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COSTCO V. OMEGA AND THE FIRST SALE DOCTRINE

*Lindsay R. Aldridge**

The first sale doctrine, simply put, is the principle that after the copyright owner has transferred a copy of the work, the new owner is free to do almost anything with the copy without the copyright owner's consent. The United States Court of Appeals for the Ninth Circuit held in Costco v. Omega that the first sale doctrine did not apply to imported goods manufactured abroad. The Supreme Court then granted certiorari, only to reach a 4-4 split decision. As a result of the Court's split, the decision of the Ninth Circuit was de facto affirmed; however, the decision fails to set a national standard. This Recent Development explores the implications of the decision, specifically, the impact on the gray market, consumers, and the manufacturing industry in the United States, as well as the implications for the utility of copyright as an import control.

I. INTRODUCTION

One of the exclusive rights conferred by the Copyright Act is the right for copyright owners to control the distribution of the copyrighted work.¹ This right of distribution, however, is limited by the first sale doctrine.²

In December 2010, the United States Supreme Court, in a 4-4 split, affirmed the decision of the United States Court of Appeals for the Ninth Circuit in *Costco v. Omega*,³ which held that the first sale doctrine did not apply to the unauthorized importation of goods manufactured abroad.⁴ However, since the Court split 4-4,

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¹ 17 U.S.C. § 106(3) (2006).

² 17 U.S.C. § 109(a) (2006).

³ *Costco Wholesale Corp. v. Omega, S.A.*, 131 S. Ct. 565 (2010).

⁴ *Omega S.A. v. Costco Wholesale Corp.*, 541 F.3d 982, 983 (9th Cir. 2008), *aff'd by an equally divided court*, 131 S. Ct. 565 (2010).

the ruling does not set a nationwide precedent. This Recent Development examines the economic implications of the Ninth Circuit's holding. Part II of this Recent Development gives a general summary of the first sale doctrine. Part III provides an overview of *Costco v. Omega*, including the background of the case, the Supreme Court split, and the Ninth Circuit's analysis of the first sale doctrine. Part IV analyzes the economic implications of the case, specifically the impact the holding will have on the gray market,⁵ consumers, and the manufacturing industry in the United States, as well as the implications for the utility of copyright as an import control. Lastly, this Recent Development calls for clarification of the first sale doctrine in light of the continuing uncertainty after the Supreme Court's split decision.

II. BACKGROUND: THE FIRST SALE DOCTRINE

Section 106(3) of the Copyright Act gives copyright owners the exclusive right to control the distribution of the copyrighted work.⁶ This right gives a copyright owner the power to decide when to introduce his work into the market, thereby creating an incentive to create additional works, which is an objective of copyright law.⁷ In addition, § 602(a) provides that importation of

⁵ The gray market is defined as:

Generally, gray market or parallel importation occurs when a third party purchases 'genuine' U.S. trademarked or copyrighted goods, manufactured or distributed abroad, and imports and sells these goods in the United States without the consent of the American holder of the trademark or copyright. Gray market goods are distinguishable from black market goods (i.e., counterfeit or imitation goods) in that the U.S. trademark or copyright holder manufactures the goods or permits a foreign licensee to produce the goods according to established specifications.

Joseph Karl Grant, *The Graying of the American Manufacturing Economy: Gray Markets, Parallel Importation, and a Tort Law Approach*, 88 OR. L. REV. 1139, 1139 (2009).

⁶ 17 U.S.C. § 106(3) (2006) ("Subject to sections 107 through 122, the owner of copyright under this title has the exclusive rights . . . to distribute copies . . . of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending.").

⁷ Michael Stockalper, *Is There a Foreign "Right" of Price Discrimination under United States Copyright Law? An Examination of the First-Sale Doctrine*

copyrighted works without the authorization of the copyright owner violates this exclusive right of distribution in § 106(3).⁸

The first sale doctrine, as codified in § 109(a), limits the scope of § 106(3)'s exclusive distribution right.⁹ Section 109(a) provides in relevant part that "[n]otwithstanding the provisions of section 106(3), the owner of a particular copy . . . 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"¹⁰ Under the first sale doctrine, the copyright owner exhausts the exclusive right of distribution after the owner has given up control of a copy of the work.¹¹ The new owner is free to do almost anything with the copy and can dispose of it without the copyright owner's consent.¹² Confusion occurs when determining the relationship between the first sale doctrine in § 109(a) and the importation right in § 602(a), specifically whether the first sale doctrine applies to copyrighted works that are made and first sold abroad, but later imported into the United States without the authorization of the copyright owner.

III. OVERVIEW OF *COSTCO V. OMEGA*

A. *Background on Costco v. Omega*

Omega manufactures watches that contain a United States copyrighted symbol engraved on the underside of the watch face.¹³ Although the engraving is registered under United States copyright law, the watches themselves are manufactured in Switzerland and

as Applied to Gray-Market Goods, 20 DEPAUL J. ART, TECH. & INTELL. PROP. L. 513, 513 (2010).

⁸ See 17 U.S.C. § 602(a) (2006) ("Importation into the United States, without the authority of the owner of copyright under this title, of copies . . . of a work that have been acquired outside the United States is an infringement of the exclusive right to distribute copies . . . under section 106").

⁹ 17 U.S.C. § 109(a) (2006).

¹⁰ *Id.*

¹¹ See 2 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 8.12[A] (2010).

¹² See *id.*

¹³ *Omega S.A. v. Costco Wholesale Corp.*, 541 F.3d 982, 983 (9th Cir. 2008), *aff'd by an equally divided court*, 131 S. Ct. 565 (2010).

sold globally.¹⁴ Costco obtained a quantity of these Omega watches from the New York company, ENE Limited.¹⁵ ENE Limited imported the watches from unidentified third parties, who obtained the watches from authorized distributors abroad that had purchased the watches directly from Omega.¹⁶ Omega authorized only the initial sales to these distributors, but did not authorize the importation of the watches into the United States nor, by extension, the sales made by Costco.¹⁷

Omega initially brought an action against Costco for copyright infringement in the United States District Court for the Central District of California alleging that Costco's purchase and sale of Omega watches constituted copyright infringement under §§ 106(3) and 602(a).¹⁸ In its defense, Costco relied on § 109(a), which codifies the first sale doctrine.¹⁹ Costco asserted that under the first sale doctrine, Omega's authorized sale of the watches to the foreign distributors precluded its claim that Costco infringed its distribution and importation rights.²⁰ The district court ruled in Costco's favor on the basis of the first sale doctrine.²¹ Omega appealed this decision to the United States Court of Appeals for the Ninth Circuit where the decision of the district court was reversed.²² Costco then appealed to the United States Supreme Court.

¹⁴ *Id.*

¹⁵ *Id.* at 984.

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ 17 U.S.C. § 106(3) (2006); 17 U.S.C. § 602(a) (2006); *Costco*, 541 F.3d at 984. Section 501(a) stipulates that "[a]nyone who violates any of the exclusive rights of the copyright owner as provided by sections 106 through 121 . . . or who imports copies . . . into the United States in violation of section 602, is an infringer of the copyright" 17 U.S.C. § 501(a) (2006).

¹⁹ 17 U.S.C. § 109(a) (2006); *Costco*, 541 F.3d at 983.

²⁰ *Costco*, 541 F.3d at 984.

²¹ *Omega S.A. v. Costco Wholesale Corp.*, No. CV 04-5443-TJH(RCx), 2005 U.S. Dist. LEXIS 47014 (C.D. Cal., June 8, 2005), *rev'd*, 541 F.3d 982, *aff'd by an equally divided court*, 131 S. Ct. 565 (2010).

²² *Costco*, 541 F.3d at 983.

B. U.S. Supreme Court

On appeal, the United States Supreme Court had the opportunity to resolve whether the first sale doctrine applies to copyrighted works that are made and sold abroad but later imported into the United States without the authorization of the copyright owner.²³ In a previous case, *Quality King Distributors, Inc. v. L'Anza Research International, Inc.*,²⁴ the Court ruled that the first sale doctrine does apply to copyrighted works that are made in the United States but later imported without authorization.²⁵ However, the Court split evenly 4-4 in the *Costco* appeal, affirming *de facto* the judgment of the Ninth Circuit.²⁶ Only eight of the nine justices voted because Justice Kagan was recused since she had worked on the case while serving as U.S. Solicitor General.²⁷

While the split does mean that the Ninth Circuit ruling stays in place, it is not an endorsement of the Ninth Circuit's interpretation of the first sale doctrine, nor does it set a nationwide precedent. Since courts in other circuits are not bound by this precedent it is unclear how these courts will apply the first sale doctrine to facts like those in *Costco*. Like the Ninth Circuit, federal district courts in the Second Circuit have not allowed the first sale doctrine as a defense to the unauthorized importation of copyrighted works made abroad; however, these courts have not utilized the same logic as the Ninth Circuit.²⁸ For example, in *Pearson Education*,

²³ *Costco Wholesale Corp. v. Omega, S.A.*, 131 S. Ct. 565 (2010).

²⁴ 523 U.S. 135 (1998).

²⁵ *Id.* at 144–52 (1998).

²⁶ *Costco Wholesale Corp. v. Omega, S.A.*, 131 S. Ct. 565 (2010). The Supreme Court's ruling was brief and consisted of one sentence, which read that "[t]he judgment is affirmed by an equally divided Court." *Id.*

²⁷ Brent Kendall, *High Court Splits Evenly in Costco Case*, THE WALL STREET JOURNAL (Dec. 14, 2010), <http://online.wsj.com/article/SB10001424052748703727804576017414255046264.html>.

²⁸ See *Pearson Educ., Inc. v. Liu*, 656 F. Supp. 2d 407 (S.D.N.Y. 2009), *interlocutory appeal granted* *Pearson Educ., Inc. v. Liu*, No. 1:08-cv-06152-RJH, 2010 U.S. Dist. LEXIS 15740 (Feb. 22, 2010); see also John Wiley &

Inc. v. Liu,²⁹ and *John Wiley & Sons, Inc. v. Kirtsaeng*,³⁰ both courts relied on dicta from *Quality King* to find that the first sale defense did not apply to copyrighted works manufactured abroad.³¹ The court in *Pearson* hinted that in the absence of such dicta it would not have restricted application of the first sale doctrine to goods manufactured in the United States.³² The court in *Kirtsaeng* acknowledged that relying on dicta was “an imperfect solution.”³³ Courts do not agree on the application of the first sale doctrine in situations like the one presented in *Costco*, indicating that it is “a close jurisprudential question.”³⁴ As a result, the split decision creates uncertainty in the application of the first sale doctrine to imported goods manufactured abroad.

C. Ninth Circuit’s Analysis

Since the Supreme Court’s split decision does not set a national precedent, this Recent Development focuses on the Ninth Circuit’s analysis of the case. The Ninth Circuit reversed and remanded the decision of the district court.³⁵ The court held that the first sale

Sons, Inc. v. Kirtsaeng, No. 08 Civ. 7834 (DCP), 2009 U.S. Dist. LEXIS 96520 (S.D.N.Y. Oct. 19, 2009).

²⁹ *Pearson*, 656 F. Supp. 2d 407.

³⁰ *John Wiley & Sons, Inc. v. Kirtsaeng*, No. 08 Civ. 7834 (DCP), 2009 U.S. Dist. LEXIS 96520 (S.D.N.Y. Oct. 19, 2009).

³¹ *Pearson*, 656 F. Supp. 2d at 416. The court wrote in its opinion that it would not limit the application of the first sale doctrine to copyrighted works made in the United States; however, respect for the dicta in *Quality King* compelled the court not to apply the first sale doctrine to copyrighted works manufactured abroad. *Id.*

³² *Id.*

³³ *John Wiley & Sons, Inc. v. Kirtsaeng*, No. 08 Civ. 7834 (DCP), 2009 U.S. Dist. LEXIS 96520, at *36–37 (S.D.N.Y. Oct. 19, 2009) (“*Quality King* thus determines the appropriate outcome in this case. Accordingly, the court concludes that the Supreme Court’s unambiguous language, though *dicta*, is sufficient to resolve the uncertainties in interpreting the Act. Although this is perhaps an imperfect solution, given the valid concerns raised in both readings of sections 109 and 602, the court nonetheless will not extend section 109(a) to cover foreign-manufactured goods.”).

³⁴ See *id.* at *17–18 (acknowledging the disagreement among courts in applying section 109(a) to goods manufactured abroad).

³⁵ *Omega S.A. v. Costco Wholesale Corp.*, 541 F.3d 982, 990 (9th Cir. 2008), *aff’d by an equally divided court*, 131 S. Ct. 565 (2010).

doctrine was unavailable as a defense because Omega made the watches abroad and Costco sold them in the United States without authority from Omega.³⁶

In its ruling, the Ninth Circuit first set out the relationship between the three relevant sections of the Copyright Act.³⁷ The court acknowledged that infringement does not occur under § 106(3)³⁸ or § 602(a)³⁹ if the conduct is covered by § 109(a)⁴⁰. The court reasoned that infringing importation under § 602(a) is a subcategory of the exclusive distribution right in § 106(3) and is not violated unless there is a violation of § 106(3).⁴¹ The exclusive distribution right in § 106(3) is limited by the first sale doctrine in § 109(a).⁴² Therefore, if actions fall within the § 109(a) limitation of the § 106(3) exclusive distribution right then there is no violation of either § 106(3) or § 602(a).⁴³

³⁶ *Id.* at 983.

³⁷ *Id.* at 984–85.

³⁸ 17 U.S.C. § 106(3) (2006) (“Subject to sections 107 through 122, the owner of copyright under this title has the exclusive rights . . . to distribute copies . . . of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending.”).

³⁹ 17 U.S.C. § 602(a) (2006) (“Importation into the United States, without the authority of the owner of copyright under this title, of copies . . . 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.”); *see* 17 U.S.C. § 501(a) (2006) (“Anyone who violates any of the exclusive rights of the copyright owner as provided by sections 106 through 122, . . . or who imports copies . . . into the United States in violation of section 602, is an infringer of the copyright . . .”).

⁴⁰ 17 U.S.C. § 109(a) (2006) (“Notwithstanding the provisions of section 106(3), the owner of a particular copy . . . 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 . . .”); *Costco*, 541 F.3d at 985.

⁴¹ *Costco*, 541 F.3d at 985.

⁴² *Id.*

⁴³ *Id.* (“[G]iven that § 106(3) is ‘subject to sections 107 through 122’ and § 109 falls within the designated portion of the Code, § 109(a) limits the exclusive distribution right in § 106(3). Second, infringing importation under § 602(a) is merely a subcategory of ‘infringement of the exclusive right to distribute copies . . . under § 106,’ so conduct that does not violate § 106(3) cannot constitute infringement under § 602(a). Finally, because conduct

For purposes of determining whether the conduct in this case was covered by the § 109(a) limitation, the key phrase in § 109(a) was “lawfully made under this title.”⁴⁴ The Ninth Circuit precedent interpreted the phrase “lawfully made under this title” to include only copies that were legally manufactured and sold in the United States and did not include copies made abroad.⁴⁵ In *BMG Music v. Perez*,⁴⁶ a case involving goods manufactured abroad and imported into the U.S. without the authorization of the copyright owner, the Ninth Circuit found that § 109(a) was not a defense to the § 602(a) claim because the goods were made and sold abroad and therefore were not “lawfully made under this title.”⁴⁷ The court gave two explanations for its decision in that case: (1) to allow § 109(a) as a defense in cases involving goods made abroad would be to extend the Copyright Act extraterritorially, and (2) if § 109(a) included foreign sales, then § 602 would not be a useful device by which to prevent unauthorized importation of non-piratical copies.⁴⁸

In a later case, *Parfums Givenchy, Inc. v. Drug Emporium*,⁴⁹ the Ninth Circuit created an exception to the *BMG Music* rule, since the rule appeared to give stronger copyright protection to copies made abroad than to copies made domestically.⁵⁰ The exception provided that § 109 could apply to copyrighted works made abroad if an authorized first sale occurred within the United States.⁵¹

covered by § 109 (a) does not violate § 106(3), and because absent a violation of § 106(3) there cannot be infringement under § 602(a), conduct covered by § 109(a) does not violate § 602(a).”).

⁴⁴ *Id.*

⁴⁵ *Id.* at 985–86.

⁴⁶ 952 F.2d 318 (9th Cir. 1991).

⁴⁷ *Id.* at 319.

⁴⁸ *See id.* at 319–20 (explaining that prior to importation there is normally a lawful foreign sale).

⁴⁹ 38 F.3d 477 (9th Cir. 1996). *Drug Emporium* involved facts almost identical to those in *BMG Music*. *Id.* at 482.

⁵⁰ *See id.* at 482 n.8.

⁵¹ *Id.* at 481 (“[T]he importation right survives as to a particular copy unless and until there has been a ‘first sale’ in the United States.”); *see also* *Denbicare U.S.A. Inc. v. Toys “R” Us, Inc.* 84 F.3d 1143 (9th Cir. 1996) (finding that a

The Ninth Circuit determined that the Supreme Court's more recent decision in *Quality King* did not invalidate the circuit's interpretation of § 109(a).⁵² The facts in *Quality King* differed from those in *Costco* because that case involved "round trip" importation in which copyrighted goods manufactured in the United States were initially exported and then eventually imported back into the country without the copyright owner's permission.⁵³ In *Quality King*, the Supreme Court found that § 109(a) could provide a defense to an infringement action under § 602(a) in situations involving round trip importation. The Supreme Court in *Quality King* did not determine the correct application of § 109(a) in situations involving goods manufactured and sold abroad and then imported without authorization.⁵⁴ The Ninth Circuit concluded that its own interpretation of § 109(a) was not incompatible with *Quality King* and therefore remained binding precedent.⁵⁵

Under Ninth Circuit precedent a defendant in a copyright infringement action may claim the first sale doctrine in § 109(a) as a defense only where the copyrighted works were made or previously sold in the United States with the copyright owner's authorization.⁵⁶ In *Costco*, the goods were made abroad and had

copyright owner exhausted the exclusive right of distribution by his voluntary sale of copies within the United States). One commentator noted that:

[T]he [Ninth Circuit] simply limited *BMG Music* to its facts and opined that § 109(a) did apply to the first authorized domestic sale of foreign-manufactured goods. However, the court did not go on to explain how foreign-made copies, which *BMG Music* had concluded could never be 'lawfully made under [Title 17]' without extraterritorial application of law, somehow could be made under that title as long as they had been authorized for distribution in the United States.

Samuel Brooks, *Battling Gray Markets Through Copyright Law: Omega, S.A. v. Costco Wholesale Corporation*, 2010 BYU. L. REV. 19, 19.

⁵² *Omega S.A. v. Costco Wholesale Corp.*, 541 F.3d 982, 987 (9th Cir. 2008), *aff'd by an equally divided court*, 131 S. Ct. 565 (2010).

⁵³ *Id.* at 987; *see also Quality King Distribs., Inc. v. L'Anza Research Int'l, Inc.*, 523 U.S. 135, 138–39 (1998).

⁵⁴ *Costco*, 541 F.3d at 987.

⁵⁵ *Id.* at 990.

⁵⁶ *Id.* at 983.

not previously been authorized for sale in the United States.⁵⁷ Therefore, the Ninth Circuit found that Costco could not use the first sale doctrine as a defense to Omega's claims under §§ 106(3) or 602(a).⁵⁸

IV. IMPLICATIONS

A. *Gray Market Implications*

The Supreme Court's split decision in *Costco v. Omega*, while affirming the Ninth Circuit precedent, leaves uncertainty for companies in other circuits that sell copyrightable goods at different prices in various markets and for retailers who benefit from these price differences via the gray market.⁵⁹

Gray market or parallel importation has become a very costly problem for manufacturers.⁶⁰ Gray market importation is generally the result of a third party acting without the authorization of the copyright owner when importing and selling genuine U.S. copyrighted goods that were manufactured and sold abroad.⁶¹ For example, in *Costco*, the Omega watches were imported without authorization from Omega and made available on the gray market, in Costco stores, at a price reduced from \$1,999 to \$1,299.⁶² The gray market affects many industries and has multi-billion-dollar consequences.⁶³

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ See Charles Sims & Jed Friedman, *Costco v. Omega: Supreme Court to Address Gray Goods Market and First Sale Doctrine*, COPYRIGHT & TRADEMARK L. BLOG (June 10, 2010, 8:12 AM), <http://www.lexisnexis.com/Community/copyright-trademarklaw/blogs/copyrightandtrademarklawblog/archive/2010/06/10/costco-v-omega-supreme-court-to-address-gray-goods-market-and-first-sale-doctrine.aspx>.

⁶⁰ Grant, *supra* note 5, at 1139.

⁶¹ *Id.* at 1140.

⁶² Petition for Writ of Certiorari at 5, *Costco Wholesale Corp. v. Omega, S.A.*, 131 S. Ct. 565 (2010) (No. 08-1423), 2010 U.S. LEXIS 9597.

⁶³ Grant, *supra* note 5, at 1140 (“[I]n 2003, the gray market for information technology goods amounted to \$40 billion, costing information technology manufacturers upwards of \$5 billion annually in lost profits.”).

There are several factors that explain why gray markets exist.⁶⁴ One factor is currency fluctuation.⁶⁵ As a result of currency fluctuations, it may be profitable to buy goods from a country that has a weaker currency and then import those goods into a country with a higher valued currency.⁶⁶ Another factor in the creation of gray markets is the difference in costs related to manufacturing goods in different countries.⁶⁷ There are many elements that contribute to the cost of production, like labor costs, tax liabilities, government subsidies, and utility costs.⁶⁸ Manufacturing goods in expensive markets could result in an increase in consumer price, whereas manufacturing goods in more economical markets could result in a decrease in the prices consumers are charged.⁶⁹ A third

⁶⁴ See *id.* at 1142.

⁶⁵ Richard M. Andrade, *The Parallel Importation of Unauthorized Genuine Goods: Analysis and Observations of the Gray Market*, 14 U. PA. J. INT'L BUS. L. 409, 413 (1993) ("During periods when the dollar is strong compared to other currencies, gray markets will emerge in the United States. The exchange rate differentials create the necessary price disparities that allow gray marketeers to reap their profits.").

⁶⁶ Grant, *supra* note 5, at 1143 ("If the exchange rate between dollars and yen changed to a ratio of 1:2, namely \$1 = [yen] 2, then a gray market situation would be born. Assume the South Korean camera manufacturer would still charge \$100 and [yen] 100 respectively to its American and Japanese distributors/licensees. Assume further that the shipping costs remain [yen] 10 (now converted to \$5 with the new exchange rate). As a result of the currency fluctuation, the Japanese distributors/licensees cost (with retail markups included) for the South Korean camera would be equal to \$ 62.50 ([yen] 125 = \$ 62.50 at a \$1: [yen] 2 currency exchange rate). With shipping costs at \$5 ([yen] 10), the total cost to sell the South Korean camera from Japan into the United States becomes \$67.50. The American distributors' and licensees' relative cost to sell its product in the United States becomes \$75. By importing into the United States, the Japanese distributor/licensee nets a profit of \$7.50 per unit sold (\$75.00 - \$67.50 = \$7.50) resulting from the parallel importation.").

⁶⁷ *Id.* at 1145.

⁶⁸ Andrade, *supra* note 65, at 416-17 ("Manufacturing costs may differ due to disparities in raw material accessibility, labor costs, utility expenses, tax liabilities, efficiency of production facilities, government subsidies, and other numerous possible expenses.").

⁶⁹ *Id.* ("If a manufacturer in a high manufacturing cost nation is to preserve his mark-up profit, then the price of the good will have to be adjusted accordingly.").

factor is price discrimination in markets.⁷⁰ The price differences between markets often reflect the ability of the consumers in each market to pay for the good.⁷¹ These resulting price differences create an environment conducive to gray markets.⁷² To hinder the gray market the seller must be able to prevent a customer from buying a product at a lower cost in one market and then selling it in another market at an elevated price, which competes with the seller's ability to sell his item at a higher cost in that market.⁷³ Copyright law does not typically make it illegal to take advantage of price differences in this manner.⁷⁴ However, the ruling of the Ninth Circuit in *Costco* arms copyright owners with the means to combat this practice.

In *Quality King*, the Supreme Court's decision to apply the first sale doctrine to imported goods that were originally manufactured in the United States allowed for importation of gray market

⁷⁰ Grant, *supra* note 5, at 1144 ("To illustrate, say it costs a U.S. widget manufacturer, McWidget, \$25 to manufacture its widget. In setting a palatable market price, McWidget may charge Americans \$250 per piece for its widgets, drawing comfort from the fact that the average American has the ability and resources to pay such a premium price. In Mexico, due to harsher economic circumstances, McWidget may charge \$50 for the same widget. In Germany, where the economy is finely tuned, McWidget might price its widgets at \$150. In Japan, McWidget might charge \$200 for the widget because the Japanese consumer has the ability to pay, much like the American consumer. Finally, in Hong Kong, McWidget might choose to price the widget at \$175. These examples demonstrate that price is largely driven by market forces—or the ability of consumers to pay for a particular product—and as a result of those market forces, manufacturers exercise a great deal of discretion within the confines of the market with respect to their pricing behavior.").

⁷¹ See Andrade, *supra* note 65, at 415 ("Foreign manufacturers can behave in an anti-competitive manner by manipulating the price that they charge in different nations. For example, the manufacturer may charge \$100 for the trademarked good in Japan, \$110 in Germany, \$ 75 in the UK, and \$200 in the United States. It is argued that, if parallel imports are excluded from the U.S. market, the price of the trademarked good will be artificially high. The lack of intra-brand competition will allow the foreign manufacturer to extract non-competitive profits from U.S. consumers.").

⁷² Grant, *supra* note 5, at 1142.

⁷³ Stockalper, *supra* note 7, at 519.

⁷⁴ See *id.* ("[B]ecause once a person purchases a lawful copy, he can resell or dispose of the property at whim under the first-sale doctrine.").

copyrighted goods.⁷⁵ The Ninth Circuit decision in *Costco v. Omega*, however, limited this ability to import gray market goods to the specific facts in *Quality King*—for goods manufactured in the United States, exported, then imported back into the United States.⁷⁶ The Ninth Circuit's ruling does not expand the ability to import gray market goods to copyrighted goods manufactured and distributed abroad but not authorized for importation.⁷⁷

Therefore, the Ninth Circuit decision in favor of Omega allows copyright holders to continue charging higher prices in the United States than those charged abroad and to do so without worrying that the gray market will offer discounted prices and thereby hurt the copyright holders' domestic sales.⁷⁸ The presence of the gray market in the United States may be diminished as a result of the Ninth Circuit's holding that the first sale doctrine is unavailable as a defense to copyright infringement.⁷⁹ A shrinking gray market means that industries will be able to exercise greater control over the importation and resale of their goods.⁸⁰

However, if other circuits choose to allow § 109(a) as a defense to copyright infringement for the unauthorized importation of goods manufactured abroad, then copyright holders will not be as able to sell copyrighted goods at different price points without suffering the economic repercussions of the gray market.⁸¹ Instead, retailers like Costco will be able to exploit price differences and offer the same goods at lower prices. Such behavior would lead to an expansion of the gray market. While many extol the potential benefits of an expanded gray market, others argue that an

⁷⁵ Grant, *supra* note 5, at 1141 (“[T]he pivotal U.S. Supreme Court decision, *Quality King Distributors v. L'anza Research International, Inc.*, . . . opened the way for legal parallel importation of gray market goods.”).

⁷⁶ *Id.*

⁷⁷ *Id.*

⁷⁸ See Sims & Friedman, *supra* note 59.

⁷⁹ Paul E. Thomas, *What Will Come from the Uncertainty of the Split Decision in Costco v. Omega*, FREDRIKSON & BYRON, P.A. (Dec. 31, 2010), http://www.fredlaw.com/articles/ip/copy_1012_pet.html.

⁸⁰ *Id.*

⁸¹ See Sims & Friedman, *supra* note 59.

expansion of the gray market and the secondary market would be harmful to U.S. manufacturing.⁸²

B. *Consumer Effects*

The gray market provides American consumers with increased access to cheaper goods because it enables retailers, like Costco, to sell goods at lower prices, which in turn puts pressure on authorized retailers to lower their prices.⁸³ The ruling in *Costco v. Omega* makes purchasing goods in the gray market riskier, meaning fewer retailers will be willing to do so.⁸⁴ Discounted goods available at stores like Costco will then become less available, and the prices of these same goods in non-discount venues will increase.⁸⁵ Therefore, consumers will likely end up paying higher prices.⁸⁶

Retailers like Costco are not the only entities that rely on the application of the first sale doctrine to imported goods manufactured abroad.⁸⁷ Consumers also depend on this application of the first sale doctrine and the Ninth Circuit's holding in *Costco* reduces consumers' personal property rights.⁸⁸ Many owners of copyrighted works do not know where their goods were made and

⁸² *Id.*

⁸³ Thomas, *supra* note 79; see Sims & Friedman, *supra* note 59.

⁸⁴ Thomas, *supra* note 79 ("This decision makes the gray market for copyrighted works a riskier place in which to do business. The Copyright Act allows a copyright owner to restrict importation of copies into the U.S. and to sue for infringement if importation occurs without the owner's consent (17 U.S.C. § 602(a)). If the First Sale doctrine is not a defense to such an infringement suit, then fewer people will risk purchasing authentic goods through the gray market in order to maximize their profits in resale in the United States. So, the long term effect of this decision could be a contraction of the size of the gray market for copyrighted works.").

⁸⁵ *INTELLECTUAL PROPERTY: Omega v. Costco Case Poses a Threat to Gray Market Goods*, JACKSON, DEMARCO, TIDUS, PECKENPAUGH <http://www.jdtplaw.com/CM/Publications/Omega-v-Costco-Case-Poses-a-Threat-to-Gray-Market-Goods.asp> (last visited Feb. 27, 2011).

⁸⁶ Thomas, *supra* note 79.

⁸⁷ *INTELLECTUAL PROPERTY: Omega v. Costco Case Poses a Threat to Gray Market Goods*, *supra* note 85.

⁸⁸ Brief for Public Citizen as Amici Curiae Supporting Petitioner at 7, *Costco Wholesale Corp. v. Omega, S.A.*, 131 S. Ct. 565 (2010) (No. 08-1423).

therefore do not know whether the first sale doctrine applies.⁸⁹ Since ignorance of the source of goods cannot be used as a defense against a claim of copyright infringement, many groups' ability to buy and sell copyrighted works will be hampered.⁹⁰ One such group that may be greatly affected by the *Costco* decision is libraries. Americans borrow books and other materials from libraries in the United States 4.4 billion times a year.⁹¹ This

⁸⁹ Mart Kuhn, *Costco v. Omega: Supreme Court Argument Recap*, PUBLIC KNOWLEDGE (Nov. 9, 2010), <http://www.publicknowledge.org/blog/costco-v-omega-supreme-court-argument-recap>.

⁹⁰ Brief for Public Citizen as Amici Curiae Supporting Petitioner, *supra* note 88, at 9–10 (“For example, under the Ninth Circuit’s rationale, an individual would be unable to resell products with foreign-made copyrighted labels at a garage sale if those products were not first sold in the United States. A car owner could not sell a used foreign automobile with a copyrighted computer system or Omega-like emblem. As long as there is a copyright hook, a Craigslist resale of a Japanese-made Costco-purchased big screen television, surround sound system, and DVD player would be off-limits. Beware of bringing that bottle of Italian wine with that interesting label to the new neighbors as a housewarming gift. An American traveler could not even purchase the Seamaster watch at the Omega factory in Switzerland to bring back to the United States to give to her father as a retirement gift without committing copyright infringement. None of these examples involves an unauthorized copy of the item or a situation involving an unauthorized initial sale. Nevertheless, they would all be examples of copyright infringement if the decision below stands. And since a manufacturer could put a copyrighted label on virtually any product, there is no limit on the everyday items affected.”); 4 NIMMER & NIMMER, *supra* note 11, § 13.08[B][1] (“In actions for statutory copyright infringement, the innocent intent of the defendant constitutes no defense to liability. A bit of reflection suffices to realize that such innocence should no more constitute a defense in an infringement action than it would to a charge of conversion of tangible personalty. In each instance, the injury is worthy of redress, regardless of defendant’s innocence. Moreover, there is added reason to apply the general rule to copyright actions, for which a defendant may easily plead innocence, and the plaintiff be left without any practical ability to disprove it. Copyright would lose much of its value if third parties, such as publishers and producers, were insulated from liability because of their claimed innocence as to the culpability of the persons who supplied them with infringing materials. Further, as between two innocent parties (*i.e.*, the copyright owner and the innocent infringer) the latter should suffer inasmuch as he, unlike the copyright owner, has the opportunity to guard against infringement by diligent inquiry.”).

⁹¹ Brief of the American Library Assoc., the Assoc. of College and Research Libraries, and the Assoc. of Research Libraries as Amici Curiae Supporting

borrowing does not infringe the copyright owners' exclusive rights of distribution under the Copyright Act because of the first sale doctrine.⁹² However, the Ninth Circuit's decision in *Costco* jeopardizes this ability to lend.⁹³ Many books contain no indication of whether they were manufactured in the United States or abroad; therefore, libraries cannot know whether a defense under the first sale doctrine is applicable.⁹⁴ Libraries will be forced to decide whether to risk copyright infringement liability by continuing to lend materials that may fall outside the protection of the first sale doctrine.⁹⁵ Going forward, libraries could adapt to the Ninth Circuit's rule by obtaining a "lending license" each time it acquires a work that is not clearly made in the United States.⁹⁶ The costs associated with acquiring and maintaining records of such licenses may result in an overall reduction in libraries' acquisitions adversely affecting the size of the collections.⁹⁷

C. *Consequences for American Manufacturing and Jobs*

Another potential implication of the *Costco v. Omega* case is the consequences for the job market in the United States. One argument against the Ninth Circuit's ruling is that it creates an incentive for American manufacturers to take their manufacturing

Petitioner at 3–4, *Costco Wholesale Corp. v. Omega, S.A.*, 131 S. Ct. 565 (2010) (No. 08-1423).

⁹² *Id.*

⁹³ *Id.* at 4.

⁹⁴ *Id.* at 14–15 (“[A] book published by a U.S. publisher that hired a U.S. printer may actually have been printed abroad. Unless a copy of a book specifically states on its copyright page that it was printed in the United States, a library has no practical way to learn where the book was printed.”).

⁹⁵ *Id.* at 17.

⁹⁶ *Id.* at 24.

⁹⁷ *Id.* at 24–25. The American Library Association describes the burden on public libraries as follows:

In 2007, public libraries purchased an estimated 75 million works at a cost of \$1.34 billion. If libraries had to pay a lending license “tax” of twenty percent of the purchase price on a third of these materials, libraries would have to pay a tax of over \$ 150 million for each year's acquisitions.

Id. at 26 (citing Institute of Museum and Library Services, *Public Libraries Survey Fiscal Year 2007* 94 (2009)).

abroad.⁹⁸ The first sale doctrine does apply to the facts presented in *Quality King*, where goods manufactured in the United States were only authorized for sale abroad.⁹⁹ In that situation, the manufacturers could not exercise control over the later, unauthorized importation of the goods.¹⁰⁰ If the goods are manufactured abroad, then manufacturers will be able to exercise greater control over importation into the United States and thereby control the presence of their goods on the gray market.¹⁰¹ A manufacturer would simply need to go outside the United States, affix a copyrighted work, like a logo, to its goods in order to harness this power over distribution.¹⁰² Considering the relative ease with which a copyrighted symbol can be applied to almost any good, the potential ramifications are great.¹⁰³ This incentive to take manufacturing abroad raises concerns about American manufacturing jobs being sent overseas.¹⁰⁴ In addition to losing manufacturing jobs, job losses would also likely occur in the secondary market.¹⁰⁵

⁹⁸ Thomas, *supra* note 79.

⁹⁹ *Quality King Distribs., Inc. v. L'anza Research Int'l, Inc.*, 523 U.S. 135 (1998).

¹⁰⁰ *Id.*

¹⁰¹ Thomas, *supra* note 79.

¹⁰² Brief for Public Citizen as Amici Curiae Supporting Petitioner, *supra* note 88, at 13. Public Citizen describes the possible deleterious effects of the Ninth Circuit's rulings by saying:

[A] California wine producer could choose to have labels produced in Mexico with the result that no one could give away or resell a bottle of their wine without permission. Car manufacturers could have their logos manufactured internationally and foreclose the used car market entirely. And, of course, this scheme applies to copyrighted works, too: for instance, printers of books could move their manufacturing abroad to eliminate the used book store market.

Id. at 14.

¹⁰³ *See id.* at 7.

¹⁰⁴ Thomas, *supra* note 79.

¹⁰⁵ Brief of eBay Inc., Google Inc., Netcoalition, The Computer & Communications Industry Association, and the Internet Commerce Coalition as Amici Curiae Supporting Petitioner at 20, *Costco Wholesale Corp. v. Omega, S.A.*, 131 S. Ct. 565 (2010) (No. 08-1423).

D. *Use of Copyright to Control Importation of Non-Copyrightable Goods*

Another problem presented by *Costco* is that manufacturers may start, or rather increase their use of, putting copyrighted designs on goods that would not otherwise be copyrightable so that the manufacturer can use the Copyright Act to gain more control over importation of the goods.¹⁰⁶ Satisfying the requirements for obtaining a copyright in the United States is fairly easy so almost any logo can gain copyright protection.¹⁰⁷ By attaching the copyrighted item to its goods, the manufacturer can exercise control over unauthorized importation.¹⁰⁸ Regardless of how many sales occur abroad, copyright law would allow the manufacturer to exercise control over distribution of the same product under American law as long as no authorized sale occurs in the United States.¹⁰⁹ In *Costco*, for example, the design on the underside of the watch was a copyrighted design, while the watch itself was a product that does not qualify for copyright protection.¹¹⁰ Omega added this engraving to its watches only after becoming aware of gray market competition.¹¹¹ Placing the design on the watch

¹⁰⁶ Thomas, *supra* note 79; see also Brief for Public Citizen as Amici Curiae Supporting Petitioner, *supra* note 88, at 7 (citing *Quality King Distrib., Inc. v. L'Anza Research Int'l, Inc.*, 523 U.S. 135, 151 (1998)) (“[M]anufacturers of ordinary functional items have discovered that they, too, can take advantage of copyright law by copyrighting products’ labels or packaging, or, as in [*Costco*], by placing tiny copyrighted etchings on the back of their products. In a case about a copyrighted shampoo label, this Court tolerated such a copyright, but explained that, in interpreting the Copyright Act, ‘we must remember that its principal purpose was to promote the progress of the ‘useful Arts’ by rewarding creativity and its principal function is the protection of original works, rather than ordinary commercial products that use copyrighted material as a marketing aid.’”).

¹⁰⁷ Brief for Public Knowledge as Amici Curiae Supporting Petitioner at 10, *Costco Wholesale Corp. v. Omega, S.A.*, 131 S. Ct. 565 (2010) (No. 08-1423).

¹⁰⁸ See *id.*

¹⁰⁹ Anjal Bhat, *Protecting the First Sale Doctrine: PK Files Amicus Brief in Costco v. Omega*, PUBLIC KNOWLEDGE (July 9, 2010), <http://www.publicknowledge.org/blog/protecting-first-sale-doctrine-pk-files-amicu>.

¹¹⁰ *Id.*

¹¹¹ *INTELLECTUAL PROPERTY: Omega v. Costco Case Poses a Threat to Gray Market Goods*, *supra* note 85.

allowed Omega to use § 602 of the Copyright Act to bring the copyright infringement suit against Costco.¹¹² Utilizing a copyrighted mark enabled Omega to exercise control over the importation of its watches that it otherwise would not have had and thereby control the downstream sale of its watches.¹¹³

V. NEED FOR CLARIFICATION

The Supreme Court's failure to set a nationwide precedent leaves the application of the first sale doctrine in an ambiguous state. Other circuits may choose to rely on the Ninth Circuit's analysis as a model for how to apply the first sale doctrine, however, other circuits are not compelled to follow the Ninth Circuit. Since significant interests are at stake it is important that the appropriateness of not applying the first sale doctrine to imported goods manufactured abroad be clarified. This clarification will need to come from either the Supreme Court or Congress. The Supreme Court would need to either accept or reject the Ninth Circuit's interpretation and ultimately declare the relationship between §§ 106, 109, and 602 in order to resolve the ambiguity surrounding the application of the first sale doctrine to unauthorized importation of goods manufactured abroad. Alternatively, Congress may need to act in the form of a clarifying amendment to the Copyright Act, which may be a more suitable route considering that the confusion of whether to apply the first sale doctrine appears to stem from the language of the Copyright Act itself. Furthermore, it may be more appropriate for Congress to address the application of the first sale doctrine since it implicates many public policy considerations, including the propriety of manufacturers' use of copyright law to control the presence of their goods on the gray market.

VI. CONCLUSION

The Supreme Court split in *Costco v. Omega* has created uncertainty in whether to apply the first sale doctrine to imported

¹¹² Thomas, *supra* note 79.

¹¹³ *INTELLECTUAL PROPERTY: Omega v. Costco Case Poses a Threat to Gray Market Goods*, *supra* note 85.

goods manufactured abroad. While the split does affirm the Ninth Circuit's ruling, other circuits are free to decide whether or not to follow the *Costco* model of not allowing the first sale defense for the unauthorized importation of goods made abroad. Whether the first sale doctrine is applied to these goods may have serious consequences for the gray market, consumers, manufacturing in the United States, and the use of copyright as a means to control importation. With such important interests at stake it is important that the confusion surrounding the proper treatment of the first sale doctrine with regards to imported goods manufactured abroad be clarified. The Supreme Court or Congress will need to supply this clarification so that Courts can confidently and uniformly apply copyright law and so that consumers and manufacturers can regain confidence regarding transactions involving copyrighted goods.