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# Can a Copyright Owner Prevent the Sale of an Item, Made Abroad, but Then Imported into the United States?

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## Can a Copyright Owner Prevent the Sale of an Item, Made Abroad, but then Imported into the United States?

### CASE AT A GLANCE

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In this case, the Supreme Court has agreed to determine whether the “first-sale” doctrine applies where a copyrighted work was initially manufactured and distributed elsewhere, but eventually imported into the United States.

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***Costco Wholesale Corp. v. Omega S.A.***

**Docket No. 08-1423**

**Argument Date: November 8, 2010**

**From: The Ninth Circuit**

by Kali Murray

Marquette University, Milwaukee, WI

### ISSUE

Does the first-sale doctrine apply to lawfully made copyrighted works that are manufactured and distributed by the copyright owner outside of the United States, and then subsequently imported into the United States?

### FACTS

Respondent Omega S.A. (Omega) is a Swiss luxury watch company that manufactures watches in Switzerland. Omega received a copyright, entitled Omega Globe Design, in 2003 in a small visual depiction of three Greek Omega symbols inside a circle. This design is laser-engraved onto each watch at Omega’s facility in Switzerland.

Petitioner Costco Wholesale Corporation (Costco), is a membership warehouse retailer, located in the United States. Costco, as part of its admitted sales strategy, sold genuine brand-name merchandise, such as Omega watches, at a significant discount. Costco obtained these watches from third parties who had imported genuine Omega watches into the United States. Costco received Omega’s watches as part of a “gray market” of parallel imports in a copyrighted work. A “gray market” sale occurs when a nonauthorized third party purchases a copyrighted work from an authorized distributor abroad, and then imports that work into the United States.

In this case, Costco obtained the watches from New York-based supplier, ENE Limited. ENE Limited had acquired the watches from unknown third parties in other countries and imported them into the United States. These third parties bought the watches from authorized distributors in other countries to which Omega directly sold its watches.

After Costco sold these watches to 43 customers, Omega sued Costco for infringing on Omega’s right to distribute its copyrighted logo.

Two provisions control the right of distribution under the Copyright Act. Under § 106(3) of the Copyright Act, copyright owners have the exclusive right to distribute their copyrighted works in the United States. In addition, § 602(a)(1) states that the import into the United States of a copyrighted work that was acquired outside of the United States, without the authority of the copyright owner, also violates the exclusive right of distribution.

Costco countered Omega’s infringement claim with the first-sale defense. The first-sale doctrine allows the purchaser of a copyrighted work to use or otherwise dispose of his or her actual copy of the copyrighted work (think, for example, of the owner of a book, who may sell his or her particular copy to a used bookstore). The first-sale doctrine is codified at § 109. Section 109 provides that the owner of a particular copy of copyrighted work “lawfully made under this title,” is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that particular copy of a copyrighted work.

On February 6, 2007, District Judge Hatter of the U.S. District Court for the Central District of California granted Costco’s motion for summary judgment and vacated the preliminary injunction. The order did not provide any explanation for the ruling.

Omega appealed to the Ninth Circuit, where a three-judge panel unanimously reversed the district court’s grant of summary judgment. *Omega S.A. v. Costco Wholesale Corp.*, 541 F.3d 982 (2008). In its reversal, the Ninth Circuit held that the “first-sale” defense only applied to those items made and distributed in the United States, and not to those items (like Omega’s watches) that were originally made and distributed outside of the United States. The Ninth Circuit based its determination on its reading on two bases, its own precedent, as well as the Supreme Court’s holding in *Quality King Distributors v. Lanza Research International*, 523 U.S. 135 (1998). *Quality King* held

that the first-sale doctrine applied to so-called round trip copyrighted works (those copyrighted works made and distributed in the United States, exported to another country, and subsequently re-imported into the United States).

Initially, in adhering to its previous precedents, the Ninth Circuit stressed two concerns. First, the Ninth Circuit stressed that applying the first-sale defense to Omega watches manufactured outside of the United States would violate the presumption against the extraterritorial application of U.S. law. Second, the Ninth Circuit wished not to expand the first-sale defense for fear that copyright infringement suits would become useless in preventing “gray market” distribution since authorized distributors could then re-sell their particular copies of their copyrighted works made outside of the United States to parties in the United States. This would disrupt the copyright owner’s ability to segregate different markets for its copyrighted goods. The Ninth Circuit concluded, then, that Costco should not have prevailed on summary judgment, based the Ninth Circuit’s reading of its own precedent.

Furthermore, the Ninth Circuit contended that its precedent was consistent with *Quality King* for three reasons. First, *Quality King* involved the category of “round trip” copyrighted works. By contrast, the Omega watches Costco sold were manufactured and initially distributed abroad, so therefore, these watches were not “lawfully made” within the United States, and thus, not within the scope of § 109. Second, the Ninth Circuit emphasized that its reading of *Quality King* was consistent with the view expressed by Justice Ginsburg in her concurring *Quality King* opinion. Finally, the Ninth Circuit repeated that extending the first-sale defense to these circumstances would impermissibly extend U.S. copyright law in an extraterritorial manner.

The Supreme Court granted certiorari on April 20, 2010.

## CASE ANALYSIS

The perceived need to combat “gray market” distribution motivated the Ninth Circuit’s adherence to its pre-*Quality King* precedent. The increased globalization of supply chains, and the perceived difficulties of policing trademarked goods within those supply chains, has led manufacturers such as Omega to use copyright law as a means of controlling their authorized distribution channels. The Supreme Court’s ultimate determination in *Costco*, however, may prevent such attempted use of copyright law; if the “first-sale” doctrine applies to the import of copies of copyrighted work, distributed through authorized distribution channels, it will mean that manufacturers will not be able to use copyright law as a tool to prevent gray market distribution.

Costco raises three primary legal claims in arguing that the first-sale defense applies here. First, Costco argues that the Ninth Circuit’s holding did not comport with the Copyright Act’s plain language, structure, and legislative history. Costco claims that within the text of § 109, the phrase “lawfully made under this title” means any authorized copies made by the copyright holder (in this case, Omega). This language is consistent with the other statutory text, such as § 110, which utilizes the same statutory language. Second, Costco disagrees with the attempt by the Ninth Circuit to limit *Quality King*

to “round-trip” imports. In particular, Costco contends that there was no extraterritorial enforcement here as Omega was attempting to prevent the distribution of watches in the United States, and so therefore, the presumption against extraterritoriality simply did not apply. Third, Costco contends that the provisions of § 602(a)(1) were not inconsistent with its reading of § 109 in that an infringement suit over a “gray market” copyrighted work would only be initiated within the United States. Therefore, according to Costco, there was no extraterritorial application of the Copyright Act.

In its response, Omega addresses the same legal claims as Costco’s brief—the statutory text of § 109, *Quality King*’s relevance as a precedent, and the relationship of § 109 to § 602—although, of course, with much different conclusions. Initially, Omega contends that the term “lawfully made under this title” means that “if the making of the copy is both governed by and consistent with the Copyright Act.” This meaning practically mirrors the interpretation advanced by Costco, but with one crucial caveat: a copyrighted work made abroad is not governed by the Copyright Act since the work was initially made and distributed abroad. Omega then turns to its understanding of *Quality King*, specifically pointing to the conclusion of the Court there, that “lawfully made” was intended to apply to those copyrighted works initially made and distributed in the United States, rather than those works “lawfully made” under the copyright laws of other nations. Finally, Omega argues that Costco’s reading of § 602(a)(1) would render it without significance within the Copyright Act. Specifically, Omega claims that as § 602 prevents unauthorized “importation” of copies of a copyrighted work into the United States, it must be read to not simply apply to unauthorized and pirated copies of a work, but also to those works that are distributed outside of the copyright owner’s authorized distribution channels. Such a reading, claims Omega, would be consistent with other provisions of § 602, such as § 602(a)(2), which prohibits the importation of pirated goods (that is, those works that would infringe upon a copyrighted work).

These legal claims aside, both Omega and Costco raise significant policy concerns that could result from any Supreme Court decision here. According to Costco, the failure to adopt a rigorous first-sale doctrine in this instance, which would significantly limit the importation of “gray market” goods, would in turn, lead to significant restriction on secondary markets for copyrighted goods, which, according to Costco, have a value of \$40 billion to \$60 billion in annual revenue. Furthermore, by allowing Omega to utilize copyright law to in essence achieve additional trademark-like protection over its luxury goods, would run counter to the general tradition (exemplified by the first-sale doctrine) to favor the free transfer of property. By contrast, Omega contends that positive economic benefits accrue from limiting the importation of gray-market goods, such as the ability of companies to engage in location-specific product promotion and distribution.

## SIGNIFICANCE

*Costco* is significant in both legal and practical contexts. *Costco* will have legal implications in both a narrow and broad sense. In a narrow sense, *Costco* will provide answers as to the scope of the Supreme Court’s holding in *Quality King*, the relationship between the first-sale doctrine under § 109 and § 602, and the availability of the first-sale defense to retailers or other parties that import a product that was legally obtained from an authorized party in another country. In

a broad sense, *Costco* will help us to understand the Supreme Court’s ongoing engagement with the extraterritorial consequences of our current intellectual property regime.

*Costco* also has larger practical implications for the vibrant secondary market in the authorized sale of “gray-market” goods. In particular, it may provide significant limits on the source of discounted goods for the relevant retailers. Moreover, if the Supreme Court affirms the Ninth Circuit’s decision, manufacturers would have a significant tool to limit the emergence of gray-market alternatives in an increasingly interconnected global economy.

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*PREVIEW of United States Supreme Court Cases*, pages 76–78.  
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