follows:

Licensed Territory

C
C

C
C

C
C

C
C

C
C
C

C
C

C
C
C

C
C
C
C
C

(SX 5, 13; CX 86, 87, 90).

71. Under the terms of the third party license agreements, the products licensed by are defined as

With respect to the foreign manufacturing licensees, provided these licensees with technical specifications and matrixing rules and were responsible for aesthetic approval before the CPK dolls were put into production. retained final approval on the dolls before they were introduced into the foreign markets. (SX 12-14, Schedule A; CX 87, 90, Schedule A; CPK 16, Reiner Dep., at 40-41, 63-64; CPX 15, Zelman Dep., at 100-04, 106-07, 110-11).

72. The royalties paid by the foreign licensees under the terms of their agreements range The majority of the license agreements provide for a royalty rate

The royalty,

(SX 12-14, ¶ 4(b), Schedule E; CX 87, 90, ¶ 4(b), Schedule E; Kahn, Tr. 114).

73. Each of the foreign license agreements restricts the territory in which the licensee may sell CPK dolls as follows:

(SX 12-14, ¶ 2(a); CX 87, 90, ¶ 2(a)).

74. Of the foreign licensees who only Coleco's CPK dolls and related products, and therefore its is As a result, has taken over distribution of CPK dolls in (Kahn, Tr. 114-15; SX 5, Brawley Aff., ¶ 4; FF 70, supra).

75. manufacturing licensee, which was a subsidiary of went bankrupt some time in 1985, and their license with has been terminated. (CPX 16, Reiner Dep., at 107-08; Kahn, Tr. 112).

76. entered into a license agreement with effective April 13, 1984. was licensed to manufacture CPK dolls in

(SX 14; CPX 16, Reiner Dep., at 65-67, 69; CPX 15, Zelman Dep., at 103-04).

77. When Coleco began to sell CPK dolls in the United States that had it encountered two problems:

Due to the fact that was a licensee of OAA and did not have a direct relationship with Coleco, Coleco was not in a position to restrict output or to control its quality and matrix standards. (CPX 16, Reiner Dep., at 69-81).

78. By the end of 1985,

(CPX 16, Reiner Dep., at 74; SX 5, Brawley Aff., ¶ 5).

79. entered into a license agreement with effective December 3, 1983. Initially,

was not authorized to sell CPK dolls outside of its territory, and eventually encountered a situation in which their production exceeded demand.

discovered that the paint used on the dolls' heads had lead content which exceed U.S. and Canadian toxicity standards. (SX 12; CPX 16, Reiner Dep., at 97-99).

80. Coleco was in a position of having to destroy a number of the dolls purchased from which did not meet toxicity standards. ceased manufacturing CPK dolls for Coleco in 1985. Its

(CPX 16, Reiner Dep., at 99-105; SX 5, Brawley Aff., ¶ 6).

81. entered into a license agreement with in effective December 7, 1983. is a company that Coleco has worked with on other products. Initially, was only selling CPK dolls, but later they also began to manufacture for sale in has the CPK dolls manufactured for it by has not encountered any quality problems with and is still a licensee of OAA. (CX 87, at 41; CPX 16, Reiner Dep., at 105-07; SX 5, Brawley Aff., ¶ 3; Kahn, Tr. 111).

82. Neither OAA nor Coleco have imposed any restrictions on the volume of production of CPK dolls by OAA's foreign manufacturing licensees. (CPX 13, Tolhurst Dep., at 62-63; Kahn, Tr. 134-35).

83. Although neither OAA nor Coleco have been able to obtain tangible proof, they both had strong suspicions that the foreign licensees, were not strictly abiding by the territorial restrictions in their license agreements. In an effort to curtail gray market imports of CPK dolls that were manufactured by

C

C (Kahn, Tr. 131-32; CPX 13, Tolhurst Dep., at 63-64; CPX 16, Reiner Dep., at 67, 69 82-84).

84. At the time of the hearing in April 1986, the only companies still manufacturing Coleco's CPK dolls were Coleco's Far Eastern vendors operating C through Coleco Far East Ltd., and OAA's licensee, C (FF 75, 78, 80, 81, supra).

85. OAA approved the foreign language adoption papers and birth certificates used by its licensees in foreign countries. (Needle, Tr. 46; CF 173).

4. Unauthorized Importation of CPK Dolls, Related Literature and Packaging

86. No foreign licensee has been granted the right to distribute CPK dolls in the United States. (Needle, Tr. 57; CF 176; see FF 69, 70, supra).

C 87. Foreign licensees who only CPK dolls in their C respective territories obtain their dolls from C sells these doll C at a price of which represents C basically the C (Kahn, Tr. 113-14; CF 179).

88. The CPK dolls and related products which have been imported into and sold in the United States by respondents and others without complainants'

authorization are produced under OAA's license agreements which license the manufacture, distribution and sale of the Coleco CPK products under OAA's copyrights and trademarks. The design and appearance of these licensed CPK products have been approved by OAA and Coleco. (FF 69-71, 103-126; Needle, Tr. 101; CPX 4, 9-11).

89. CPK dolls imported into the United States without complainants' authorization were produced either by the same Far East vendors who supply CPK dolls to Coleco, or by companies who were licensed under the 801 and 804 copyrights to manufacture CPK dolls by OAA, for sale in specific foreign territories. (FF 69, 70, 76, 87).

90. The birth certificates and adoption papers that accompany CPK dolls imported into the United States without complainants' authorization are similar in appearance to the Coleco birth certificates and adoption papers that are the subject of the 777 and 778 copyrights. However, in many instances, the text of the documents accompanying these imported dolls is in a foreign language. In some instances, the imported documents feature both a foreign language and English. Also, in some instances, the graphics (including border and print design) of the imported documents are not identical to the graphics which are present in the Coleco counterparts. (Needle, Tr. 48-49; CX 8, 12; SF C34).

91. The retail boxes in which imported CPK dolls are sold are similar in appearance to the Coleco packages which are the subject of the 526 copyright. However, in many instances, the text of the imported packages is

in a foreign language, or appears in both a foreign language and English. (CPX 2-4, 9-11; SF C35).

92. CPX 2 is a CPK doll manufactured by Jesmar. The packaging for this doll is entirely in Spanish, and on the back, in the upper right corner there is a copyright notice and an indication in Spanish that the doll was manufactured by Jesmar. On the back of the doll's head, there is a copyright notice, and the following marking: "Manufactured by Jesmar, S.A., Made in Spain." The accompanying birth certificate and adoption papers are entirely in Spanish, and indicate that the doll's name is Betty Crucita. The return envelope for fulfilling the adoption process is addressed, in Spanish, to Alicante, Spain. The price sticker on the package indicates that the doll was offered for sale by Sav-On at a price of $34.95. (CPX 2).

93. CPX 3 is a CPK doll manufactured by Tri-Ang Pedigree. All written material on the package appears in both English and Afrikaans, and on the back, in the lower left corner, there is an indication that the doll is distributed by: "Tri-Ang Pedigree, Sacks Circle, Bellville South, Cape, S.A." On the back of the doll's head, there is a copyright notice. A tag stitched to the doll indicates that it was manufactured by Tri-Ang Pedigree. The price sticker on the package indicates that Boscov's was offering this doll for sale for $49.99. The birth certificate and adoption papers for this doll are missing. (CPX 3).

94. CPX 4 is a CPK doll, also known as "P'tits Bouts de Choux" manufactured for Coleco. The written material on the package appears in both French and English. On the back of the package, in the lower left corner is

the marking "Imported by/Importe par: Coleco (Canada) Limitee. . . ." There is a copyright notice on the back of the doll's head, and a marking that the doll is manufactured by Coleco. The birth certificate and adoption papers indicate that the doll's name is Alphonse Ellery. These papers are printed in English on one side, and in French on the other. To obtain the validated adoption certificate, the papers are to be sent to a certification center in Ottawa, Ontario. (CPX 4).

95. CPX 9 is a CPK doll manufactured by Tsukuda. The written material on the package appears in both English and Japanese. On the right side of the package, in the upper right corner appears the following: "NOTICE: 'The Cabbage Patch Kids' doll in this package is intended exclusively for sale and adoption in Japan. The birth certificate and adoption papers included with the doll will not be honored if the doll is sold in the United States or Canada, or any other country other than Japan." The tag stitched to the doll indicates that it was manufactured by Tsukuda and made in Japan. The birth certificate and adoption papers indicate that the doll's name is Jackson, and all of the written material appears in English, followed by Japanese. The return envelope is printed in Japanese, and there is an enclosed card which gives the fulfillment instructions in English. (CPX 9).

96. CPX 10 is a CPK doll manufactured by Tsukuda. The written material on the package appears in both English and Japanese. On the back of the package in the lower right corner is the marking, in English "Printed in Japan." The label stitched to the doll indicates OAA's copyright, and that the doll is manufactured by Tsukuda. The price sticker on the package

indicates that J.C. Penny offered this doll for sale for $44.99. The birth certificate and adoption papers for this doll are missing. (CPX 10).

97. CPX 11 is a CPK doll, also known as "Les Patoufs," manufactured by Coleco and distributed by Ideal. The written material on the package is entirely in French. There is a copyright notice engraved on the back of the doll's head, with the marking that the doll was manufactured by Jesmar in Spain. The birth certificate and adoption papers are in French, and the return address for fulfillment is to Ideal Loisirs in France. (CPX 11).

98. The CPK dolls which are imported into the United States by respondents and others, together with their related birth certificates, adoption papers and packaging are products manufactured under license to OAA, and therefore embody the subject matter of each of the copyrights in issue in the investigation. Inasmuch as the importation of these CPK products into the United States by respondents and others occurs without the authorization of OAA or Coleco, such importation violates the copyright owner's exclusive right of distribution, and therefore infringes each of the subject copyrights. (FF 22-97, 103-126).

B. 17 U.S.C. § 601(a) - The Manufacturing Clause

99. OAA's copyright registrations for its birth certificate, adoption papers, and packaging (the 777, 778, and 526 copyrights) indicate that all are manufactured for the copyright owner in the United States. (CX 9-11 at item 7).

100. CX 14 contains samples of birth certificates and adoption papers received by Coleco or its fulfillment houses which accompanied CPK dolls imported into the United States without complainants' authorization. Five of these samples display text in both English and Chinese; two samples are in English and Afrikaans. One sample is a copy of Official Adoption Papers for "Zita Belvia," the text of which is entirely in English. This sample displays a 1983 copyright notice of OAA. There is a hand written notation that it is from the United Kingdom. (CX 14).

101. Based on the facts of record, I find that complainants have complied with the requirements of 17 U.S.C. § 601 by having their birth certificates and adoption papers manufactured in United States. The imported paper work that is alleged to infringe complainants' copyrights and is bilingual is not subject to the Manufacturing Clause. Furthermore, I determine that the Manufacturing Clause has no application to the imported CPK birth certificates and adoption papers under the facts of this case, inasmuch as they are not imported by the copyright owner. (FF 99-100).

C. Failure To Mark Country of Origin

102. The CPK dolls which have been imported into the United States without complainants' authorization are generally marked with the identity of the manufacturer and the country of origin on the doll itself. However, the packaging of these imported dolls, which in some cases is entirely in a foreign language, is generally not marked with the country of origin in English. (FF 92-97, supra; CPX 2-4, 9-11).

103. In view of my finding that the CPK dolls themselves are marked with the country of origin, and that the imported packages are either in foreign languages or bilingual, I determine that complainants have not established that the failure to mark the package in which gray market CPK dolls are sold violates the requirements of the Customers Marking Statute, or that noncompliance with Customs marking requirements is an unfair act under Section 337. (FF 92-97, 102).

V. IMPORTATION AND SALE

104. OAA first detected the presence of "gray market" CPK dolls in the United States during the Christmas season of 1984. (CPX 13, Tolhurst Dep., at 73; See CPX 14, Schwefel Dep., at 67; CPX 15, Zelman Dep., at 71-72).

105. Respondents and others have imported or sold in the United States approximately 390,000 genuine CPK dolls intended for sale outside the United States, but imported into the United States without complainants' authorization. (Hereafter, the term "gray market" CPK dolls will be used to refer to genuine CPK dolls intended for sale outside the United States, but imported into the United States without complainants' authorization). (SX 4; see FF 86-97, 106-25).

A. Importation and Sale by Respondents

106. Complainants' Physical Exhibit 9 is a gray market CPK doll purchased from respondent Murrell. (CPX 9; CX 19, at 1; see FF 95, supra).

107. Murrell told Mr. Steven Iken, a private investigator retained by complainant OAA, that he (Murrell) had sold 10,000 gray market CPK dolls in the United States. (CX 19, at 2).

108. In a deposition conducted on OAA's behalf in related federal district court litigation, Murrell only admitted to having purchased 1,500 gray market CPK dolls. The dolls purchased by Murrell were packaged in boxes which displayed Japanese language writing. Murrell acquired these dolls from SMC, 6730 View Dr. S.E., Port Orchard, WA. (CPX 19, Murrell Dep., at 30, 33, 39).

109. In January 1985, Murrell paid $37.50 per doll for gray market CPK dolls. Later in 1985, Murrell paid $29.00 per doll. The Seattle Times reported Murrell's sales of gray market CPK dolls on August 21, 1985. (CPX 18, Murrell Dep., at 34; CX 19, at 01303).

110. Mr. Mike Moffat, who claims to be the United States representative of respondent JIC, says he has imported and sold 45,000 gray market CPK dolls. In July of 1985 Mike Moffat sold 1,000 CPK dolls to Avery H. Smith & Co. of San Jose, CA. (CX 19; CX 21, at 30313).

C 111. Respondents Osco and Sav-On (Midwest Chain) purchased gray market CPK dolls in 1985. Osco and Sav-On purchased these dolls in the following quantities from the following entities:

Units

C
C

C
C

C
C
C
C
C

TOTAL

(CX 22, at 3; see FF 12, supra).

112. Purchases of gray market CPK dolls by respondent HMI (Ben Franklin Stores) are evidenced by an agreement between OAA and Westhampton Group, Inc. (Westhampton) submitted in settlement of a copyright infringement action brought by OAA in the District Court for the District of New Jersey. Exhibit "B" to the agreement identifies HMI's subsidiary, Ben Franklin Stores, as one of the firms to whom Westhampton delivered gray market CPK dolls. The volume of CPK dolls Ben Franklin purchased from Westhampton is not specified. (CX 23, at 30488).

113. Complainants have submitted a series of invoices which indicate that respondent Calila imported at least 37,034 CPK dolls from Zabco Sales Representation (Zabco), Cape Town, South Africa, from August 1985 through November 1985. Gray market CPK dolls obtained by Calila were manufactured in South Africa. In September 1985, Calila purchased 3,510 CPK dolls from Zabco at a price of $16.00 per doll. In October and November of 1985, Calila purchased 33,524 CPK dolls from Zabco at a price of $13.50 per doll. (CX 24, at 1-12).

114. The gray market CPK dolls obtained by Calila were shipped via air carrier in master cartons, not yet packaged for retail sales. The retail

cartons were shipped separately. Calila arranged for the imported dolls to be packaged in the United States, and Calila incurred the expenses of boxing the dolls. (CX 24, at 16, 43).

115. Calila also corresponded with Polychem, Cape Town, South Africa, respecting importation of CPK dolls from South Africa. In a letter dated July 10, 1985, D.M. Buda of Polychem informed Calila that Calila's customers could have their CPK adoption papers processed by sending them to an address in South Africa. Gray market CPK dolls obtained by Calila from Polychem were to be accompanied by a certificate from Tri-Ang guaranteeing that the dolls' adoption papers would be honored by Tri-Ang. (CX 24, at 16, 33).

116. In July 1985, Calila received the following telex from Polychem:

> All [gray market CPK] items have computer scannable product code (UPC bar-code) stickers placed upon offending statement re. validity of adoption papers.
>
> Liro Inc. [one of Calila's customers] has my blessing to send a representative by the FTY [factory] to inspect goods before shipment so they will be satisfied that all conditions are complied with . . . .

(CX 24, at 17).

117. From September 1985 through December 1985, Calila sold gray market CPK dolls, at prices ranging from $17.72 to $25.25 per doll, to the following entities:

Kent Int'l Marketing,
Address unknown;
Gene Lahaie,
Tujunga, CA;
Harry Guthertz,
San Francisco, CA;

Elliot and Associates,
Northbrook, IL;
Concord,
Address unknown;
Westhampton Group, and
Culver City, CA;
Liro, Inc.
Los Angeles, CA

(CX 24, at 38-58).

118. Respondent International Panasound Ltd. purchased 48 gray market CPK dolls from Newport of Japan Radio Corp., New York, N.Y. (CX 25).

B. Importation and Sale by Other Third Parties

119. From December 1984 through February 1985, E.T. Trading Co., Ltd. (E.T.) purchased gray market CPK dolls. E.T. purchased gray market dolls from the following entities at the following invoice prices:

Supplier	Price/Doll
C	
C	
C	
C	

The invoice prices listed above do not include commission due, freight and finance charges, all of which were paid by E.T. (SX 1, at 1-2).

120. E.T. was told that the gray market dolls it purchased were manufactured in Spain. The packaging for the dolls displayed Italian language writing. (SX 1, at 2, ¶ 3).

121. From February-May 1985, E.T. sold gray market CPK dolls to

various customers in the United States at wholesale prices ranging from

During this period, Coleco's wholesale list prices for CPK dolls were approximately $25.00 per doll through March 4, 1985, and $26.50 per doll thereafter. (SX 1, 8).

122. One of customers was a chain of grocery stores located in California. purchased gray market CPK dolls from in May and June of 1985. (CX 43).

123. From December 1984 through March 1985, C.K.O. International Trading Co. (C.K.O.), of Englewood Cliffs, NJ, purchased 28,000 gray market CPK dolls from entities located in Spain and France. 8,000 dolls were purchased at $28.00 per doll, and 20,000 dolls were purchased at $25.00 per doll. (SX 2, at 1-2; CX 76).

124. Sales of gray market CPK dolls in the United States by C.K.O. are corroborated by the affidavit and accompanying documents of Kenneth E. Rapacz, Vice President of Finance of Wiebolt Stores, Inc., a midwestern regional department store chain. In his affidavit, Mr. Rapacz states that Wiebolt purchased approximately 16,000 gray market CPK dolls from C.K.O. (CX 76).

125. The following chart illustrates importation and sale of gray market CPK dolls by defendants in lawsuits initiated by OAA in various courts:

Exhibit	Defendant	Court	Units
SX 3	Joe Olla Enterprises, Inc.	C.D. Cal.	2,000
CX 30	Baroco Ent.	S.D. N.Y.	7,984

CX 36	Greenwood Distributors, Inc.	S.D. Fla.	10,000
CX 41	Watson Triangle Company and Greenman Bros., Inc.	S.D. Fla.	15,074
CX 56	Guild Sales, Inc.	E.D. N.Y.	825
CX 65	Metro Cash and Carry of Illinois, Inc.	N.D. IL.	44,000
CX 74	Venture Stores	D. N.Y.	3,000
CX 75	Allen L. Mitchell	E.D. N.Y.	750
		TOTAL	83,653

C. Sources of Gray Market "Cabbage Patch Kids" Dolls

126. Gray market CPK dolls have come principally from Spain, South Africa, Japan and France. (CPX 2, 3, 9, 11, 12; CPX 13, Tolhurst Dep., at 95; CPX 16, Reiner Dep., at 69; see FF 69, 76, 79, 81).

127. From review of the documentary exhibits submitted by complainants, it is possible to ascertain the country of origin for approximately one-half of the CPK dolls known to have been imported into the United States without complainants' authorization. Based on the information contained in these exhibits (which is summarized in SX 6), it appears that gray market CPK dolls have been imported from the following countries in the following percentages:

Country	%
Spain	62
South Africa	31
Other	7

(SX 6).

VI. DOMESTIC INDUSTRY

A. Original Appalachian Artworks

128. In addition to making soft CPK dolls available for "adoption" from its Babyland General Hospital facility in Cleveland, Georgia, OAA markets these dolls throughout the United States, primarily to the gift market. (Needle, Tr. at 31; see FF 2, 3, 16-18).

C C C C 129. OAA employs persons who participate in the design of OAA's CPK dolls; employees are engaged in the manufacture of OAA's CPK dolls; and employees are responsible for controlling the quality of OAA's CPK dolls; employees are involved in processing birth certificates and adoption papers. (SX 17, Answer to Interrog. No. 2; CPX 13, Tolhurst Dep. at 23).

C C C 130. OAA employs full time individuals in its licensing department, and was hiring full time employee in February 1986. It uses additional employees half-time in its licensing department. (CPX 13, Tolhurst Dep., at 21).

131. In addition to manufacturing and marketing its CPK dolls, OAA processes birth certificates and adoption papers submitted by purchasers of C OAA's CPK dolls. persons (including employed through contract with an independent fulfillment center) are employed in processing these documents. (SX 17, Answer to Interrog. No. 2(e); CPX 13, Tolhurst Dep., at 24-25).

132. OAA has appointed Schlaifer Nance & Co. (SNC) as its exclusive licensing agent for CPK products, with the exception of OAA soft CPK dolls. C selects licensees and presents these choices to for approval. OAA has final approval of prospective licensees and licensing terms, as well as all products produced under license. (CPX 13, Tolhurst Dep., at 12; Needle, Tr. at 19-21; CX 4; SX 17, Answer to Interrog. No. 3; FF 60 supra).

133. Under the licensing agreement between OAA and SNC, OAA receives C and SNC of the net income received from licensees. Provisions C exist for to receive an if total net sales exceed a specified value. (CX 4, at 5-6).

134. OAA has the following responsibilities and duties with respect to its licensees for CPK dolls: protecting the copyrights and trademarks; ensuring that trademark/copyright protection is in force in a particular country; approving all products; and promotions. (CPX 13, Tolhurst Dep., at 61-62).

135. Della Tolhurst, OAA's president, supervises OAA's licensing C activities. Approximately other OAA employees are involved in evaluating products submitted for approval by licensees. (SX 17, Answer to Interrog. No. 4; Needle, Tr. at 31).

B. Coleco

1. License Agreements

C 136. Coleco was originally granted under the CPK copyrights and trademarks. However, in 1984, OAA, SNC, and Coleco agreed

C (Needle, Tr. at 24; CPX 13, Tolhurst Dep., at 16; see FF 64-66, supra).

C 137. The January 5, 1984 agreement was entered into in part

C

C The agreement was also intended to clarify the manner in which foreign licensing was to be conducted. (CPX 13, Tolhurst Dep., at 58-59; CPX 14, Schwefel Dep., at 37; see FF 65 supra).

138. Royalties paid by third party licensees in the North American

C Territory are

C share of foreign

C royalties comes to approximately per doll. (CX 3, January 4, 1985 Agreement, at 2; Kahn, Tr. at 114, 117, 132).

139. Royalties paid by third party licensees in foreign countries

C outside of North America are

C (CX 3, January 4, 1984 Agreement, at 3).

140.

(Kahn, Tr. at 114; see FF 7, 67, 72, 87 supra).

2. Design/Matrixing

141. The CPK dolls that Coleco is licensed by OAA to manufacture have the same overall appearance as the dolls manufactured by OAA, but differ in that Coleco's dolls have a molded plastic head and are smaller. Coleco's CPK doll is 16 inches tall and its "Preemie" CPK doll is 14 inches tall. (Needle, Tr. at 11-13; CPX 15, Zelman Dep., at 35-38; CPX 5-8; FF 19).

142. From the time the CPK doll concept was presented to Coleco to the time a finalized CPK doll was developed by Coleco, employees worked full time for four or five months. (CPX 15, Zelman Dep., at 40-41).

143. The concepts for new CPK products originate either at Coleco, at outside design groups on retainer to Coleco, at OAA, or from a combination thereof. Once the concepts are accepted by Coleco management and marketing, they are turned over to the Coleco engineering department, which interprets the marketing requirements into practical, manufacturable concepts. These activities may include making a master mold of the sculpted head, or providing engineering drawings for outfits, sewing patterns, sewing samples, and quality control standards. (CPX 16, Reiner Dep., at 19-20).

144. The engineering groundwork for all aspects of CPK products originates with Coleco personnel in the United States, and is approved by OAA. This engineering groundwork is transferred to engineers in the Far East C who work for Coleco's agent, where it is executed. (CPX 16, Reiner Dep., at 19-21, 53-61; Needle, Tr. at 32; FF 8, supra).

C 145. The organization acts on Coleco's behalf as an agent to C oversee Far East production of Coleco products, including CPK dolls. C activities are devoted totally to Coleco. has approximately 200 C employees. With the exception of some engineers, most employees are C not devoted exclusively to CPK products. However, about 70% of activities are CPK product related, or proportional to the amount of Coleco's business devoted to CPK products. (CPX 16, Reiner Dep., at 13-17; See CX 85, at 6).

146. Coleco's engineering staff in the United States devoted to CPK C products is larger than engineering staff in the Far East devoted to CPK products. (CPX 16, Reiner Dep., at 18-19).

C 147. Coleco added new head styles for CPK dolls in 1985 and plans C an additional new head styles for 1986. These head styles were designed in the United States by Coleco personnel and members of outside design groups. OAA approved these new head designs. (CPX 16, Reiner Dep., at 54-56).

148. Taking into account all the foreign vendors, the total tooling C for any one head design is approximately per head, and this cost is incurred in the Far East. (CPX 16, Reiner Dep., at 55).

149. Coleco has its dolls manufactured with various combinations of features. The various combinations of head styles, hair color, eye color, skin color, and clothing presently used by Coleco yield approximately different dolls. (CPX 16, Reiner Dep., at 36-39).

150. Coleco has developed a "matrixing" system which is used at all levels of production and distribution to assure each retailer of as diverse an assortment of CPK dolls as possible. (CPX 16, Reiner Dep., at 19-21, 28-32, Dep., Exhibits 37-42).

151. The matrix controls the packing of dolls both as to specific

C requirements

C and random requirements (CPX 16, Reiner Dep., at 29-33).

152. One of the essential attributes of the CPK doll that has contributed to its commercial success is that it appears to the consumer that each doll is unique and individual. This characteristic is the result of the matrixing system. (CPX 16, Reiner Dep., at 171-73).

C 153. Matrix rules

C Each new CPK doll, such as Cornsilk dolls, requires unique matrix rules. (CPX 16, Reiner Dep., at 34-35).

C 154.

C

(CPX 16, Reiner Dep., at 63).

3. Production/Value Added

155. Coleco's version of the CPK doll was introduced to the public in 1983 as a 16 inch doll. Coleco has continued to engage in engineering and development with respect to this doll. (CX 85, at 5).

156. In 1985, the CPK doll models that Coleco produced and sold in the United States were as follows: 16" CPK doll (CPX 5); 14" CPK doll (CPX 6); Twins (CPX 7); and World Travelers (CPX 8). The new 1986 line includes all of the above-mentioned dolls plus "Cornsilk Kids," "Preemie Twins," "Koosas," and 12" babies. (Needle, Tr. at 11-15; CPX 15, Zelman Dep., at 8-9; CX 85, at 5; FF 43-45 supra).

157. Using the designs and engineering specifications supplied by
C Coleco U.S. and by the organization, offshore vendors in the Far East,
C assemble CPK dolls for Coleco
C (CPX 16, Reiner Dep. at 19-21; Kahn, Tr. at 113).

158. Specifically, Coleco has contracted with manufacturers in Hong Kong, Korea, Taiwan, and the People's Republic of China for production of the CPK dolls it is licensed to manufacture. (CPX 15, Zelman Dep., at 72-74, Dep. Ex. 7).

159. After the CPK dolls are manufactured by Coleco's vendors in the Far East, and then inspected, they are shipped in bulk to Coleco's pack-out facilities in Amsterdam, New York or Tustin, California. (CPX 15, Zelman Dep., at 75-76; CPX 16, Reiner Dep., at 133-34, 157-59).

160. Quality control functions in the Far East are performed by C which checks for safety, aesthetic factors, and compliance with matrix requirements. Inspections are performed both during the manufacturing process and prior to shipping the completed product. The sample size C inspected is typically of the shipment. However, metal detection in the Far East is on 100% of the CPK dolls. (CPX 16, Reiner Dep., at 11, 124-28, 134).

C 161. About off-shore employees are devoted to quality control, at C an annual cost of about for 1986. (CPX 16, Reiner Dep., at 132).

162. At the Amsterdam, New York and Tustin, California facilities, several additional production steps are performed by Coleco. The dolls are groomed, and accessories, such as pacifiers, crayons, eyeglasses, etc., are placed on the dolls. Then the dolls are inserted, secured, and positioned in their retail boxes, and birth certificates and adoption papers are added. (CPX 16, Reiner Dep., at 158-59).

C 163. About employees at Amsterdam, New York are involved in pack-out/quality control, and about 70% of these are devoted to CPK products, C at a cost of about million in 1985. The Amsterdam facility occupies C square feet. (CPX 16, Reiner Dep., at 138-39; Complaint, Ex. 6, Attachment F).

164. The pack out/quality control costs in Tustin, California were about C in 1985. The Tustin facility occupies about square feet. (CPX 16, Reiner Dep., at 138-39; Complaint, Ex. 6, Attachment F).

165. The quality control tests done in the United States are similar to those performed in the Far East, and are to an extent repetitive of tests performed in the Far East. (CPX 16, Reiner Dep., at 139).

166. Every CPK doll received from the Far East is inspected in the United States. There is both a metal inspection to detect any foreign matter that might have been left in the doll during production, and a visual inspection, after which certain cosmetic operations, such as cleaning the face, are performed. (CPX 16, Reiner Dep., at 134, 140-41, 158).

167. Any dolls that cannot be corrected during this inspection are sent to the hospital in Coleco's pack out facility for repair. In 1985, between C of all dolls were sent to this hospital for major repairs. (CPX 16, Reiner Dep., at 140, 162-64).

168. Coleco's total cost of returns of unsatisfactory product in 1985 was C of sales, compared to a return rate of for Coleco's outdoor products. (CPX 16, Reiner Dep., at 148-49).

169. All of the accessories, as well as the birth certificates and adoption papers that accompany the dolls, are of U.S. manufacture. (CPX 16, Reiner Dep., at 158-59; FF 47-49, 51-52 supra).

170. Coleco's adoption program is carried out by three U.S. companies, called "fulfillment houses," under contract to Coleco. (CPX 16, Reiner Dep., at 159-61; FF 20 supra).

171. The fulfillment houses provide the birth certificate and adoption application that are included in the box with each CPK doll. When a purchaser fills in the application, it is returned to one of the fulfillment houses where an adoption certificate is prepared and mailed and from where, one year later, a birthday card is also sent. (CPX 16, Reiner Dep., at 159-61).

172. The relative U.S. and foreign value added for Coleco's 16 inch CPK dolls for 1985 is as follows (cost per unit):

	U.S. content	Foreign content	Total
C Net Sales			
Cost components:			
C Material 1/			
C Labor			
C Overhead			
C Variances			
C Royalties			
C Advertising			
Selling and Admin.:			
C Engineering/ Development			
C Other S&A			
C Total Costs			
C Percent			
C Operating profit			

C 1/ (See FF 107-08).

(CX 83).

173. The relative U.S. and foreign value added for Coleco's 14 inch CPK dolls for 1985 is as follows (cost per unit):

	U.S. content	Foreign content	Total
Net Sales			
Cost components:			
Material			
1/			
Labor			
Overhead			
Variances			
Royalties			
Advertising			
Selling and Admin.:			
Engineering/ Development			
Other S&A			
Total Cost			
Percent			
Operating profit			

1/ (See FF 107-08).

(CX 83).

174. For the Coleco division of Coleco Industries, income taxes were 4.7% of net sales for the first three quarters of 1985. (CPX 17, Sande Dep., Ex. 48 at 30).

175. Coleco used SKU (stock keeping unit) for the 16 inch CPK doll and SKU for the 14 inch CPK doll as representative of the unit costs of the CPK doll line.

(CPX 17, Sande Dep., at 76; Dep. Ex. 48, at 2, Dep. Ex. 49).

176. Certain operating costs were allocated. These include advertising, selling and administrative, and interest expenses. Allocations were made on the same basis upon which such allocations are made in Coleco's 10-K statement, on the basis of sales volume. Royalty and licensing costs are actual. (CPX 17, Sande Dep. at 73-75, Dep. Ex. 48, at 2, Dep. Ex. 49).

177. The sales data utilized by Coleco in its value added review is the per unit sales data contained in an internal report, the Gross Profit Analysis, which is prepared in the ordinary course of Coleco's business. (CPX 17, Sande Dep. at 78-79, Dep. Ex. 49, at 2).

178. The standard material and labor costs were obtained from documents used by Coleco in the ordinary course of its business. (CPX 17, Sande Dep. at 80-81; Dep. Ex. 49 at 2).

179. The overhead costs in the value added calculation are rates that Coleco has developed for its internal accounting purposes. Coleco develops an overhead rate by accumulating actual overhead expenses for a period, allocating that overhead to individual product groups, and dividing those overhead dollars by the hours worked by the product group. (CPX 17, Sande Dep., at 81-85, 93-95, Dep. Ex. 49, at 2).

180. Overhead costs include wages and salaries associated with indirect labor in the manufacturing plants, purchasing functions, quality control, inventory control, production control, administrative employees

located at the manufacturing site, design and development, activities of independent toy designers, and matrixing costs. (CPX 17, Sande Dep., at 82-83, 85-90).

181. Some engineering activities are also included in the administrative costs, including management personnel of the Engineering Department. The unit cost of this activity was (CPX 17, Sande Dep., at 97; See FF 172-73).

182. The cost of Coleco personnel located in Hong Kong is included under the "foreign content" column of overhead. (CPX 17, Sande Dep., at 90-92).

183. The variances used in the value added analysis are the differences between standard costs and actual costs. These variances include material and labor variances, as well as the cost of the fulfillment process for CPK dolls. (CPX 17, Sande Dep., at 98-100).

184. The cost of actual materials of the birth certificate, adoption papers, and birthday cards would be included in the material costs component of the value added. (CPX 17, Sande Dep., at 100-01).

185. Royalty costs are based upon the actual royalty percentages from the royalty agreement between Coleco and SNC. (CPX 17, Sande Dep., at 102; CPX 49, at 2).

186. The advertising costs in the value added review were allocated based on a percentage of net sales of CPK dolls. (CPX 17, Sande Dep., at 102-03, Dep. Ex. 49, at 2).

187. The interest expense is based on the percentage of the total corporate interest expense which was incurred to finance the Cabbage Patch product line.

C
C

(CPX 17, Sande Dep., at 104-05, Dep. Ex. 49 at 2).

188. The S&A expense in the value added review was made on the same basis upon which this calculation is performed for Coleco's 10-K report. S&A expenses include costs associated with the sales force to obtain orders, certain marketing department costs, information services, computer department, accounting function, legal and executive management group and related staff. (CPX 17, Sande Dep., at 106-08).

189. The foreign content figure of the value added computation includes the purchase price of the basic doll, freight costs to the United States, a factor allowing for losses upon arrival in the United States, any brokers commissions, and the cost of the organization in the Far East. (CPX 17, Sande Dep., at 114-15, 129-31, Dep. Ex. 54).

C

190. The purchase price of the basic doll (foreign material cost) would include the foreign labor content. (CPX 17, Sande Dep., at 115).

C 191. The domestic cost for the 14 inch doll is the 16
C inch doll principally because there is a associated with the 14 inch doll's fulfillment papers. (CPX 17, Sande Dep., at 129).

192. Based on the foregoing findings, I determine that the relevant domestic industry consists of the domestic operations of OAA devoted to the production of soft sculpture CPK dolls and the licensing of soft/vinyl sculpture CPK dolls and related products; the domestic operations of SNC involved in the licensing of soft/vinyl sculpture CPK dolls and related products; and the domestic operations of Coleco involved in the production and post-sale fulfillment process for soft/vinyl sculpture CPK dolls, together with related literature and packaging. (FF 60-61, 65-66, 69, 72, 75-76, 79, 81, 128-91).

VII. EFFICIENT AND ECONOMIC OPERATION

C 193. In 1985, Coleco's advertising expenses represented of the
C unit cost of 16 inch CPK dolls and of the cost of 14 inch CPK dolls. (CX 15).

194. Coleco's media expenditures for CPK dolls was as follows during 1983-1985:

C
C
1983
1984
1985 1/

1/ Media expenditures for the last half of 1985 were estimated by Coleco. (Complaint, Ex. 6, Attachment E).

195. Coleco provides a full range of benefits for its employees. (Complaint, ¶ 39, Ex. J).

196. In September 1985, Coleco's current assets exceeded its current C liabilities by This ratio was an over the current ratio of December 31, 1984, and is attributable to a substantial degree to Coleco's sales of CPK dolls and related products. (CPX 17, Sande Dep., at 33-34, Dep. Ex. 48 at 2).

197. Coleco's costs for CPK dolls in 1985 were than had been forecast for that year. (CPX 17, Sande Dep., at 40-41, Dep. Ex. 48 at 4).

198. Not Used.

199. OAA's revenue from royalties and sales of its own CPK dolls is as follows:

	1983	1984	1985 1/
C Royalty from Coleco			
C OAA CPK revenue			
C OAA total income 2/			

1/ As of May 1985.
2/ Includes royalty from other licensees. (Complaint, Ex. 5; Complaint, at 8-9).

200. OAA has granted licenses to entities other than Coleco to manufacture, market or distribute authorized copies of the copyrighted CPK dolls outside the territories of the United States. (Complaint, at 8; FF 65-66, 69-85).

201. OAA is directly involved in reviewing the performance of foreign licensees for CPK dolls. (CPX 13, Tolhurst Dep., at 12; FF 66, 71).

202. Mr. Roberts of OAA promotes CPK dolls by doing promotional tours and newspaper and magazine articles. (CPX-13, Tolhurst Dep., at 40).

203. In view of the foregoing facts, I find that the relevant domestic industry is efficiently and economically operated. (FF 193-202).

VIII. SUBSTANTIAL INJURY

A. Industry Condition

204. The value of OAA's revenue from sales of its original CPK dolls and related articles, as well as royalty payments received from Coleco, is shown in the tabulation below:

	1983	1984	Jan.-May 1985
C OAA CPK Revenue			
C Coleco Royalty			

(Complaint, Ex. 5).

205. The value and quantity of Coleco's net sales of 14 inch and 16 inch CPK dolls from 1983 to 1985 was as follows (in millions):

	1983	1984	1985
C Quantity			
C Value			

(CPX 17, Sande Dep., Ex. 49, at 4; CX 16, at 4).

206. Coleco's profits for the years 1983, 1984 and 1985 were as follows for 14 inch and 16 inch CPK dolls combined (in thousands):

	1983	1984	1985
C Net Sales			
Cost of Sales:			
C Material			
C Labor			
C Overhead			
C Gross Profit			
Operating Expenses 1/:			
C Advertising			
C Royalties			
C S&A			
C Operating Profit			

1/ Because Coleco did not break out aggregate operating expenses for 14 inch and 16 inch CPK dolls, these data were computed by multiplying the unit operating costs for 14 inch and 16 inch CPK dolls by unit sales for these dolls in 1984 and 1985. Unit operating costs by doll size were not reported for 1983.

(CPX 17, Sande Dep., Ex. 49 at 4-6; See FF 91-92).

C 207. Coleco's gross profit on CPK dolls in 1985 for three

C main reasons:

C

C (CPX 17, Sande Dep., at 42).

208. Coleco's operating profit as a percentage of net sales for all

C Cabbage Patch products was in 1983, in 1984, and in 1985.

C Fourteen and sixteen inch CPK dolls accounted for of Cabbage Patch product

C sales in 1983, of sales in 1984, and of sales in 1985. (CPX 17, Sande Dep., Ex. 49 at 4).

209. Coleco's pre-tax profit as a percentage of net sales for all CPK products was in 1983, in 1984, and in 1985. The pretax profit contained in CPX 17, Ex. 49 at 4, appears to contain an error which results for 1984. The percentages above were computed from the corrected pretax profit. (CPX 17, Sande Dep., Ex. 49, at 4).

210. Coleco's wholesale price for CPK dolls increased from $18.50 in 1983 to $26.50 in 1985. (Complaint, Ex. 6, Attachment A).

211. Coleco elected not to honor birth certificates or adoption papers submitted by purchasers of gray market CPK dolls because it would be costly for Coleco to do so, between per doll The cost of the fulfillment process on the CPK dolls that Coleco sells in the United States is built into the price of the doll. In view of the fact that Coleco makes approximately a royalty on gray market CPK dolls, it was decided that the cost of fulfillment on these dolls was too high. (CX 18; Kahn, Tr. at 118-20, 133).

B. Capacity Constraints

212. Due to consumer demand in the United States for CPK dolls in 1984, Coleco was unable to fill all orders for CPK dolls received during the year. For full year 1984, Coleco's shipment to booking ratio was for the 14 inch and 16 inch CPK dolls. (Kahn, Tr. 127; SX 7a; CPX 15, Zelman Dep., at 131-34).

213. For mid-year 1985 (YTD for June), Coleco's shipment to booking ratio was for the 16 inch CPK doll and for the 14 inch CPK doll. For the full year 1985, Coleco's shipment to booking ratio was for 16 inch CPK dolls and for the 14 inch CPK doll. Coleco's ability to satisfy demand was reached sometime in the middle of 1985. (CX 89; CPX 15, Zelman Dep., at 152-53; CPX 16, Reiner Dep., at 115).

214. During at least the first half of 1985, some toy retailers in the United States found it difficult to obtain adequate supplies of CPK dolls from authorized sources. Many retailers, therefore, arranged to purchase gray market CPK dolls. (SX 10, at 1-2; CX 76, at 2; CX 43, at 2, 4-5; CX 55, 58).

215. In most cases, during the first half of 1985 the price to retailers of gray market dolls was comparable to or greater than Coleco's list prices. For example, Alpha Beta Stores (Skaggs) purchased gray market CPK dolls from at a cost of $33.50 per doll. (CX 43, at 25). Weibolt Stores purchased gray market CPK dolls from C.K.O. International for $29.50 or $30.00 per doll. (CX 76, at 26-33). During the same period, Coleco's wholesale list price to retailers was $25.00 or $26.50 per CPK doll. (SX 8; See FF 219-224).

216. Coleco currently possesses the capacity to manufacture CPK dolls in sufficient quantities to satisfy the United States demand for CPK dolls. The capacity of Coleco's Far East suppliers to produce CPK dolls was operating at seven days a week, in February 1986. (CPX 15, Zelman Dep., at 152-53; CPX 16, Reiner Dep., at 86, 113-14. See SX 11).

217. Since about mid-1985, when Coleco was better able to meet consumer demand in the United States for CPK dolls, gray market CPK dolls were sold to retailers at prices generally lower than Coleco's prices. (See FF 134-143).

218. In the last half of 1985, Coleco's sales of CPK dolls was
C approximately million. At an average price of $26.00, this results in
C sales of about million CPK dolls. Imports during the last half of 1985
C totaled over 80,000 CPK dolls for an import penetration ratio of about (CX 80, See FF 226-35).

C. Prices/Lost Sales

219. With the exception of an advertisement allowance to retailers (a type of discount), Coleco's list prices reflect their sales prices to retailers. (CPX 15, Zelman Dep., at 178-79).

C 220. sold CPK dolls to retailers during January-February 1985 for prices ranging from $28.00 to $33.50 per doll for quantities ranging
C from 336 to 7,002 dolls. purchase price was generally $24.00 or $25.00, although for one order of about 4,800 dolls the purchase price was $20.00. (SX 1, at 1-5).

221. C.K.O. International purchased CPK dolls from France during December 1984-March 1985 at $25.00 or $28.00 per doll. C.K.O.'s average selling price for sales of 28,000 CPK dolls was $30.36. (SX 2, at 1-3).

222. In February 1985, Dillards in Ft. Worth, TX was offered Spanish and German CPK dolls for $39.75 for quantities of 6,000 or for 1,500 per week. Coleco's prices during this period were $25.00 to $26.50 per CPK doll. (CX 51; SX 8).

223. The retailers, Osco Drug and Sav-On purchased a total of about gray market CPK dolls from four importers from late 1984 to May 1985 for prices ranging from $28.50 to $40.00. (CX 22, at 5-48, 51-56; See CX 47, at 30548). Subsequent to May 1985, purchase prices from these importers ranged from $21.00 to $30.00 for single CPK dolls. The price for CPK twins during October-November 1985 was $60.00. (CX 22, at 49-50, 57-76). Coleco's list price for the CPK twins was also $60.00. (SX 8).

224. Clark Drug purchased 700 CPK dolls for $31.00 from Dolls Are Us, on or before July 10, 1985. (CX 34, at 30553, 30240).

225. Washington Wholesalers ordered 19,508 CPK dolls from Matapa Agencies in South Africa for $25.42 during the period May-July 1985. (CX 30).

226. In July, 1985, Time Products International, Morton Grove, IL, purchased 168 CPK dolls with Spanish writing from Lubro Export & Import Co. for $26.50, the same price offered by Coleco. (CX 39, 30022; SX 8).

227. In July 1985, Avery H. Smith & Co., San Jose, CA, purchased 1,000 foreign CPK dolls from Mike Moffat and MO-3 Corp. for $22.00 per doll. (CX 21, at 30313).

228. In August, 1985, Guild Sales, Chicago, IL, purchased 521 Spanish and South African CPK dolls for $24.50 or $26.00 from Elliot & Associates Inc. In September-October 1985, Guild Sales purchased 276 Spanish and South African CPK dolls from Elliot for $21.00 to $26.00 per doll. The Coleco price during this period was $26.50. (CX 56; SX 8).

229. During the period August-October 1985, Calila, Inc. purchased a total of about 27,700 CPK dolls from Zabco in South Africa for $13.50 to $16.00 per doll, c.i.f. Los Angeles. However, these dolls were provided unpacked. (CX 24, at 1, 3-10, 16, 20; 41-42, 45).

230. Calila's sales price to wholesalers/retailers in late 1985 ranged from $17.92 to $25.25 for quantities ranging from 6 to 5,952 CPK dolls. Prices were most often $20.50. (CX 24, at 32, 46-78).

231. In September-October 1985, South African CPK dolls were offered for sale by Bill Weaver for $25.00 per doll compared to the Coleco price of $26.50 during a "One Day Only Sale" that took place from a Holiday Inn in Crawfordsville, Indiana. (CX 42; SX 8).

232. During June-October 1985, Spencer Gifts, Pleasantville, NJ, purchased 15,450 foreign CPK dolls from Constantine Salvage for prices ranging from $24.75 to $25.00 per doll, compared to the Coleco price of $26.50. (CX 72; SX 8).

233. During the week of September 25 to October 1, 1985, Metro Cash and Carry, Hillside, IL, offered CPK dolls for sale for $18.88 per doll. (CX 65, at 30049-50).

234. During September-December 1985, Venture Stores, St. Ann, MO, purchased approximately 16,000 to 25,000 CPK dolls from Eximin in France for $24.00 or $24.50 per doll. (CX 74).

235. In December 1985, an importer, Newport of Japan Radio Corp. sold 48 CPK dolls to respondent IPL for $25.00 per doll. IPL had apparently also purchased gray market CPK dolls prior to December 1985. Coleco's list price during this period was $26.50. (CX 25, 26; SX 8).

236. Based on the foregoing facts, I determine that the domestic industry in this case has been substantially injured by unauthorized imports of CPK dolls. (FF 204-35).

IX. TENDENCY TO INJURE

A. Factors Contributing to Gray Market Imports

237. To minimize gray market competition, Coleco has maintained the quality of its CPK dolls, and has increased the supply of CPK dolls so that there is less of a demand for gray market goods. (CPX 16, Reiner Dep. at 113-14).

238. To try to minimize gray market imports

(CPX 16, Reiner Dep., at 69-70; FF 76-78, 83 supra).

239. The fact that production exceeded demand in Europe contributed to the importation into the United States of gray market CPK dolls from Europe. (CPX 16, Reiner Dep. at 66-67; see FF 82 supra).

240. The high profit available for sale of CPK dolls contributed to the importation into the United States of gray market CPK dolls. (CPX 16, Reiner Dep., at 66).

241. In mid-1985, the decision was made to terminate as a manufacturer of CPK dolls. (CPX 16, Reiner Dep., at 79-80; SX 5, at 3; FF 78 supra).

242. According to Mr. Reiner of Coleco, its Far Eastern subcontractors producing CPK dolls would not have sold CPK dolls to unauthorized purchasers because they are OEM manufacturers, and do not have the wherewithal to sell the product at retail. In addition, Coleco has an inspection staff at the Far Eastern subcontractors. (CPX 16, Reiner Dep., at 91-92; FF 87-79 supra).

243. The fact that sold unpackaged CPK dolls to the European licensees at much lower prices than the wholesale price in the United States ($25.00 or $26.50) for a

packaged CPK doll, enabled the re-export of CPK dolls back into the United States from Europe at competitive prices, even when the additional costs of packaging, freight, duty, etc. were added. Coleco's cost for importing a 16" C CPK doll from its Far Eastern Suppliers was in 1985. (CPX 16, Reiner Dep., at 92-96; SX 8; See FF 172 supra).

C 244. were OAA's C licensees in respectively. These licensees are no longer licensed to distribute CPK dolls in Europe. Coleco is authorized to distribute CPK dolls in these territories in 1986. (SX 5, at 3; CPX 13, Tolhurst Dep., at 63-66, 69, 95; see FF 74, supra).

245. Gray market CPK dolls have been imported into the United States from England, France, and Germany. (CPX 13, Tolhurst Dep., at 63-66; see SX 6).

C 246. Coleco controlled the sale of CPK dolls from C (CPX 16, Reiner Dep., at 94).

C 247. Production of CPK dolls by former licensee C located in ceased at the end of 1984 or the beginning of 1985. C license expired on December 31, 1985, and its right to dispose of any remaining inventory expired on March 21, 1986. (CPX 16, Reiner Dep., at 97-99; Kahn, Tr. at 130-31; SX 5, at 3; FF 79-80 supra).

248. According to Mr. Reiner of Coleco, he was not aware of gray C market imports of CPK dolls exported by In

C July 1985, had expressed concern about not having enough of the new CPK dolls (with eyeglasses, etc.), and had purchased CPK dolls from Coleco. (CPX 16, Reiner Dep., at 107).

249. OAA has no control over the volume of CPK dolls produced by its foreign manufacturing licensees. (CPX 13, Tolhurst Dep., at 62; FF 82 supra).

B. Foreign Prices

250. Quantities sold and prices charged for CPK dolls by the licensee

C in as reported in its royalty statements to SNC, were as follows for various royalty reporting periods:

Period	Quantity	Price
C Jan.-Mar. 1985		
C April-June 1985		
C July-Sept. 1985		

(CX 88, at 15, 49, 57).

251. Quantities sold and prices charged for CPK dolls by the licensee

C as reported in its royalty statements to SNC, were as follows for various royalty reporting periods:

Period	Quantity	Price
C Jan.-Mar. 1985		
C July-Sept. 1985		

(CX 88, at 17, 22).

252. Quantities sold and prices charged for CPK dolls by the licensee

C as reported in its royalty statements to SNC, were as follows for various royalty reporting periods:

Period	Quantity	Price
Jan.-Mar. 1985		1/
April-June 1985		2/
July-Sept. 1985		3/

C 1/ Based on a unit price converted to dollars with an exchange rate of

C 2/ Based on a unit price of converted to dollars with an exchange rate of

C 3/ Based on a unit price of converted to dollars with an exchange rate of

(CX 88, at 44, 52, 61).

C 253. Based on the exchange rate of per U.S. dollar that existed in late April 1985, the selling price in dollars would have been (See FF 158; See SB App. A).

254. Quantities sold and prices charged for CPK dolls by the licensee in as reported in its royalty statements to SNC, were as follows for various royalty reporting periods:

Period	Quantity	Price
Jan.-Mar. 1985		1/
April-June 1985		2/
July-Sept. 1985		3/

C 1/ Based on a unit price of converted to dollars with an exchange rate of

C 2/ Based on a unit price of converted to dollars with an exchange rate of

C 3/ Based on a unit price of converted to dollars with an exchange rate of

(CX 88, at 45, 51, 60).

255. Quantities sold and prices charged for CPK dolls by as reported in its royalty statements to SNC, were as follows for various royalty reporting periods for assorted CPK dolls:

Period	Quantity	Price
August 1985		
Sept. 1985		
Oct. 1985		
Nov. 1985		

(CX 88, at 91-92, 96-97, 101-02, 106-07).

256. Quantities sold and prices charged for CPK dolls by the licensee as reported in its royalty statements to SNC, were as follows for various royalty reporting periods:

Period	Quantity	Price
Jan.-Mar. 1985		
April-June 1985		
July-Sept. 1985		

(CX 88, at 234, 258, 289; see FF 97 supra).

257. Quantities sold and prices charged for CPK dolls by the licensee as reported in its royalty statements to SNC, were as follows for various royalty reporting periods:

Period	Quantity	Price
Jan.-Mar. 1985		
April-June 1985		
July-Sept. 1985		

(CX 88, at 235, 256, 288).

258. Quantities sold and prices charged for CPK dolls by the licensee as reported in its royalty statements to SNC, were as follows for various royalty reporting periods:

	Period	Quantity	Price
C	Jan.-Mar. 1985		
C	April-June 1985		
C	July-Sept. 1985		

(CX 88, at 236, 257, 290).

259. At the time of the hearing in this matter, OAA had terminated the C licenses of of its foreign manufacturing licensees, C Therefore, the only existing manufacturers of Coleco C CPK dolls are and Coleco's Far East C vendors. In addition, has ceased to be a distributor, and Coleco has taken over distribution and sale of CPK products in England, France, and Germany. (FF 75, 78, 80, 84 supra).

260. Based on the foregoing facts, I determine that there exists a tendency to substantially injure the domestic industry by reason of unauthorized imports of CPK dolls. (FF 237-59).

OPINION

I. INTRODUCTION

This investigation presents the Commission with the subject of the "gray market" in the now durable marketing phenomenon, "Cabbage Patch Kids" dolls. The complainants, Original Appalachian Artworks (OAA) and Coleco Industries, Inc. (Coleco), owner and licensee, respectively, of several copyrights which cover Cabbage Patch Kids (CPK) dolls, together with related birth certificates, adoption papers, and packaging (FF 16-21), seek to prevent the continued unauthorized importation into the United States of CPK dolls which are legitimately manufactured abroad under license to OAA, and intended for distribution and sale only in specific licensed territories outside of the United States. It is complainants' contention that such unauthorized importation constitutes infringement of the five registered copyrights at issue.

This proceeding represents only one prong of a major offensive by complainants to thwart the activities of CPK doll gray marketeers. Thus, the named respondents, all domestic companies, account for a relatively small proportion of the volume of gray market imports which complainants have shown to have entered the United States without authorization. In addition to curbing the volume of production of certain overseas manufacturing licensees (FF 84), OAA has commenced or threatened numerous legal actions in courts around the country against other gray market importers. (See CX 23, 29-32, 36, 39-41, 44-45, 56-57, 65, 68-69, 74, 77-79; SX 3; ALJX 2).

Several respondents named in this investigation have entered into settlement agreements with complainants, and have been terminated as parties by the Commission. (FF 11, 12, 14, 15). The remaining three respondents did not participate in discovery or appear at the hearing in this matter, and have been found to be in default. (FF 9, 10, 13). (See Procedural History, supra at 4). In view of this lack of participation by respondents, complainants have presented their evidence, and moved pursuant to Rule 210.50 for summary determination in their favor as to all issues in this investigation, on the basis that there are no genuine issues of material fact, and that they are entitled to a summary determination that there is a violation of Section 337 as a matter of law. (Motion Docket No. 231-12). The Commission investigative attorney substantially supports complainants' position, and agrees that a violation of Section 337 should be found.

In addition to the complaint and the documents, depositions and evidence supporting complainants' motion for summary determination, the record under consideration consists of exhibits submitted by the Commission investigative staff together with their response to Motion 231-12, exhibits and testimony requested by the Administrative Law Judge by Order No. 16, and presented at the hearing and oral argument held on April 14-15, 1986, and the post hearing briefs and additional evidence submitted following the hearing.

To the extent, and for the reasons more fully set forth hereinafter, Motion 231-12 is granted, with the determination that there is a violation of Section 337 in the unauthorized importation into the United States, or in the sale of certain soft sculpture dolls, popularly known as "Cabbage Patch Kids," together with their related literature and packaging.

II. JURISDICTION

Section 337 confers subject matter jurisdiction on the International Trade Commission to investigate, and if appropriate, to remedy, unfair methods of competition and unfair acts which occur in the importation of articles into the United States, or in their sale by the owner, importer, consignee or agent of either, and which have the effect or tendency to destroy or substantially injure an efficiently and economically operated domestic industry. 19 U.S.C. § 1337(a). To have the power to decide a case, a court or agency must have both subject matter jurisdiction, and jurisdiction over either the parties or the property involved. Certain Steel Rod Treating Apparatus and Components Thereof, Inv. No. 337-TA-97, Commission Memorandum Opinion, 215 U.S.P.Q. 229, 231 (1981).

The power of the Commission to issue a remedy in a Section 337 investigation is based on its in rem jurisdiction over the property involved. This remedy operates against property, rather than against parties, and thus may be invoked irrespective of whether the Commission has personal jurisdiction over a named party. Sealed Air Corp. v. U.S. International Trade Commission, 209 U.S.P.Q. 469 (C.C.P.A. 1981); see also In re Orion, 21 U.S.P.Q. 563, 571 (C.C.P.A. 1934). Since the complaint alleges unfair acts and unfair methods of competition in the unauthorized importation of CPK dolls and related literature and packaging into the United States, or in their sale, the effect or tendency of which is alleged to substantially injure an efficiently and economically operated domestic industry, I find that the Commission has in rem jurisdiction over the accused imported CPK articles, as well as jurisdiction over the subject matter of this investigation.

In this matter, the Commission Secretary served the complaint and notice of investigation on all respondents. The record is clear that all respondents received such service, and thus have actual notice of the pendency of this investigation. (FF 1). Furthermore, all respondents are domestic companies doing business in the United States. (FF 9-15). Therefore, I find that the Commission also has personal jurisdiction over each of the respondents named in the notice of investigation, as amended.

III. UNFAIR ACTS

A. Copyright Infringement

The principal unfair methods of competition or unfair acts in which respondents and others are alleged to have engaged consist of infringement of complainant OAA's five copyrights in the CPK doll itself, as well as in the birth certificates, adoption papers and packaging distributed by complainant Coleco. Copyright infringement is an unfair act or method of competition under Section 337. Certain Products With Gremlin Character Depictions, Inv. No. 337-TA-201 (1986); Certain Cloisonne Jewelry, Inv. No. 337-TA-195 (1985); Certain Personal Computers and Components Thereof, Inv. No. 337-TA-140, 224 U.S.P.Q. 270 (1984)(Personal Computers); Certain Coin-Operated Audiovisual Games and Components Thereof (Viz., Rally-X and Pac Man), Inv. No. 337-TA-105, 218 U.S.P.Q. 924 (1982)(Games II); Certain Coin-Operated Audiovisual Games and Components Thereof, Inv. No. 337-TA-87, 214 U.S.P.Q. 217 (1981)(Games I).

Section 106 of the Copyright Act (17 U.S.C. § 106) sets forth the exclusive rights protected by a copyright:

> Subject to sections 107 through 118, the owner of copyright under this title has the exclusive rights to do and to authorize any of the following:
>
> (1) to reproduce the copyrighted work in copies . . .;
>
> (2) to prepare derivative works based upon the copyrighted work;
>
> (3) to distribute copies . . . of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending; . . . .

An action for infringement of copyright falls under § 501:

> (a) Anyone who violates any of the exclusive rights of the copyright owner as provided by sections 106 through 118, or who imports copies . . . into the United States in violation of section 602, is an infringer of the copyright.

To support a claim of copyright infringement, complainants must demonstrate ownership of the copyrights and copying by respondents. Games I, 214 U.S.P.Q. at 223, and cases cited therein.

1. Copyright Ownership

A prima facie case of copyright ownership is established by proof of (1) originality in the author, (2) copyrightability of the subject matter, (3) citizenship status of the author such as to permit a claim of copyright, (4) compliance with applicable statutory formalities, and (5) if complainant is not the author, a transfer of rights or other relationship between the author and complainant so as to constitute complainant the valid copyright claimant. Id. at 223-24; Games II, 218 U.S.P.Q. at 928; 3 Nimmer on

Copyright § 13.01[A] (1985). The copyright registration certificate will establish most of these elements. A certificate of registration made within five years after first publication of the work constitutes prima facie evidence of the validity of the copyright and of the facts stated in the certificate. 17 U.S.C. § 410(c). The issuance of a certificate of registration is an indication that the material deposited with the Copyright Office has been examined, that the Register of Copyrights has determined that it constitutes copyrightable subject matter, and that the other legal and formal requirements of the the statute have been met. 17 U.S.C. § 410(a).

In the present case, complainants have submitted copyright registrations for the CPK doll, birth certificate, official adoption papers and packaging. (FF 22). There are two copyright registrations for the CPK doll: the 804 copyright covers the original soft sculpture doll created by Xavier Roberts; the 801 copyright is a derivative work which covers Coleco's version of the CPK doll. (FF 23-24, 33, 371. With respect to all of the subject copyrights, registration was made within one year, or within a year and a half, in the case of the packaging, of the date of first publication. (FF 23, 25, 33-34, 47-48, 53, 57). The originality and validity of the 804 copyright for the original CPK doll has been confirmed in Federal District Court and affirmed by the Eleventh Circuit in Original Appalachian Artworks, Inc. v. The Toy Loft, 489 F. Supp. 174 (N.D. Ga. 1980), aff'd 684 F.2d 821 (11th Cir. 1982). (FF 31).

The first copyright for "The Little People," the 804 copyright, was registered in the name of Xavier Roberts, and subsequently assigned to OAA. The assignment agreement for this copyright has been recorded in the Copyright

Office. (FF 23-32). The copyright covering the version of the CPK doll manufactured by Coleco, the 801 copyright, is registered in the name of OAA. (FF 33-38). The copyrights covering the birth certificate and official adoption papers made by Coleco are works made for hire, registered in the name of OAA, and are derivative works from the original OAA papers. (FF 47-56). The copyright in Coleco's packaging for its CPK dolls is also registered to OAA. (FF 57-58). All of the copyright registrations indicate that the author is a national of the United States, and the registrations for the birth certificate, adoption papers and packaging also indicate that manufacture of the work occurs in the United States. (FF 59, 99). See 17 U.S.C. § 104(b).

The contents of the copyright registrations for each of the copyrights at issue stand unchallenged on this record, and raise the presumption that the subject matter of each is copyrightable, and that the legal and formal requirements of the statute have been met. 17 U.S.C. § 410(a). In addition, each of the copyrighted items is marked with an appropriate copyright notice affixed in such manner and location as to give reasonable notice of the copyright claim. (FF 39-40, 51, 56, 58). 17 U.S.C § 401.

2. Transfer of Rights

Although copyright ownership initially vests in the author of a work, such ownership can be transferred in whole or in part:

> Any of the exclusive rights comprised in a copyright, including any subdivision of any of the the rights specified by section 106, may be transferred . . . and owned separately. The owner of any particular exclusive right is entitled, to the extent of that right, to all of the protection and remedies accorded to the copyright owner by this title.

17 U.S.C. § 201(d). The statute further defines a "transfer of copyright ownership" in § 101 as

> an assignment, mortgage, exclusive license, or any other conveyance, alienation, or hypothecation of a copyright or of any of the exclusive rights comprised in a copyright, whether or not it is limited in time or place of effect, but not including a nonexclusive license.

Complainant OAA is identified as the owner or the owner by assignment of each of the copyright registrations at issue. (FF 22, 32). OAA, through its licensing agent, Schlaifer Nance & Co. (SNC) has granted Coleco to manufacture, distribute and sell CPK dolls embodying the subject copyrights. (FF 60-64).

but Coleco remains the exclusive licensee for the United States. (FF 65-70, 86). Thus, Coleco is entitled to the protections and remedies accorded under the Copyright Act to the extent of the rights granted by its exclusive license with OAA. See Wales Industrial Inc. v. Hasbro Bradley, Inc., 226 U.S.P.Q. 584, 586 (S.D.N.Y. 1985). OAA is the owner of the remaining rights under the copyrights not transferred to Coleco.

3. Infringement by Unauthorized Importation -- 17 U.S.C. § 602(a)

The accused CPK dolls and related products which complainants seek to exclude by this investigation are dolls which are manufactured abroad under license to OAA, through its licensing agent SNC, and subsequently imported into the United States by third parties without complainants' authorization. During 1984, OAA had licensed four companies overseas to manufacture CPK dolls

C in accordance with Coleco's specifications:

(FF 69-71).

In addition to these manufacturing licensees, OAA has licensed a number of companies overseas to distribute and sell the Coleco version of CPK dolls. (FF 70). These distributing licensees generally obtain their supplies of CPK

C dolls from

C (FF 76, 87). In all cases, the distributors and manufacturers are restricted by the terms of their license agreements to distributing and selling CPK dolls only within a designated geographic territory. (FF 73). Each foreign licensee pays royalties to SNC on its net sales, and these

C royalties are (FF 72). Thus, the CPK dolls imported into the United States by third parties are not counterfeit dolls, but are dolls which have been legitimately manufactured overseas by OAA's licensees.

The activity from the foregoing scenario which complainants contend is unfair and infringes their copyrights is the importation of these CPK dolls into the United States by third parties, including respondents, without complainants' authorization. Unlike other actions for copyright infringement, the issue of substantial similarity and access by respondents and other importers is easily resolved: the products imported by respondents and others are copies which have been approved by OAA and Coleco for manufacture and distribution overseas, in many cases were actually manufactured for Coleco, and in all cases bear OAA's copyright notice. (FF 39-41, 64-67, 69-71, 76, 87-88). See, e.g., Games II, 218 U.S.P.Q. at 932, and cases cited therein.

Thus, the focus of infringement is not on the act of copying, but rather on the act of unauthorized importation.

Complainants contend that the unauthorized importation of CPK dolls, together with their related literature and packaging, constitutes infringement under § 602(a) of the Copyright Act of all five of the registered copyrights at issue. The Commission investigative staff agrees that such unauthorized importation infringes the 801 copyright for Coleco's version of the CPK doll, but contends that the remaining copyrights are not infringed because the products imported are derivative works of these copyrights, rather than "copies" within the meaning of § 602. (Response to Motion 231-12, at 23-25). However, the investigative staff argues that, in view of infringement of the 801 copyright, it is unnecessary to reach infringement of the remaining copyrights. (Id. at 24-25). Complainants do not agree with the staff's position on this point. (CB at 8-14).

Section 602 of the Copyright Act provides in pertinent part that:

> (a) Importation into the United States, without the authority of the owner of copyright under this title, of copies or phonorecords of a work that have been acquired outside the United States is an infringement of the exclusive right to distribute copies . . . under section 106, actionable under section 501.

This provision of the 1976 statute does not have a counterpart in the earlier copyright act. The legislative history of § 602 describes its application as follows:

> Section 602 . . . deals with two separate situations: importation of "piratical" article[s] (that is, copies or phonorecords made without any authorization of the copyright owner), and unauthorized importation of copies or phonorecords that [were] lawfully made. The general approach of section 602 is to make unauthorized importation

> an act of infringement in both cases, but to permit the United States Customs Service to prohibit importation only of "piratical" articles [under § 602(b)].
>
> . . .
>
> The second situation covered by section 602 is that where the copies or phonorecords were lawfully made but their distribution in the United States would infringe the U.S. copyright owner's exclusive rights. As already said, the mere act of importation in this situation would constitute an act of infringement and could be enjoined.

Copyright Law Revision, H. Rep. No. 94-1476, 94th Cong., 2d Sess. 169-70 (1976). This description of § 602(a) paraphrases an earlier report of the Register of Copyrights to the House Judiciary Committee, Supplementary Report of the Register of Copyrights on the General Revision of the U.S. Copyright Law, Comm. Print, 89th Cong., 1st Sess. 148-50 (1965) (Supplementary Report). The Supplementary Report offered an example in which § 602(a) would apply "where the copyright owner had authorized the making of copies in a foreign country for distribution only in that country." Id. at 150.

It is noteworthy that the position of the Register of Copyrights on the issue of unauthorized importation as stated in the Supplementary Report represents a significant change of position from its analysis in the first report issued in 1961. In that earlier report, the Register made the following observation:

> When arrangements are made for both a U.S. edition and a foreign edition of the same work, the publishers frequently agree to divide the international markets. The foreign publisher agrees not to sell his edition in the United States, and the U.S. publisher agrees not to sell his edition in certain foreign countries. It has been suggested that the import ban on piratical copies should be extended to bar the importation of the foreign edition in contravention of such an agreement.
>
> . . .
>
> We assume, without considering the antitrust questions involved, that agreements to divide international markets for copyrighted works are valid and enforceable contracts as between the parties. But we do not believe that the

> prohibition against imports of piratical copies should be extended to authorized copies covered by an agreement of this sort. To do so would impose a territorial restriction in a private contract upon third parties with no knowledge of the agreement. And even as between the parties, Customs does not seem to be an appropriate agency for the enforcement of private contracts.

Report of the Register of Copyrights on the General Revision of the U.S. Copyright Law, Comm. Print, 87th Cong., 1st Sess. 125-26 (1961) (1961 Report). Although the Copyright Office did not agree with the proposed application of the current § 602(a) in the 1961 Report, it clearly understood the intent of Congress to be to impose a ban on unauthorized importation.

The concern of the Register of Copyrights stated in the 1961 Report is analogous to the issue of the applicability of the so-called "first sale doctrine" of § 109(a) to § 602(a). Section 109(a) places a limitation on a copyright owner's exclusive right of distribution in the following terms:

> (a) Notwithstanding the provisions of section 106(3), the owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord.

The underlying rationale of § 109(a) is that "where the copyright owner has transferred ownership of a particular copy or phonorecord of a work, the person to whom the copy or phonorecord is transferred is entitled to dispose of it by sale, rental, or any other means." H. Rep. No. 94-1476, supra, at 79. This doctrine is designed to strike the delicate balance between protecting the rights of a copyright holder, and preventing such an extension of those rights as to result in a restraint of trade. Thus, "the ultimate

question under the 'first sale' doctrine is whether or not there has been such a disposition of the copyrighted article that it may be fairly said that the copyright proprietor has received its reward for its use." Burke & Van Heusen, Inc. v. Arrow Drug, Inc., 143 U.S.P.Q. 17, 19 (E.D. Pa. 1964).

Although § 602(a) refers to a copyright owner's exclusive right of distribution under § 106(3), the legislative history of the Copyright Act nowhere explicitly addresses whether the limitation of § 109(a) on § 106(3) was intended also to apply to § 602(a). The limited judicial precedent on this issue holds that, in a factual context comparable to that of this investigation, § 109(a) does not preclude a finding of infringement under § 602(a). See Columbia Broadcasting System, Inc. v. Scorpio Music Distributors, Inc., 222 U.S.P.Q. 975 (E.D. Pa. 1983), aff'd without opinion, 738 F.2d 424 (3d Cir. 1984) (Scorpio Music); see also Nintendo of America, Inc. v. Elcon Industries, Inc., 564 F. Supp. 937 (E.D. Mich. 1982) (Nintendo).

Complainants and staff both agree that the factual scenario presented in Scorpio Music is comparable to the facts of this case, and the result obtained in that matter should equally apply here. Although I conclude that the outcome of Scorpio Music is correct and should likewise be reached in this investigation, the rationale applied by the court in Scorpio Music has been the subject of criticism and is not persuasive when viewed in the circumstances of the present case. See, e.g., Cosmair, Inc. v. Dynamite Enterprises, Inc., 226 U.S.P.Q. 344, 347 (S.D. Fla. 1985) (Cosmair).

In reaching its determination that § 109(a) has no application to § 602(a), the court in Scorpio Music interpreted the phrase in § 109(a) "copy . . . lawfully made under this title" to mean copies manufactured and sold

within the United States. The court went on to conclude that "[t]he protection afforded by the United States Code does not extend beyond the borders of this country unless the Code expressly states." 222 U.S.P.Q. at 977.

This interpretation of § 109(a) does not take into account the legislative history of either § 109 or of § 602. The House report on the copyright law revision states that:

> To come within the scope of section 109(a), a copy or phonorecord must have been "lawfully made under this title," though not necessarily with the copyright owner's authorization. For example, any resale of an illegally "pirated" phonorecord would be an infringement, but the disposition of a phonorecord legally made under the compulsory licensing provisions of section 115 would not. (Emphasis added).

H. Rep. 94-1476, supra, at 79. Clearly the purpose of the phrase "lawfully made under this title" was to indicate that such copies can be lawful even if made without the authorization of the copyright holder, rather than to place any geographic requirement on the location of manufacture and sale.

Similarly, the legislative history of § 602(a) describes a situation in which the copies acquired outside the United States "were lawfully made but their distribution in the United States would infringe the U.S. copyright owner's exclusive rights." Id. at 170. In § 602, a distinction is made between pirated copies--copies made outside the United States without the authorization of the copyright owner, whose making "would have constituted an infringement of copyright if this title had been applicable," (§ 602(b))--and authorized copies made outside the United States and intended to be

distributed outside the United States (§ 602(a)). Thus, the focus of § 602 is on the authorization of the copyright owner and has the effect of characterizing a copy made outside the United States as being lawful or unlawful in accordance with the standards of the U.S. Copyright Act.

Accordingly, I conclude that Scorpio Music's interpretation of § 109(a) is inconsistent with comparable terminology in § 602 and interprets the application of the Copyright Act in a manner that does not appear to have been contemplated by Congress. The suggestion contained in Scorpio Music that the application of § 109 to § 602 would in all cases obliterate the underlying purpose of § 602 and do violence to the intent of Congress goes well beyond the facts of that case. Thus, in Cosmair, the court was of the opinion that with its different facts, it would be proper for § 109 to take priority over § 602. 226 U.S.P.Q. at 347.

In Cosmair, the copyrighted product was manufactured in the United States for export and sale outside of the United States. After export, the product was then re-exported back to the United States by third parties without the authorization of the copyright holder. For purposes of determining the applicability of § 109, the court was concerned with the location of passage of title on the first sale of the product. Id. at 346-47. Although the court did not have sufficient facts on the motion for preliminary injunction before it to reach a conclusion as to the location of passage of title, its conclusion as to the applicability of § 109 appears to be based on the fact that the first sale occurred in the United States before the act of importation, thus the court did not believe that § 602 would control.

My determination that § 109(a) does not limit the application of § 602 in this case is based on the particular facts of this investigation. All of the CPK dolls at issue are manufactured outside the United States with the authority of the copyright owner, and thus are copies "lawfully made." OAA, as the copyright owner, exercises its exclusive rights to reproduce, make derivative works, and distribute copies of CPK dolls by licensing others to engage in these activities in specific geographic locations. (FF 60, 64, 65, 69, 70, 73). OAA itself does not manufacture or distribute CPK dolls, related literature, or packaging which falls under the 801, 777 or 778 copyrights. (FF 46). The reward to OAA for its copyrights is the receipt of royalties from its licensees, and OAA receives royalties regardless of where in the world the product is first sold. (FF 64, 72). The only difference between the CPK dolls sold by Coleco in the United States and those sold by respondents and other third parties is that the dolls sold by Coleco are imported with Coleco's and OAA's authorization.

Coleco, by contrast, has been granted the exclusive right to distribute CPK dolls in the United States. It pays royalties to OAA in exchange for that right, and expects to receive profits on the sale of CPK dolls in the United States in the exercise of its exclusive rights. (FF 60-68, 86). Although OAA may not be harmed directly when third parties purchase CPK dolls overseas and import them into the United States, such unauthorized importation invades the exclusive distribution right granted to Coleco and prevents Coleco from exercising the full scope of exclusive copyright rights granted to it by OAA. Section 602 is designed to protect the exclusive right of distribution in this situation.

My determination of infringement in the facts of this case is based on the nature of the rights to be protected by the Copyright Act, and on the focus of § 602 on the authorization of the owner of the right to be protected, rather than on the location of manufacture or of passage of title on the first sale. Notwithstanding the potential uncertainty concerning the interpretation of § 602 as illustrated in Scorpio Music and Cosmair, my finding is based on an evaluation of the apparent intent of Congress with respect to the application of § 602, as set forth in the legislative history. This conclusion appears to be in accord with the interpretation of Congressional intent by the Copyright Office as stated in its 1961 Report and its Supplemental Report, supra and is further bolstered by the provisions of § 602(a) which set forth the limited circumstances in which § 602 does not apply:

> . . . This subsection does not apply to--
> (1) importation of copies or phonorecords under the authority or for the use of the Government of the United States or of any State or political subdivision of a State, but not including copies or phonorecords for use in schools, or copies of any audiovisual work imported for purposes other than archival use;
>
> (2) importation, for the private use of the importer and not for distribution, by any person with respect to no more than one copy or phonorecord of any one work at any one time, or by any person arriving from outside the United States with respect to copies or phonorecords forming part of such person's personal baggage; or
>
> (3) importation by or for an organization operated for scholarly, educational, or religious purposes and not for private gain, with respect to no more than one copy of an audiovisual work solely for its archival purposes, and no more than five copies or phonorecords of any other work or its library lending or archival purposes, unless the importation of such copies or phonorecords is part of an activity consisting of systematic reproduction or distribution, engaged in by such organization in violation of the provisions of section 108(g)(2).

Clearly, these limitations contained in § 602(a) should supersede any application of § 109(a) in a gray market situation such as the present case. In addition, § 501, prohibiting infringement of copyrights, makes specific reference to violation of § 602, in addition to violation of the exclusive rights provided in §§ 106-118. See Opinion, supra, at 76.

For the foregoing reasons, I find that the importation of CPK dolls into the United States by respondents and other third parties without the authorization of complainants violates Coleco's exclusive right of distribution in the United States, and therefore infringes the subject copyrights under 17 U.S.C. § 602(a). (FF 98).

4. Infringement of the 804 Copyright

The Commission investigative staff asserts that it is not clear whether the unauthorized importation of the subject CPK dolls infringes the 804 copyright for the original CPK doll because the imported dolls are derivative works covered by the 801 copyright. Naturally, complainants contend that both copyrights are infringed by the unauthorized importation.

The 801 copyright, by its terms, is a derivative work of the 804 copyright. (FF 37). The scope of protection of a derivative work is set forth in § 103 of the Copyright Act:

> (a) The subject matter of copyright as specified by section 102 includes compilations and derivative works . . .

> (b) The copyright in a . . . derivative work extends only to the material contributed by the author of such work, as distinguished from the preexisting material employed in the work, and does not imply any exclusive right in the preexisting material. The copyright in such work is independent of, and does not affect or enlarge the scope, duration, ownership, or subsistence of, any copyright protection in the preexisting material.

Therefore, a work based in whole or substantial part on a preexisting work is separately copyrightable, if it satisfies the requirements of originality and is not itself an infringing work. 1 Nimmer, supra, § 3.01. The copyright in a derivative work protects only against copying the original contribution contained in the derivative work, and affords no protection to the preexisting material on which the derivative work is based. Id. at § 3.04.

The original work added to obtain the 801 copyright, which is the extent of protection afforded by that copyright, is stated to be "[f]orming the face out of plastic and the proportion, form, contour, configuration and conformation of the work in view of the original effort required in reducing the work with great exactness into a smaller scale." (FF 37). The 801 copyright further describes the preexisting material on which it is based, which is the work covered by the 804 copyright: "Soft sculpture, infant-size dolls manufactured and sold by the author under the trademarks "THE LITTLE PEOPLE" and the "CABBAGE PATCH KIDS." (CX 5, items 5, 6; FF 23-28, 37).

Thus, the CPK dolls manufactured by Coleco, as well as the dolls imported without authorization, embody both the 801 and the 804 copyrights. (FF 42). Consequently, the CPK dolls imported without complainants' authorization infringe both the 801 and the 804 copyrights under § 602(a).

5. Infringement of the Copyrights in the Literature and Packaging

The Commission investigative attorney likewise takes the position that the unauthorized importation of the foreign birth certificates, adoption papers and packaging do not infringe complainants' copyrights under § 602 because they are derivative works rather than copies. It is the staff's position that § 602 is directed to protecting a copyright owner's right to distribute copies, and not the owner's right to prepare derivative works. (Response to Motion 231-12 at 23-24). The investigative staff points out that the accused imported literature and packaging are either in foreign languages or bilingual, and therefore are translations or adaptations of the copyrighted works. (See FF 90, 92-97).

The copyrights for the literature and packaging accompanying Coleco's CPK dolls state that the material copyrighted consists of the "compilation, selection and arrangement of text and artwork." (CX 9-11, items 2, 6). The copyrights for the birth certificate and adoption papers are themselves derivative of OAA's papers which accompany the original CPK doll. (FF 47-56).

Under § 106(2) of the Copyright Act, the copyright owner has the exclusive right to prepare or to authorize the preparation of a derivative work based upon the copyrighted work. A derivative work is defined as "a work based upon one or more preexisting works, such as a translation, . . . or any other form in which a work may be recast, transformed, or adapted." 17 U.S.C. § 101. A work will be considered derivative only if it would be considered infringing if the preexisting material on which it is derived had been taken without the

consent of the copyright owner of the preexisting work. It is saved from being infringing only because the copied material was taken with the consent of the copyright owner of the underlying work, or because the preexisting work is in the public domain. 1 Nimmer, supra, § 3.01.

The foreign birth certificates, adoption papers and packaging are produced under the terms of the license agreements with OAA, and OAA has authorized the preparation of translations and adaptations by its licensees. (FF 85). As with the distribution of CPK dolls, these licensees would be limited to distributing the adapted foreign language or bilingual literature and packaging only in their licensed territories. (FF 71, 73).

For purposes of this investigation, the offending activity is not the preparation of the derivative works, which has been authorized by OAA, but the unauthorized importation of copies of those derivative works. The foreign language literature and packaging are so substantially similar in compilation, content and appearance to the works subject to the 777, 778 and 526 copyrights that they would constitute an infringement of those copyrights were they not authorized as derivative works. Nevertheless, the importation of copies of these derivative works is not authorized by complainants. Therefore, I find that the importation of CPK literature and packaging by respondents and other third parties without complainants' authorization constitutes infringement of each of the 777, 778 and 526 copyrights under 17 U.S.C. § 602(a). (FF 98).

B. Violation of 17 U.S.C. § 601(a), The Manufacturing Clause

Complainants have alleged that the unauthorized importation into the United States of English language birth certificates and adoption papers which

accompany the imported CPK dolls also violates 17 U.S.C. § 601(a), the so-called American Manufacturing Clause. It is further asserted that this infraction constitutes a separate unfair act under Section 337. (Complaint, ¶ 44). Thus, this alleged unfair method of competition is included in the Notice of Investigation.

In support of their motion for summary determination, complainants have submitted samples of English language and bilingual birth certificates and adoption papers which are claimed to have been sent in to complainants or their fulfillment houses by purchasers of CPK dolls imported without complainants' authorization. (CX 14). Complainants assert that these English language papers were printed outside the United States, that they are not the copyrighted papers distributed by Coleco, and that therefore they violate the provisions of the Manufacturing Clause.

The Manufacturing Clause is a complex and highly controversial provision of the Copyright Act which provides, in pertinent part, as follows:

> (a) Prior to July 1, 1986, . . . the importation into or public distribution in the United States of copies of a work consisting preponderantly of nondramtic [sic] literary material that is in the English language and is protected under this title is prohibited unless the portions consisting of such material have been manufactured in the United States or Canada.
> . . .
> (d) Importation or public distribution of copies in violation of this section does not invalidate protection for a work under this title. However, in any civil action . . . for infringement of the exclusive rights to reproduce and distribute copies of the work, the infringer has a complete defense with respect to all of the nondramatic literary material comprised in the work . . . .

The purpose of the Manufacturing Clause was originally to protect the U.S. printing industry by requiring English language books and periodicals to be printed in the United States as a requirement of copyright protection. This clause has undergone considerable amendment and liberalization since its enactment in 1909. Nevertheless, in its present form in § 601 of the Copyright Act, it still conditions the copyright protection of a U.S. owner of the copyright in a nondramatic literary work. See generally, Second Supplementary Report of the Register of Copyrights on the General Revision of the U.S. Copyright Law: 1975 Revision Bill, Ch. XIV (1975); 2 Nimmer supra § 7.22.

Most significantly, for purposes of the present investigation, the Manufacturing Clause is not designed to give a copyright owner an additional basis for claiming copyright infringement, but rather is intended to require the copyright owner to manufacture his nondramatic literary work in the United States. In the event that he fails to do so, one who is alleged to infringe the copyright owner's exclusive rights to reproduce and distribute may have a complete defense against the alleged infringement. 17 U.S.C. § 601(d); 2 Nimmer, supra § 7.22[C][3].

The House Judiciary Committee had the following observation about the Manufacturing Clause:

> [T]he Committee concludes that there is no justification on principle for a manufacturing requirement in the copyright statute, and although there may have been some economic justification for it at one time, that justification no longer exists. While it is true that section 601 represents a substantial liberalization and that it would remove many of the inequities of the present manufacturing

> requirement, the real issue of whether retention of a provision of this sort in a copyright law can continue to be justified [sic]. The Committee believes it cannot.

H. Rep. No. 94-1476, supra, at 166. The Judiciary Committee further indicated that the Manufacturing Clause does not extend to foreign language, bilingual, or multilingual works. Id. The Manufacturing Clause was to expire in 1982 under the original § 601, and was subsequently amended by Congress, over Presidential veto, to expire on July 1, 1986. Pub. L. No. 97-215 (1982). See also Study of the Economic Effects of Terminating the Manufacturing Clause of the Copyright Law, U.S.I.T.C. Pub. No. 1402, at xi-xvii (1983).

In view of the foregoing, I must conclude that the Manufacturing Clause is inapplicable to this investigation. The registrations of OAA's copyrights for its birth certificate and adoption papers indicate that complainants manufacture these works in the United States. (FF 99). The samples of birth certificates and adoption papers alleged by complainants to violate § 601, with one exception, are in both English and Chinese or English and Afrikaans. (FF 100). The paperwork accompanying the CPK dolls submitted as exhibits by complainants is also bilingual. (FF 92, 94, 95, 97). The one sample submitted by complainants in support of this claim that is entirely in English bears a copyright notice of OAA and a hand written notation that it is from the United Kingdom. (FF 100). Even if this one example constituted probative evidence of manufacture in English outside of the United States, it does not fall within the purview of § 601. Rather, the Manufacturing Clause is directed to conditioning the scope of complainants' copyright protection and is not directed to the activities of an alleged infringer. Thus, complainants' right of action in this case arises only under § 602.

In apparently the only judicial decision to consider § 601, the court was concerned with the definition of "preponderantly" when the work at issue contained both English language nondramatic literary material and other material not subject to § 601. Stonehill Communications, Inc. v. Martuge, 212 U.S.P.Q. 500 (S.D.N.Y. 1981). In Stonehill, the court applied a mechanical test in reaching its result and determined that:

> a book 'consists of preponderantly nondram[a]tic literary material . . . in the English language' when more than half of its surface area, exclusive of margins, consists of English language text.

Id. at 502. This case, however, involved a United States author of a book published in Italy. The dispute arose over a Customs Service determination that the book violated § 601, and was thus ineligible for copyright protection. Notably, this case was not an action for copyright infringement.

The CPK birth certificates and adoption papers in this investigation consist of text, graphic illustrations, blank lines to be filled in by the purchaser of the CPK doll, and blank space. (See CX 7, 8, 14). Even applying the mechanical test of Stonehill, it is uncertain whether these papers constitute "preponderantly nondramatic literary material" subject to the requirements of the Manufacturing Clause. However, in view of my finding that the Manufacturing Clause is inapplicable to this investigation, it is unnecessary to determine whether complainants' birth certificates and adoption papers are subject to § 601.

Accordingly, I find that complainants have not established either the applicability or the violation of § 601. Section 601 appears to have no

relevance to the facts of this investigation, inasmuch as it is more appropriately an affirmative defense to be raised by respondents. (FF 101). Therefore, I determine that violation of § 601(a), as alleged by complainants, is not an unfair act for purposes of Section 337.

C. Failure to Mark Country of Origin

Under the terms of the Customs Marking Statute, 19 U.S.C. § 1304:

> (a) . . . every article of foreign origin (or its container, as provided in subsection (b) hereof) imported into the United States shall be marked in a conspicuous place as legibly, indelibly, and permanently as the nature of the article (or container) will permit in such manner as to indicate to an ultimate purchaser in the United States the English name of the country of origin of the article.

The related Customs regulations define the "ultimate purchaser" as "the last person in the United States who will receive the article in the form in which it was imported." 19 C.F.R. § 134.1(d). If an article is excepted from the requirements of marking, that article's container is to be marked so as to indicate the English name of the country of origin of the article. 19 U.S.C. § 1304(b).

In their Motion for Summary Determination, complainants allege that the packages of the CPK dolls which are imported into the United States without complainants' authorization are not marked with the country of origin as required by the Customs Marking Statute. Complainants further allege that this shortcoming constitutes an unfair act under Section 337. The Commission investigative attorney concurs in complainants' position.

As noted by the parties, in the present case, the CPK dolls imported without authorization are marked with the country of origin on the doll itself. This marking appears on the back of the doll's head or on a tag stitched to the side of the doll, underneath its clothing. (FF 102). At the point of retail sale, CPK dolls are packaged in cardboard boxes with full litho windows, so that the doll can be seen through the box. (See, e.g., CPX 2-4, 9-11). In order to see the country of origin marking on the doll, the ultimate purchaser would have to remove the doll from the package. Although some of the packages indicate the origin of the package or the location of the importer or distributor, none identify the country of origin of the doll. (FF 93, 94, 96). This is in contrast to the CPK dolls imported by Coleco, which indicate on the upper right corner of the back of the box that the doll is manufactured in Hong Kong, China or Taiwan. (See CPX 1, 5-8).

Both complainants and the Commission investigative staff assert that the CPK dolls imported into the United States without complainants' authorization do not comply with Customs marking regulations due to their failure to mark the country of origin on the package. The Commission staff cites to the following Customs regulation:

> Sealed containers or holders. Disposable containers or holders of imported merchandise, which are sold without normally being opened by the ultimate purchaser (e.g., individually wrapped soap bars or tennis balls in a vacuum sealed can), shall be marked to indicate the country of origin of their contents.

19 C.F.R. § 134.24(d)(2). This regulation appears in a section of Customs rules that apply to the marking of containers under 19 U.S.C. § 1304(b) when the article itself is excepted from marking. 19 C.F.R. §§ 134.21, 134.22(a).

It has not been shown on this record that the accused imported CPK dolls have been excepted from marking under 19 U.S.C. § 1304(a)(3), so as to require the marking of their packages under 19 U.S.C. § 1304(b). Inasmuch as the CPK dolls themselves are marked in English with the country of origin, I must find that complainants have not established, as a matter of law, that the accused imported CPK dolls do not comply with 19 U.S.C. § 1304. See Certain Alkaline Batteries, Inv. No. 337-TA-165, ID at 79-80 (1984).

Even if the accused imported CPK dolls were found not to comply with Customs marking requirements, under the circumstances of this investigation, the failure to mark country of origin does not constitute an unfair act for purposes of Section 337. In past Commission decisions involving alleged trademark or trade dress infringement, the failure to mark conspicuously the country of origin has been found to constitute an unfair act "if the effect on a domestic industry or on trade and commerce required by Section 337 could be shown." Certain Swivel Hooks and Mounting Brackets, Inv. No. 337-TA-53, RD at 4, adopted by Commission, 207 U.S.P.Q. 669, 670 (1979).

As noted in Swivel Hooks, the basis for the marking requirement on imported goods is the finding that the public prefers products of domestic origin. Id. RD at 3-4 and cases cited therein. In a trademark case, a complainants' property right that is being adversely affected by an unfair method of competition is the identification of the source or origin of the product which bears the trademark. Thus, failure of a respondent to adequately mark the country of origin on a product that also confusingly trades on a complainant's trademark may constitute a misrepresentation of

geographic origin, and compound the unfair methods of competition. See, e.g., Certain Miniature Plug-In Blade Fuses, Inv. No. 337-TA-114, 221 U.S.P.Q. 792, 806 n.145 (1983).

In the present investigation, complainants seek to prevent infringement of their copyrights. Thus, the rights to be protected are the right to reproduce, distribute and sell the products which embody their copyrights. Complainants' CPK dolls are not manufactured in the United States. Thus a country of origin marking will not serve the salutary purpose of enabling consumers to seek out and purchase a domestically made CPK doll. In addition, the accused imported CPK dolls arrive in packages that are in foreign languages, or in English with another foreign language. (FF 102). It is unlikely, therefore, that an American purchaser would buy this product in the belief that it was of domestic origin.

The lack of a prominent country of origin marking on the package of the accused imported CPK dolls does not impinge on complainants' exercise of the rights granted to them under their copyrights. Therefore, even assuming that the accused products do not comply with the Customs Marking Statute, such infraction does not adversely affect complainants' rights in their copyrights. Accordingly, I find that the alleged failure to comply with 19 U.S.C. § 1304, in the circumstances of this case, does not constitute an unfair act or unfair method of competition for purposes of Section 337. See Certain Trolley Wheel Assemblies, Inv. No. 337-TA-161, ID at 54-55 (1984).

IV. IMPORTATION AND SALE

To invoke the subject matter jurisdiction of the Commission and to support a finding that a violation of Section 337 exists, complainants must establish that the accused product has been imported and/or sold in the United States. Respondents and others have imported or sold in the United States approximately 390,000 genuine "Cabbage Patch Kids" (CPK) dolls intended for sale outside the United States, but imported into the United States without complainants' authorization. (FF 105). The major sources of gray market CPK dolls appear to have been Spain, South Africa, Japan, and France. (FF 126-27).

Respondents who have imported or sold foreign CPK dolls in the United States have included: Murrell, which purchased 1,500 to 10,000 CPK dolls packaged in boxes that displayed Japanese writing (FF 106-09); JIC, which imported and sold 1,000 to 45,000 gray market CPK dolls (FF 110); Osco and Sav-On, which purchased C CPK dolls in 1985 from various importers (FF 111); HMI (Ben Franklin Stores) (FF 112); Calila, which imported over 37,000 CPK dolls from Zabco in South Africa, and subsequently resold to retailers (FF 113-17); and IPL, which purchased 48 gray market CPK dolls from an importer. (FF 118).

Other third parties who have imported or sold foreign CPK dolls in the United States have included: C which purchased over 83,000 gray market CPK dolls (FF 119-22); C.K.O. International Trading, which purchased 28,000 gray market CPK dolls from Spain and France (FF 123-24); and other entities that imported a total of about 83,600 CPK dolls. (FF 125).

Therefore, there is no genuine issue of material fact that unauthorized importation into and sale in the United States of gray market CPK dolls has occurred.

V. DOMESTIC INDUSTRY

When the unfair acts or methods of competition alleged under Section 337 are based on the infringement of copyrights, the relevant domestic industry is defined as the domestic operations of the complainant(s) devoted to exploitation of the proprietary rights at issue. See e.g., Certain Products With Gremlins Character Depictions (Gremlins), Inv. No. 337-TA-201, at 13 (1986); Certain Plastic Food Storage Containers, Inv. No. 337-TA-152 (1984); Certain Coin Operated Audiovisual Games and Components Thereof, Inv. No. 337-TA-87, 214 U.S.P.Q. 217 (1981). See also Schaper Manufacturing Co. v. U.S. International Trade Commission, 219 U.S.P.Q. 665, 668 (Fed. Cir. 1983).

In the present investigation, OAA's production of soft sculpture CPK dolls occurs under the 804 copyright. (FF 23-32). In addition, OAA's and SNC's licensing activities with respect to Coleco's soft/vinyl sculpture CPK doll and related products constitute exploitation of the 801, 804, 777, 778 and 526 copyrights, inasmuch as a copyright owner is entitled by the Copyright Act to authorize others to exercise individual copyright rights. (FF 33-42). See 17 U.S.C. § 106; Opinion, supra, at 76. Licensee Coleco's production of soft/vinyl CPK dolls together with the related literature and packaging are covered by all five of the registered copyrights of OAA at issue in this

investigation. (FF 22-42, 47-58). Coleco's post-sale fulfillment process is also an important and inherent part of its CPK doll sales package, and should be included within the scope of the domestic industry. (See FF 170-71).

A. Original Appalachian Artworks

OAA has been engaged in the manufacture and sale of soft sculpture dolls in the United States since 1977. These dolls were originally sold under the name "The Little People," but since July 1982 OAA has been marketing these dolls under the name "Cabbage Patch Kids." (FF 17-18, 29-30). OAA employs persons in the manufacture of its soft sculpture CPK dolls, and additional employees are engaged in design, quality control, and processing of documents such as birth certificates and adoption papers. (FF 129).

OAA's soft sculpture CPK dolls are larger and more expensive than are the CPK dolls sold by Coleco. Because OAA's dolls do not compete directly with Coleco dolls (and, therefore, with gray market imports), OAA argues that information with respect to its operations is irrelevant to this investigation. (See SX-17, at 2).

The Commission has recently determined that the scope of competition between domestic production and imports, or between various domestically produced products, should not be used to define the scope of the domestic industry. Gremlins, supra at 13. OAA's soft sculpture dolls are covered by one of the copyrights at issue in this investigation. (FF 23-32). Therefore, OAA's operations relating to the production of CPK dolls should be included within the definition of domestic industry based on the Gremlins precedent,

even though it is possible that OAA's soft sculpture dolls may not be relevant for the injury analysis because of the different nature of these dolls relative to the imports at issue.

In Gremlins the Commission rejected the concept that licensing activity per se could be considered a domestic industry under Section 337. Id. at 6-11 (Vice-Chairman Liebeler dissenting). However, the Commission left open the question of whether licensing activity combined with production activity could jointly be included within the scope of the domestic industry, stating:

> Further treatment of the issue of combining licensing activities and production activities must await another investigation in which the parties have adequately raised the issue and developed the factual record before the Commission.

Id. at 11.

In this investigation, OAA's status within the domestic industry should include its activities relating to production of soft sculpture CPK dolls, its licensing activities with respect to the Coleco version CPK doll, as well as Schlaifer Nance and Co.'s (SNC) licensing activities related to CPK dolls.[1/] OAA has appointed SNC as its exclusive licensing agent for CPK products, with the exception of OAA-produced soft sculpture CPK dolls. (FF 132). OAA has final approval of prospective licensees and licensing terms submitted by SNC, as well as having the ultimate responsibility of protecting the copyright and trademark rights. (FF 60-66, 132-35). OAA employs about

---

1/ OAA's soft sculpture doll is covered only by the 804 copyright. Because OAA's fulfillment papers for its soft sculpture "Little People" dolls are not covered by any of the copyrights at issue in this investigation (specifically, the 777 and 778 copyrights, which cover only the derivative work Coleco CPK papers) OAA's fulfillment process should not be included within the scope of the domestic industry. (See FF 22, 50).

employees for its licensing functions. (FF 130). OAA's royalty revenue from its licensee Coleco was substantial, and in 1984 such revenue approached what OAA earned from sales of its own soft sculpture CPK doll and related products. (FF 199). For the above reasons, I find that both OAA's and SNC's licensing activities related to CPK dolls are within the scope of the domestic industry.

B. Coleco Industries, Inc.

Complainant Coleco Industries, Inc. (Coleco) is a corporation organized and existing under the laws of Connecticut, and is located in West Hartford Connecticut. (FF 4). Based on SNC's authority under its license agreement with OAA, SNC granted to Coleco in 1982 the exclusive right to engage in the manufacture and sale of CPK dolls. (FF 5, 64). The copyright that covers CPK dolls manufactured by Coleco was registered in December 1983. (FF 33-38).

Under its original license agreement with SNC, Coleco

(CX 3, August 8, 1982 Agreement, at 4). Under a subsequent agreement between OAA, Coleco and SNC, SNC was designated as the sole licensor of CPK property, although

(FF 65-66, 136). Royalties paid by foreign third party licensees are

(FF 138-39). Third party royalty payments are generally assessed at

(FF 72, 140).

1. Initial and Ongoing Product Development

Coleco's version of the CPK doll was introduced to the public in 1983 as a 16 inch doll. (FF 155). The CPK dolls that Coleco is licensed by OAA to manufacture have the same overall appearance as the dolls manufactured by OAA, but differ in that Coleco's dolls have a molded plastic or vinyl head and are smaller. Coleco's CPK doll is 16 inches and its "Preemie" CPK doll is 14 inches. (FF 19, 141). From the time the CPK doll concept was presented to
C Coleco to the time a finalized CPK doll was developed by Coleco,
C employees worked full time for four or five months. (FF 142).

The concepts for new CPK products originate either at Coleco, at outside design groups on retainer to Coleco, at OAA, or from a combination thereof. Once the concepts are accepted by Coleco management and marketing, they are turned over to the Coleco engineering department, which interprets the marketing requirements into practical, manufacturable concepts. These activities may include making a master mold of the sculpted head, or providing engineering drawings for outfits, sewing patterns, sewing samples, and quality control standards. (FF 143). The engineering groundwork for all aspects of CPK products originates with Coleco personnel in the United States, and is approved by OAA. This engineering groundwork is transferred to engineers in
C the Far East who work for Coleco's agent, where the groundwork is executed. (FF 144). Coleco's U.S. engineering staff devoted to CPK products
C is larger than the Far East engineering staff devoted to CPK products. (FF 146).

C The organization acts on Coleco's behalf as an agent to oversee
C Far East production of Coleco products, including CPK dolls.
C activities are devoted totally to Coleco, and it has approximately
C employees. About of activities are CPK product related, or roughly proportional to the amount of Coleco's business devoted to CPK products. Accordingly, with the exception of some engineers, most employees are not devoted exclusively to CPK products. (FF 145).

C Coleco added new head styles for CPK dolls in 1985 and plans an
C additional new head styles for 1986. These head styles were designed in the United States by Coleco personnel and members of outside design groups. OAA approved these new head designs. (FF 147-48). In 1985, the CPK doll models that Coleco produced overseas and sold in the United States were as follows: 16" CPK doll; 14" CPK doll; Twins; and World Travelers. (FF 34, 43-44, 156). The new 1986 line includes all of the above dolls plus "Cornsilk Kids," "Preemie Twins," "Koosas," and 12" babies. (FF 49, 156).

2. Matrixing

Coleco has developed a "matrixing" system which is used at all levels of production and distribution to assure each retailer of as diverse an assortment of CPK dolls as possible. (FF 150-51). One of the essential attributes of the CPK doll that has contributed to its commercial success is that the consumer sees each doll as unique and individual. This characteristic is the result of the matrixing system. (FF 152). The various combinations of head styles, hair color, eye color, skin color, and clothing
C presently used by Coleco yield approximately different dolls. (FF 149).

C

Each new CPK doll, such as Cornsilk dolls, requires unique matrix rules. (FF 153).

C

C

(FF 154).

3. Production/Value Added

The existence of a domestic industry must be determined according to an assessment of the nature and significance of the activities carried out in the United States in connection with the product. Certain Miniature, Battery-Operated, All-Terrain Wheeled Vehicles, Inv. No. 337-TA-122 (1982), aff'd sub nom. Schaper, 219 U.S.P.Q. 665 (Fed. Cir. 1983). One method to assess the nature and significance of domestic activities where all, or a substantial part, of the production process occurs overseas is to determine the value added to the product by domestic activities as a percentage of the product's total value. Certain Cube Puzzles, Inv. No. 337-TA-112, 219 U.S.P.Q. 322, 334-35 (1982). This type of evaluation is important because it helps to determine whether a complainant's domestic activities differ in kind from the activities that would normally be performed by an importer. Schaper, 219 U.S.P.Q. at 669. A value-added analysis, however, is recognized as "simply one factor in considering the nature and significance of a party's relevant activities in the United States. It is not necessarily dispositive [of this issue]." Certain Fluidized Supporting Apparatus, Inv. No. 337-TA-182/188, at 15 (1984).

The Commission has never determined the exact percentage of domestic value-added required to constitute a domestic industry under Section 337.

See e.g., Certain Cube Puzzles, Inv. No. 337-TA-112, 219 U.S.P.Q. 322 (1982) (domestic industry based on 50% value added); see also Certain Cloisonne Jewelry, Inv. No. 337-TA-195 (1985). Because of differing circumstances in each investigation, the Commission has also never precisely defined those industry components which constitute domestic value-added, but rather relies on an evaluation of the nature and extent of a complainant's domestic activities in the United States minus those activities normally performed by an importer, including customs, and components of transportation, marketing, and general and administrative activities. See Schaper, 219 U.S.P.Q. at 668-69; Cube Puzzles, supra at 335; Certain Modular Structural Systems, Inv. No. 337-TA-164, USITC Pub. No. 1668, at 13 (1984).

Using the designs and engineering specifications supplied by Coleco U.S. and by in the Far East, offshore vendors assemble CPK dolls for Coleco (FF 157). Specifically, Coleco has contracted with manufacturers in Hong Kong, Korea, Taiwan, and the People's Republic of China for production of the CPK dolls it is licensed to manufacture. (FF 158).

Coleco Far East is a manufacturing control operation based in Hong Kong that is responsible for the control and supervision of Coleco's vendors in the Far East. (FF 7). The organization is the agent of Coleco Far East. (FF 8, 144). After the CPK dolls are manufactured by Coleco's vendors in the Far East, and then inspected, they are shipped in bulk to Coleco's pack-out facilities in Amsterdam, New York or Tustin, California. (FF 159).

C Quality control functions in the Far East are performed by which checks for safety, aesthetic factors, and compliance with matrix requirements. Inspections are performed both during the manufacturing process and prior to shipping the completed product. The sample size inspected is C typically of the shipment size. However, metal detection in the Far C East covers 100% of the CPK dolls. (FF 160). About off-shore employees C are devoted to quality control, at an annual cost of about forecast for 1986. (FF 161).

At the Amsterdam, New York and Tustin, California facilities, several additional production steps are performed by Coleco. The dolls are groomed, and accessories, such as pacifiers, crayons, eyeglasses, etc., are placed on the dolls. Then the dolls are inserted, secured, and positioned in their retail boxes, and birth certificates and adoption papers are added. C (FF 162). About employees at Amsterdam, New York are involved in quality C control, and about of these are devoted to CPK products, at a cost of C about in 1985. (FF 163). The quality control costs in Tustin, C California were about in 1985. (FF 164). Although the quality control tests done in the United States are similar to those performed in the Far East, and are to an extent repetitive of tests performed in the Far East, every CPK doll received from the Far East is inspected in the United States. There is both a metal inspection to detect any foreign matter that might have been left in the doll during production, and a visual inspection, after which certain cosmetic operations, such as cleaning the face, are performed. (FF 165-66). Any dolls that cannot be corrected during this inspection are

sent to the hospital in Coleco's pack out facility for repair. In 1985, between C of all dolls were sent to this hospital for major repairs. (FF 167).

Coleco's fulfillment houses provide the birth certificates and adoption applications that are included in the package with each CPK doll. When a purchaser fills in the application, it is returned to one of the fulfillment houses where an adoption certificate is prepared and mailed and from where, one year later, a birthday card is sent. (FF 171). All of the accessories, as well as the birth certificates and adoption papers that accompany the dolls, are of U.S. manufacture. (FF 169). Coleco's adoption program is carried out by three U.S. companies, called "fulfillment houses," under contract to Coleco. (FF 170). Because the fulfillment process is inherently part of the sales package for the CPK doll, and the adoption papers and birth certificates are covered by individual copyrights at issue in this investigation, I determine that this this post-sale activity is included within the scope of the domestic industry. (See FF 22, 183). In addition, the manufacture of Coleco's birth certificates, adoption papers and packaging under the 777, 778 and 526 copyrights occurs entirely in the United States, and thus is an integral part of the domestic industry. (FF 99, 184).

Coleco provided a value added analysis to support its claim that its domestic operations relating to CPK dolls are sufficient to determine that a domestic industry exists. Based on manufacturing, administrative, and overhead costs, in 1985 the domestic value added to the 16 inch CPK doll was C of total costs; this percentage was for the 14 inch CPK doll. (FF 173-73; See FF 175-91). If domestic advertising and other S&A costs are

excluded from the domestic costs, the domestic value added to the 16 inch CPK doll for the 14 inch CPK doll this percentage (FF 172-73). S&A expenses include costs associated with the sales force to obtain orders, certain marketing department costs, information services, computer department, accounting function, legal and executive management group, and related staff. (FF 188).

Regardless of whether or not other S&A and advertising costs are included, the U.S.-based share of total costs is sufficient for a determination that a U.S. industry exists. This is particularly true in view of the inclusion in the industry of OAA's production activities under the 804 copyright, and OAA's and SNC's licensing activities under all of the subject copyrights. In addition, if operating profit is included in the U.S. value added, the U.S. content for the 16 inch CPK doll and to for the 14 inch CPK doll, even when S&A and advertising costs are excluded. (FF 172-73). Profit should be included in a value added comparison because it is a return to a factor of production necessary for the production process. Both the Commission staff and complainants argue that it is not proper to include profit in a value added analysis because it is inconsistent with Commission precedent. See SB, at 9; CB, at 15. The staff cites to Gremlins, where the Commission reiterated that "production related" activities are the proper focus of a domestic industry analysis. The staff takes the position that profit is not a production related item, but the difference between sales price and the value added by production related activities.

Profit is a return to the creative effort involved in initially formulating the CPK doll concept; to those owners who have taken the risk of supplying

capital to the firm to enable production before the success of the product was known; and to those who have organized the production process (with the exception of salaried managers, where the return would be included in labor costs rather than in profit). Clearly, the initial creative effort, capital investment, and organization are necessary for and inherent in production and are, therefore, "production related." The return to these inputs in the form of profit are a legitimate reward for the exercise of the subject copyrights and should therefore be included in the definition of the domestic industry.[2/]

For the reasons discussed above, there is no genuine issue of material fact that a domestic industry exists, and it is defined in this investigation as: the domestic operations of OAA involved in the production of soft sculpture CPK dolls under the 804 copyright and the licensing of Coleco's version of CPK dolls with literature and packaging under all copyrights at issue; the domestic operations of SNC involved in the licensing of OAA's copyrights in CPK dolls, related literature and packaging; and the domestic operations of Coleco and its contractors involved in the production and post-sale fulfillment process for CPK dolls, and related literature and packaging under each of the subject copyrights. (FF 192).

2/ Additionally, the staff in its argument has confused value and cost. Profit per CPK doll is the difference between sales price and the unit cost added by production related activities. The perception by consumers of what the product is worth, i.e., sales price, actually reflects the value added by production.

VI. EFFICIENT AND ECONOMIC OPERATION

In order to prevail under Section 337, a complainant must establish that the domestic industry is efficiently and economically operated. The guidelines set forth by the Commission to assess whether a domestic industry is efficiently and economically operated include: (1) use of modern equipment and manufacturing facilities; (2) investment in research and development; (3) profitability of the relevant product line; (4) substantial expenditures in advertising, promotion, and development of consumer goodwill; and (5) effective quality control programs. See e.g., Certain Methods for Extruding Plastic Tubing, Inv. No. 337-TA-110, 218 U.S.P.Q. 348 (1982); Certain Coin Operated Audio Visual Games and Components Thereof, Inv. No. 337-TA-105, 216 U.S.P.Q. 1106 (1982); Certain Slide Fastener Stringers and Machines and Components Thereof, Inv. No. 337-TA-85, 216 U.S.P.Q. 907 (1981).

A. Coleco

There is no doubt that complainant Coleco is efficiently and economically operated. The value of Coleco's sales of CPK dolls increased from C in 1983 to C in 1985, and its operating profit for CPK dolls was about C in 1985. (FF 205-06). The ratio of current assets to current liabilities for Coleco C between 1984 and 1985, in large part because of Coleco's sales of CPK dolls and related products. (FF 196). Coleco's unit costs for CPK dolls in 1985 were C than had been forecast for that year. (FF 197).

Coleco continues to develop new CPK dolls in order to generate consumer demand for its product, and its advertising expenditure represented about C of the cost of its CPK dolls in 1985. (FF 147, 156, 193-94). Coleco administers extensive quality control on its CPK dolls and had a return rate of C in 1985, well below the return rate for other Coleco outdoor products. (FF 162-68).

B. OAA

Although little financial data are contained in the record with respect to OAA, its revenues since 1983 have increased substantially. (FF 199). OAA has earned significant revenue through the widespread licensing of the CPK doll concept. (FF 199-201). The soft sculpture CPK doll has been promoted directly by the creator of CPK dolls. (FF 202). There is nothing in the record to indicate that OAA is inefficient or uneconomic.

For the reasons discussed above, there is no genuine issue of fact that the domestic industry as defined herein is efficiently and economically operated. (FF 203).

VII. SUBSTANTIAL INJURY

As a final element in a Section 337 investigation, complainant must show that respondents' unfair methods of competition and unfair acts have the effect or tendency to destroy or substantially injure the domestic industry. 19 U.S.C. § 1337(a). Injury requires proof separate and independent from evidence of an unfair act. Complainants must establish a causal relationship

between respondents' unfair acts and the injury suffered as a result of such acts. Certain Spring Assemblies and Components Thereof and Methods of Their Manufacture, Inv. No. 337-TA-88, 216 U.S.P.Q. 225, 243 (1981). In addition, the Federal Circuit recently determined that the quantum of proof of injury

> is less in the context of patent, trademark, or copyright infringement . . . than in other types of unfair trade practices, because the holder of the former type of rights is entitled to exclude competitors entirely from using the intellectual property covered by those rights. . . .

Textron Inc. v. U.S. International Trade Commission, 224 U.S.P.Q. 625, 632 (Fed. Cir. 1985); See also, Spring Assemblies, 216 U.S.P.Q. at 243.

Section 337(a) states in part that it is unlawful for an owner, importer, consignee, or agent of either, to participate in (1) unfair methods of competition and unfair acts, (2) in the importation of articles into the United States, or in their sale, (3) 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. 19 U.S.C. § 1337(a). All elements of Section 337 must be established if complainant is to prevail. However, the existence of each element is not sufficient evidence of a violation of Section 337 where one element is not related to another. See generally, Certain Centrifugal Trash Pumps, Inv. No. 337-TA-43, 205 U.S.P.Q. 114, 117 (1979). The unfair methods of competition or unfair acts must be in the importation or sale of the subject articles such that the combination of these two elements destroys or substantially injures a domestic industry.

Several factors are relevant to a determination of substantial injury to a domestic industry, including, but not limited to: (1) lost and declining sales; (2) volume of imports and capacity to increase imports; (3) loss of market share; (4) lost customers; (5) decreased employment; (6) decreased production and profitability; (7) underselling; and (8) excess domestic capacity. See e.g., Certain Vertical Milling Machines and Parts, Attachments, and Accessories Thereto, Inv. No. 337-TA-133, 223 U.S.P.Q. 332, 348 (1984); Certain Drill Point Screws for Drywall Construction, Inv. No. 337-TA-115 (1983); Spring Assemblies, 216 U.S.P.Q. at 242-45; Certain Roller Units, Inv. No. 337-TA-44, 208 U.S.P.Q. 141, 144 (1979).

Although OAA was included within the scope of the U.S. industry, its original CPK dolls are larger, more expensive, and are sold through different channels of distribution than are the imported CPK dolls. Additionally, because gray market imports are produced by licensees that pay royalties to OAA, the argument cannot be made that OAA lost royalty payments through the sale of gray market imports. OAA receives the same royalty percentage wherever an authorized CPK doll is first sold. (Compare FF 138 to FF 139). Therefore, the discussion below on injury will focus on Coleco, which sells CPK dolls in the United States that compete directly with gray market CPK dolls.

All economic indicators for the segment of Coleco producing CPK dolls show that it is healthy. Sales [redacted] in 1983 to [redacted] in 1985. (FF 205). Gross profits [redacted] from 1983 to 1985. Although operating profits [redacted] between 1984 and 1985, the ratio of operating profit to net sales was [redacted] in 1985. (FF 206-09). Coleco's wholesale

price for CPK dolls increased from $18.50 in 1983 to $26.50 in 1985. (FF 210). Coleco was operating at full capacity through mid-1985, and close to full capacity through the end of 1985. (FF 212-17). However, even though the industry was healthy, primarily because of the success of CPK dolls in the market, injury is still possible in view of Coleco's entitlement to 100% of the United States market, if it could have done better but for the gray market CPK dolls. See Textron, 224 U.S.P.Q. 625. This issue will be addressed below.

Coleco was operating at full capacity through about mid-1985, and was not able to fully meet demand in the U.S. market for CPK dolls. (FF 212-13). The record shows that Coleco's inability to meet domestic demand contributed to the importation of gray market CPK dolls, as retailers sought alternative sources of supply. (FF 214). Prior to mid-1985, retailers generally paid higher prices for gray market CPK dolls than the Coleco price, also reflecting the inability of Coleco to meet demand. (FF 215, 220-24). There is some question, then, whether Coleco was injured by gray market imports of CPK dolls before mid-1985, since it could not have made those sales at that time.

The staff argues that complainants are the owner and licensee of the copyrights covering CPK dolls, and Coleco has the exclusive right to distribute such dolls in the United States. Therefore, according to the staff, every sale of an infringing CPK doll is a sale that should have gone to Coleco, and once made is irretrievably lost, citing Certain Cube Puzzles, 219 U.S.P.Q. at 322. The staff argues that injury did occur, even though Coleco was operating at full capacity, because Coleco would have made those sales later when its backlog of orders was eliminated. Response to Motion 231-12, at 40-41, 45.

It is unlikely that each consumer who was unable to obtain a CPK doll from Coleco prior to mid-1985 would have waited to purchase an authorized Coleco doll until after mid-1985, given changes in taste and the popularity of the CPK doll over time, although some such customers likely exist. Therefore, only a portion of gray market imports prior to mid-1985 can be considered injurious, although the record contains no evidence to enable an estimate of what this proportion would be. This lack of evidence is not critical to the injury analysis, however, because the record contains evidence that lower-priced gray market CPK dolls were imported after mid-1985, when Coleco did have the capacity to supply the market.

Since about mid-1985 Coleco was able to satisfy consumer demand for CPK dolls, and gray market CPK dolls were generally sold by unauthorized importers to retailers at prices lower or the same as Coleco's wholesale price. (FF 216-17, 224-35). Since June 1985, over 80,000 gray market CPK dolls were sold in the United States to retailers at prices ranging from $17.92 to $26.50 per doll, i.e., below or at Coleco's sales price of $26.50. (See FF 225-35). It is reasonable to assume that these retailers would likely have purchased a significant proportion of this quantity from Coleco, especially given the strong demand still existing at the consumer level in the last half of 1985, and the apparent insensitivity to a higher price for this product that had been shown by many consumers, with prices often at $49.95 or more at retail. (See CX-37, at 00324; CX 38, 53, 61).

C Although Coleco earns royalties

C (FF 140), Coleco earns a

C royalty of only about per CPK doll sold by a foreign licensee, compared

C to its operating profit margin of for each doll it sells directly. (Compare FF 138 with FF 172-73). Therefore, Coleco is adversely affected by sales of gray market CPK dolls in the U.S. market due to the loss of profit on sales lost to gray market dolls.

For the reasons discussed above, there is no genuine issue of material fact that the domestic industry producing CPK dolls has been substantially injured by imports of gray market CPK dolls. (FF 236).

VIII. TENDENCY TO SUBSTANTIALLY INJURE

When an assessment of the market in the presence of the accused imported product demonstrates relevant conditions or circumstances from which probable future injury can be inferred, a tendency to substantially injure the domestic industry has been shown. Certain Combination Locks, Inv. No. 337-TA-45, RD at 24 (1979). Relevant conditions or circumstances may include foreign cost advantage and production capacity, ability of the imported product to undersell complainant's product, and the ability and intention to penetrate the United States market. Certain Methods for Extruding Plastic Tubing, Inv. No. 337-TA-110, 218 U.S.P.Q. 248 (1982); Reclosable Plastic Bags, Inv. No. 337-TA-22, 192 U.S.P.Q. 674; Panty Hose, Tariff Commission Pub. No. 471 (1972). The legislative history of Section 337 indicates that "where unfair methods and acts have resulted in conceivable loss of sales, a tendency to substantially injure such industry has been established." Trade Reform Act of 1973, Report of the House Comm. on Ways and Means, H. Rep. No. 93-571, 93d Cong., 1st Sess. 78 (1973), citing In re Von Clemm, 108 U.S.P.Q. 371 (C.C.P.A. 1955). Although this legislative history suggests a low threshold with

respect to the "tendency" language of Section 337, the injury must be a substantive and clearly foreseeable threat to the future of the industry, not based on allegation, conjecture, or mere possibility. Certain Braiding Machines, Inv. No. 337-TA-130 (1983); Expanded Unsintered Polytetraflouroethylene in Tape Form, Inv. No. 337-TA-4 (1976).

Complainants maintain that there are no genuine issues of fact with respect to whether the importation of gray market CPK dolls have the tendency to substantially injure the domestic industry. Complainants argue that "all that is required before gray market importations . . . begin is for that article to become popular in the U.S. market," and that gray market imports will continue to exist as long as CPK dolls are popular in the U.S. market. (CRB, at 7, 9).

The strong demand in the U.S. market for CPK dolls, resulting in part from complainants' efforts to promote the product, coupled with weaker foreign demand, resulted in higher wholesale prices in the U.S. market relative to foreign markets, according to complainants. (See FF 243). Thus, sellers of gray market CPK dolls unjustifiably reaped the benefit of U.S. promotion efforts by buying at the lower foreign price and reselling at the higher U.S. price. (CRB, at 7).

The staff takes the position that there remain genuine issues of fact with respect to whether a tendency to substantially injure the domestic industry exists. The staff maintains that gray market importations that occurred during 1984-85 were fueled primarily by a shortage of CPK dolls in the United States and overproduction of CPK dolls by OAA's manufacturing licensees. The

staff argues that by eliminating these two factors, complainants have reduced to a substantial degree the likelihood that importation of gray market CPK dolls will continue. (SB, at 10-11).

For gray market importations to exist, each of two general conditions are required. First, there must be production of authorized product abroad.[3/] Second, exportation and importation through other than authorized distribution channels, in this case primarily by third parties, must be economically profitable. (See FF 240). This second condition is essentially a function of the price difference for CPK dolls between the U.S. and foreign markets in which authorized CPK dolls are sold. (See FF 250-58). The price difference is in turn affected by relative demand and supply conditions between the U.S. and foreign markets, and by exchange rates. Thus, strong demand is included within this second general condition.

Strong demand is not, however, all that is required for gray market importations to occur, as is argued by complainants. Strong demand in the United States compared to demand overseas would not necessarily lead to a price difference that would make gray market exportations to the United States profitable. Changes in relative supply conditions, or in exchange rates, could conceivably offset the stronger demand in the United States so that the price difference that gave rise to gray market importations would disappear. The record reflects the relevance of supply conditions and exchange rates as contributing to gray market importations of CPK dolls. (See FF 237-39).

3/ In the absence of such authorization, importations would be counterfeits rather than gray market goods. See CRB, at 5.

Although the record shows that certain conditions have changed that will tend to reduce the volume of gray market importation into the United States (See FF 213, 216, 237, 241, 247), the question remains as to whether a sufficient price difference currently exists at the wholesale level between authorized U.S. and foreign CPK dolls, so that future importation of gray market CPK dolls is probable. Although manufacturing licensees no longer manufacture (FF 259), exportation by third parties of gray market dolls originating from the remaining manufacturing licensees and passing through foreign distributing licensees will likely remain profitable, based on lower wholesale prices offshore relative to the United States. In the third quarter of 1985, home market prices for these licensees (in the Netherlands, Sweden, Japan, and England) ranged from so that even with the weakening of the dollar, gray market exportations would be feasible based on Coleco's current U.S. wholesale price of $26.50.[4/5/] (FF 250-53, 257; See FF 243). However, the wholesale price of other foreign licensees in their home markets, such as France, Germany, or Canada, appears to preclude profitable third party exportation to the United States in the future from these countries. (FF 255-56, 258). Therefore, the record

---

4/ Sales prices within would also indicate that gray market importation from that country is feasible, but the has ceased production, and was given until March 1986 to dispose of remaining inventory. (See FF 247, 254).

5/ Complainants provided royalty statements for these licensees only through the third quarter of 1985, thus current price differences can only be inferred from this information. The quarterly royalty statements contained in the record were generally issued within the month following the end of a quarter. (See CX 88).

supports a finding that there will remain sufficient profit margins for some third party importers to enable continued importation of gray market CPK dolls into the United States.

For the above reasons, I find that there are no genuine issues of material fact that there exists a tendency to substantially injure the domestic industry by reason of gray market imports of CPK dolls. (FF 260).

CONCLUSIONS OF LAW

1. The Commission has jurisdiction over the subject matter of this investigation, in rem jurisdiction over the property at issue, and in personam jurisdiction over each of the respondents named in this investigation. 19 U.S.C. § 1337.

2. Each of the registered copyrights at issue in this investigation: VA 35-804 and VA 141-801 for the soft sculpture Cabbage Patch Kids doll; TX 1-254-777 for Coleco's CPK "Official Adoption Papers"; TX 1-254-778 for Coleco's CPK Birth Certificate; and TX 1-261-526 for the package for Coleco's CPK doll is a valid copyright owned by complainant Original Appalachian Artworks, Inc. and licensed in the United States exclusively to complainant Coleco Industries, Inc. 17 U.S.C. § 410.

3. The importation into and sale in the United States by respondents and other third parties, without the authorization of complainants, of Cabbage Patch Kids dolls, and related birth certificates, adoption papers and packaging, manufactured overseas by complainant OAA's licensees under the copyrights at issue, and intended for sale outside the United States, constitute infringement of each of the registered copyrights at issue in this investigation. 17 U.S.C. § 602(a).

4. Copyright infringement is an unfair act or unfair method of competition under Section 337. 19 U.S.C. § 1337.

5. It has not been established that 17 U.S.C. § 601, the Manufacturing Clause, is applicable to the CPK birth certificates or adoption papers at issue in this investigation, or that the English language paperwork imported into the United States by respondents and other third parties without complainants' authorization is in violation of the Manufacturing Clause. 17 U.S.C. § 601.

6. Under the facts of this investigation, violation of 17 U.S.C. § 601 is not an unfair act or unfair method of competition for purposes of Section 337.

7. It has not been established that the CPK dolls and packaging imported into the United States by respondents and others without the authorization of complainants is in violation of the requirements of the Customs Marking Statute and related regulations. 19 U.S.C. § 1304.

8. Under the facts of this investigation, violation of Customs marking requirements is not an unfair act or unfair method of competition for purposes of Section 337. 19 U.S.C. § 1304.

9. The domestic industry consists of the domestic operations of Coleco and its domestic contractors devoted to the production and post-sale fulfillment process of CPK dolls and related literature and packaging under the subject copyrights, the domestic operations of OAA devoted to production of soft sculpture CPK dolls under the 804 copyright, and the domestic operations of OAA and SNC devoted to the licensing of each of the subject CPK copyrights.

10. The relevant domestic industry is efficiently and economically operated.

11. The effect and tendency of the unfair acts and unfair methods of competition of respondents and other third parties is to substantially injure the relevant domestic industry.

12. There is a violation of Section 337.

Based on the foregoing findings of fact, conclusions of law, the opinion, and the record as a whole, and having considered all of the pleadings and arguments presented orally and in briefs, it is the Administrative Law Judge's DETERMINATION, pursuant to 19 C.F.R. §§ 210.50 and 210.53(c), that there is no genuine issue of material fact as to any issue, and that, as a matter of law, there is a violation of Section 337 in the unauthorized importation into and sale in the United States of the accused soft sculpture CPK dolls and their related birth certificates, adoption papers, and packaging.

The Administrative Law Judge hereby CERTIFIES to the Commission this INITIAL DETERMINATION, together with the record in this investigation, consisting of the following:

1. Complainants' Motion for Summary Determination (Motion Docket No. 231-12), together with complainants' memorandum and all depositions and exhibits submitted in support thereof; the memorandum and all exhibits submitted by the Commission investigative staff in response to Motion 231-12;

2. The transcript of the hearing and oral argument held in this matter, together with the submissions and exhibits submitted in response to Order No. 16;

3. Complainants' submission of additional information and exhibits following the hearing and oral argument;

4. The Administrative Law Judge's Exhibits 1 and 2.

The complaint and post-hearing pleadings of the parties are not certified, since they are already in the Commission's possession in accordance with the Commission's Rules of Practice and Procedure.

Further, it is ORDERED that:

1. In accordance with 19 C.F.R. § 210.44(b), all material heretofore marked in camera for reasons of business, financial and marketing data found by the Administrative Law Judge to be cognizable as confidential business information under 19 C.F.R. § 201.6(a) is to be given in camera treatment.

2. Pursuant to 19 C.F.R. §§ 210.50 and 210.53(c), Complainants' Motion for Summary Determination, Motion 231-12, is granted on the terms stated herein;

3. The Commission investigative attorney's Motion To Reopen the Record, Motion 231-15, is granted;

4. The Secretary shall serve a public version of this Initial Determination upon all parties of record, and the confidential version upon all counsel of record who are signatories to the Protective Order issued herein, and upon the Commission investigative staff;

5. Counsel for complainants shall indicate to the Administrative Law Judge those portions of this Initial Determination which contain confidential business information to be deleted from the Public Version of this Initial Determination not later than July 18, 1986.

6. This Initial Determination shall become the determination of the Commission pursuant to 19 C.F.R. § 210.53(h) thirty (30) days after the service hereof on the parties, unless the Commission, within thirty (30) days after the date of such service shall have ordered review of the Initial Determination or certain issues therein, pursuant to 19 C.F.R. § 210.54(b) or 210.55, or by order shall have changed the effective date of this Initial Determination.

John J. Mathias
Administrative Law Judge

Issued: July 11, 1986