

# LACKING SWISS PRECISION: THE FIRST-SALE DOCTRINE IN *COSTCO v. OMEGA*

JUSTIN YEDOR\*

## I. INTRODUCTION

Copyright law seeks to achieve its constitutional mandate “to promote the progress of Science”<sup>1</sup> in part by providing copyright owners with the exclusive right to control the distribution of their copyrighted works.<sup>2</sup> The first-sale doctrine,<sup>3</sup> which provides that “[o]nce [a] copyright owner consents to the sale of particular copies of his work, he may not thereafter exercise the distribution right with respect to those copies,”<sup>4</sup> limits the exclusive distribution right. In *Costco Wholesale Corp. v. Omega, S.A.*,<sup>5</sup> the Supreme Court granted certiorari to clarify whether the first-sale doctrine applies to imported goods manufactured abroad.<sup>6</sup> U.S. retailers often import foreign-made goods previously sold to third parties by the goods’ manufacturers.<sup>7</sup> Whether the first-sale doctrine applies determines whether U.S. retailers must obtain a manufacturer’s permission before importing goods the manufacturer has already sold abroad. Nevertheless, the

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1. U.S. CONST. art. I, § 8, cl. 8.

2. See 17 U.S.C.A. § 106(3) (West 2010) (providing an exclusive distribution right); 17 U.S.C.A. § 602(a)(1) (West 2010) (providing an exclusive importation right).

3. 17 U.S.C.A. § 109(a) (West 2010).

4. 2 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 8.12[b][1] (2010).

5. *Costco Wholesale Corp. v. Omega S.A.*, 131 S. Ct. 565 (2010) (per curiam) (Kagan, J., took no part in considering or deciding the case).

6. Petition for Writ of Certiorari at i, *Costco Wholesale Corp. v. Omega S.A.*, No. 08-1423 (U.S. May 18, 2009).

7. One study estimated such activity accounted for \$58 billion in revenue in 2007. *Effective Channel Management is Critical in Combating the Gray Market and Increasing Technology Companies’ Bottom Line*, KPMG GRAY MARKET STUDY UPDATE (KPMG LLP), 2008, at 30, [http://www.agmaglobal.org/press\\_events/press\\_docs/KPMG%20AGMAGrayMarketStudyWebFinal071008.pdf](http://www.agmaglobal.org/press_events/press_docs/KPMG%20AGMAGrayMarketStudyWebFinal071008.pdf).

equally divided Supreme Court's one-line per curiam decision leaves this important question without an authoritative answer.<sup>8</sup>

## II. FACTS

Petitioner Costco Wholesale Corporation is a "membership warehouse club" that sells discounted brand-name merchandise.<sup>9</sup> Respondent Omega S.A. is a Swiss manufacturer of luxury wristwatches, which it sells throughout the world through authorized distributors and retailers.<sup>10</sup> In 2003, after fruitless negotiations to become an authorized Omega retailer,<sup>11</sup> Costco obtained Omega watches from third-party importers and sold them in its retail stores.<sup>12</sup>

In response to complaints from authorized dealers about Costco's low retail prices,<sup>13</sup> Omega began engraving a simple symbol, which it registered with the United States Copyright Office, on the back of its Seamaster watches.<sup>14</sup> In 2004, Costco sold forty-three Seamaster watches, some of which originally had been sold by Omega to authorized distributors in Paraguay who subsequently resold them.<sup>15</sup> A distribution agreement between Omega and the Paraguayan distributors restricted resale of the watches to geographical areas outside the United States.<sup>16</sup>

When Omega discovered the unauthorized sales, it filed suit against Costco, alleging infringement of its exclusive importation and distribution rights under the U.S. Copyright Act of 1976.<sup>17</sup> Costco moved for summary judgment on the ground that Omega's sale of the watches abroad extinguished its importation and distribution rights in those copies, providing a complete defense under the first-sale

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8. *Costco Wholesale Corp.*, 131 S. Ct. at 565 (per curiam) (Kagan, J., took no part in considering or deciding the case).

9. Brief for the Petitioner at 7, *Costco Wholesale Corp.*, 131 S. Ct. 565 (2010) (No. 08-1423).

10. Brief for Respondent at 1, *Costco Wholesale Corp.*, 131 S. Ct. 565 (2010) (No. 08-1423).

11. *Id.* at 3.

12. *Id.*

13. For example, Costco sold the Omega Seamaster, which carried a suggested retail price of \$1,995, for \$1,299. Brief for the Petitioner, *supra* note 9, at 8.

14. *Id.* at 8-9. According to Costco, Omega's sole purpose for engraving the symbol on its watches was to restrict their resale. Omega did not market or advertise the symbol, nor make public any plans regarding it. *Id.* at 9.

15. *Id.* at 9.

16. Brief for Respondent, *supra* note 10, at 3.

17. Brief for the Petitioner, *supra* note 9, at 9.

doctrine.<sup>18</sup> The district court agreed and granted summary judgment for Costco.<sup>19</sup> On appeal, the Ninth Circuit reversed, holding that the phrase “lawfully made under this title,” which limits the scope of the first-sale doctrine, grants first-sale protection “only to copies legally made . . . in the United States.”<sup>20</sup> The Supreme Court granted Costco’s petition for writ of certiorari to clarify whether the first-sale doctrine applies to imported goods manufactured abroad.<sup>21</sup>

### III. LEGAL BACKGROUND

Section 602(a)(1) of the Copyright Act of 1976 gives copyright owners the exclusive right to control the importation of their copyrighted works.<sup>22</sup> This right stems from § 106(3)’s exclusive distribution right.<sup>23</sup> In *Bobbs-Merrill Co. v. Straus*,<sup>24</sup> the Supreme Court limited the copyright owner’s right to control sales<sup>25</sup> to the “first sale” of the copyrighted work.<sup>26</sup> Congress subsequently codified the first-sale doctrine in § 109(a), which provides that “[n]otwithstanding 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.”<sup>27</sup>

*Costco v. Omega* is the latest in a long line of cases arising from the tension between § 602(a)(1)’s exclusive-importation right and the § 109(a) first-sale defense. The issue first arose in 1983 in *CBS v.*

18. *Id.* at 9–10.

19. *Omega S.A. v. Costco Wholesale Corp.*, No. CV 04-05443 TJH (RCx), 2007 WL 7029734 (C.D. Cal. Feb. 6, 2007).

20. *Omega S.A. v. Costco Wholesale Corp.*, 541 F.3d 982, 990 (9th Cir. 2008) (quotation marks omitted).

21. Petition for Writ of Certiorari, *supra* note 6, at i.

22. 17 U.S.C.A. § 602(a)(1) (West 2010) (“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 or phonorecords under section 106, actionable under section 501.”).

23. *Id.*

24. *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339 (1908).

25. The Copyright Act of 1897 secured the author of a copyrighted work the rights of “printing, reprinting, publishing, completing, copying, executing, finishing, and vending the same.” Copyright Act of 1897, 60 U.S. Rev. Stat. § 4952, [http://www.ipmall.info/hosted\\_resources/lipa/copyrights/Public%20Acts%20Relating%20to%20Copyright%20Passed%20by%20the%20Congress.pdf](http://www.ipmall.info/hosted_resources/lipa/copyrights/Public%20Acts%20Relating%20to%20Copyright%20Passed%20by%20the%20Congress.pdf).

26. *Bobbs-Merrill*, 210 U.S. at 350.

27. 17 U.S.C.A. § 109(a) (West 2010) (originally enacted as Copyright Act of 1909, ch. 320, § 41, 35 Stat. 1084).

*Scorpio Music Distributors*<sup>28</sup> when the district court for the Eastern District of Pennsylvania held that the phrase “lawfully made under this title” limited the scope of the § 109(a) defense to “copies which have been legally manufactured and sold within the United States.”<sup>29</sup> Accordingly, the first-sale defense was unavailable to an importer of Philippine-made phonorecords intended by the manufacturer for distribution outside the United States.<sup>30</sup>

The Supreme Court first addressed importation and the first-sale doctrine in *Quality King Distributors, Inc. v. L’anza Research International, Inc.*,<sup>31</sup> which arose from a circuit split between the Third and Ninth Circuit Courts of Appeal.<sup>32</sup> In that case, the plaintiff, L’anza, manufactured beauty supplies with copyrighted labels in California, then exported the goods and sold them abroad.<sup>33</sup> The defendant, Quality King, purchased the goods on the gray market,<sup>34</sup> imported them and resold them in the United States.<sup>35</sup> Interpreting a syllogistic structure to the relevant statutes, the Court held that § 602(a)(1) “does not categorically prohibit the unauthorized importation of copyrighted materials”; rather, § 602(a)(1) merely says that unlawful importation can infringe the exclusive distribution right found in § 106(3).<sup>36</sup> Because the distribution right is subject to the first-sale defense, so too is the importation right.<sup>37</sup> Without specifically limiting its holding to goods manufactured in the United States, the Court held that the shampoo manufacturer could not control the importation and distribution of products it already sold abroad.<sup>38</sup>

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28. *Columbia Broad. Sys., Inc. v. Scorpio Music Distribs., Inc.*, 569 F. Supp. 47 (E.D. Pa. 1983), *aff’d sub nom.* *CBS, Inc. v. Scorpio Music Distribs.*, 738 F.2d 421 (3d Cir. 1984) and *aff’d sub nom.* *Scorpio Music Distribs. v. CBS, Inc.*, 738 F.2d 424 (3d Cir. 1984).

29. *Id.* at 49.

30. *Id.*

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

32. *Compare Sebastian Int’l, Inc. v. Consumer Contacts (PTY) Ltd.*, 847 F.2d 1093 (3d Cir. 1988) (holding that the first-sale defense is available when the reimported goods were manufactured in the United States) *with* *L’anza Research Int’l, Inc. v. Quality King Distribs., Inc.*, 98 F.3d 1109 (9th Cir. 1996) (holding that the first-sale doctrine does not apply when the goods in question were sold abroad, even if they were manufactured in the United States).

33. *Quality King*, 523 U.S. at 138–39.

34. A gray market is “a market using irregular channels of trade.” WEBSTER’S THIRD NEW INTERNATIONAL DICTIONARY 993 (Merriam-Webster, Inc. 1993).

35. *Quality King*, 523 U.S. at 139.

36. *Id.* at 143–44.

37. *Id.* (“The introductory language in § 106 expressly states that all of the exclusive rights granted by that section—including, of course, the distribution right granted by subsection (3)—are limited by the provisions of §§ 107 through 120.”).

38. *Id.* at 152.

The *Quality King* Court appeared to declare, but did not explicitly state, that the first-sale defense applies to all foreign sales of products bearing U.S. copyright.<sup>39</sup> Justice Ginsburg joined the Court in *Quality King* with the proviso that “we do not today resolve cases in which the allegedly infringing imports were manufactured abroad.”<sup>40</sup> This discrepancy between the majority and the concurrence in *Quality King* formed the basis for the dispute in *Costco v. Omega*.<sup>41</sup>

#### IV. THE NINTH CIRCUIT’S HOLDING

The Ninth Circuit held that *Quality King* is limited to U.S.-manufactured goods sold abroad and reimported into the United States.<sup>42</sup> It began by acknowledging the controlling authority of *Quality King*<sup>43</sup> and asking whether *Quality King* “undercut the theory or reasoning underlying the prior circuit precedent in such a way that [its relevant case law is] clearly irreconcilable.”<sup>44</sup> The court determined that *Quality King* did not directly overrule its three main first-sale importation cases<sup>45</sup> since *Quality King* involved a “round trip” importation of U.S.-made goods, which is factually distinct from the one-way importations in those earlier cases.<sup>46</sup> Nor was the reasoning of *Quality King* incompatible with the “general rule that § 109(a) is limited to copies ‘legally made . . . in the United States.’”<sup>47</sup> The Ninth Circuit therefore concluded that “*Quality King* did not invalidate our general rule that § 109(a) can provide a defense against §§ 106(3) and 602(a) claims only insofar as the claims involve domestically-made copies of U.S.-copyrighted works.”<sup>48</sup> Since *Omega* manufactured the

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39. *See id.* (neglecting to specifically limit the holding to cases of re-importation and noting the “broad scope” of § 109(a)).

40. *Id.* at 154 (Ginsburg, J., concurring).

41. Brief for the Petitioner, *supra* note 9, at i.

42. *See Omega S.A. v. Costco Wholesale Corp.*, 541 F.3d 982, 987 (9th Cir. 2008) (stating that *Quality King* did not address “claims involving unauthorized importation of copies made abroad”).

43. *Id.* at 983.

44. *Miller v. Gammie*, 335 F.3d 889, 900 (9th Cir. 2003).

45. *BMG Music v. Perez*, 952 F.2d 318 (9th Cir. 1991); *Parfums Givenchy, Inc. v. Drug Emporium, Inc.*, 38 F.3d 477 (9th Cir. 1994); and *Denbicare U.S.A. Inc. v. Toys “R” Us, Inc.*, 84 F.3d 1143 (9th Cir. 1996).

46. *Omega*, 541 F.3d at 987.

47. *Id.* (quoting *BMG Music*, 952 F.2d at 319).

48. *Id.* at 985; *see id.* at 988–89 (explaining that the phrase “lawfully made under this title” requires “the making of the copies *within the United States*”).

watches bearing the copyrighted design in Switzerland, the court held that the first-sale doctrine did not apply.<sup>49</sup>

The Ninth Circuit based its decision on concerns about extraterritorial application of U.S. law and nullification of the § 602(a)(1) importation right if the first-sale doctrine applied to foreign-made goods.<sup>50</sup> In light of the international nature of intellectual property, the court followed a “more robust version” of the extraterritoriality doctrine<sup>51</sup> and determined that “[t]o characterize the making of copies overseas as lawful under Title 17 would be to ascribe legality under the Copyright Act to conduct that occurs entirely outside the United States.”<sup>52</sup> The court evinced concern about providing incentives for foreign manufacturing, but decided that allowing the first-sale doctrine to apply where a foreign manufacturer itself imports the goods adequately addressed the issue.<sup>53</sup> Therefore, faced with a difficult statutory interpretation question, the Ninth Circuit erred on the side of expanding the copyright proprietor’s rights.<sup>54</sup>

## V. ARGUMENTS

### A. *Costco’s (Petitioner’s) Arguments*

First, Costco argued that § 109(a) is not limited to domestically manufactured copies of U.S.-copyrighted works.<sup>55</sup> Costco contended that the phrase “lawfully made under this title” means goods made in legal compliance with the Copyright Act.<sup>56</sup> Because Omega holds the U.S. copyright to the globe symbol, it has the exclusive right to make or authorize copies of the symbol.<sup>57</sup> Therefore, any copies Omega produces—regardless of where it makes them—are “lawfully made under this title” and the first-sale doctrine should apply to them.<sup>58</sup>

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49. *Id.* at 983.

50. *Id.* at 986.

51. *Id.* at 987–88. The extraterritoriality doctrine presumes that U.S. statutes apply only to conduct that occurs within or has an effect within the United States. RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 38 (1965).

52. *Omega*, 541 F.3d at 988 (quotation marks omitted).

53. *Id.* at 989.

54. *See id.* at 990 (weighing the implications of the *BMG* rule and deciding they are best addressed by allowing the copyright owner’s importation decision to control).

55. Brief for the Petitioner, *supra* note 9, at 15.

56. *Id.* (citing Title 17, the Copyright Act) (emphasis and quotation marks omitted).

57. *Id.* at 15–16 (citing 17 U.S.C.A. § 106(1) (West 2010)).

58. *Id.*

Second, Costco argued that the Ninth Circuit’s opinion conflicts with *Quality King* because *Quality King* rejected the argument that “applying the first-sale doctrine here would amount to an extraterritorial application of U.S. law.”<sup>59</sup> According to Costco, applying the first-sale doctrine to foreign-manufactured goods would not extend U.S. law extraterritorially because when the goods are inside the United States and a plaintiff sues in a U.S. court, no extraterritorial application of the Copyright Act occurs.<sup>60</sup>

Third, Costco argued that “applying the first-sale doctrine here is not in tension with the importation provisions codified in Section 602,” even though § 109(a) limits the importation right.<sup>61</sup> In Costco’s view, applying the first-sale doctrine does not nullify § 602(a)(1) because § 602(a)(1) still prohibits the importation of (1) “piratical” copies, (2) copies in the possession of a non-owner such as a bailee or licensee, and (3) copies made under the copyright law of another country.<sup>62</sup>

Finally, Costco argued that the Ninth Circuit’s geographical limitation on the first-sale doctrine allows manufacturers of foreign-made goods to control their resale in ways unavailable to those who produce goods domestically.<sup>63</sup> This provides incentive for U.S. copyright holders to produce copyrighted goods abroad<sup>64</sup>—surely a result undesired by Congress.<sup>65</sup>

### *B. Omega (Respondent’s) Arguments*

First, Omega argued that a copy made abroad for foreign distribution is not made “under this title” and does not implicate any

59. *Id.* at 27. Indeed, in a brief footnote, the *Quality King* Court noted that “[s]uch protection does not require the extraterritorial application of the Act any more than § 602(a)’s ‘acquired’ abroad language does.” *Quality King Distribs., Inc. v. L’anza Research Int’l, Inc.*, 523 U.S. 125, 145 n. 14 (1998).

60. Brief for the Petitioner, *supra* note 9, at 32, 41–42.

61. *Id.* at 41–46; *see also Quality King*, 523 U.S. at 146 (expressly rejecting the argument that applying the first-sale doctrine would render § 602(a)(1) superfluous).

62. Brief for the Petitioner, *supra* note 9, at 33 (citing *Quality King*, 523 U.S. at 146–47). Petitioner also made several sub-arguments regarding copies made under the copyright law of another country. *Id.* at 34–46.

63. *Id.* at 46–47 (identifying the restriction of “rental-, lease- and other lending-based markets” as an example).

64. *Id.* at 48.

65. *See* Brief for the United States as Amicus Curiae Supporting Respondent at 19, *Costco Wholesale Corp. v. Omega S.A.*, 131 S. Ct. 565 (2010) (No. 08-1423) (“[t]here is no reason to suppose that Congress anticipated and intended [such] result[s]”).

of the copyright holder's exclusive rights under the Copyright Act.<sup>66</sup> According to Omega, "lawfully made under this title" means the copy "is both governed by and consistent with the Copyright Act."<sup>67</sup> Since the Copyright Act applies only within the United States, it does not govern foreign manufacture and sale.<sup>68</sup> Applying the Act in such a situation constitutes extraterritorial application of U.S. law.<sup>69</sup>

Second, Omega contended that *Quality King* forbids Costco's construction of § 109(a).<sup>70</sup> The *Quality King* Court noted that § 602(a)(1) "applies to . . . copies that were 'lawfully made' not under the United States Copyright Act, but instead under the law of some other country."<sup>71</sup> Omega argued that the Swiss-made watches were not "made under" U.S. copyright law because they were not manufactured in the United States or intended for sale there.<sup>72</sup> Consequently, applying the first-sale doctrine would extend § 109(a) beyond the bounds set by *Quality King*.

Third, Omega argued that manufacturers and consumers benefit from market segmentation,<sup>73</sup> and there is no empirical evidence that the Ninth's Circuit's rule caused a shift to overseas manufacturing. Omega argued that market segmentation stimulates investment in location-specific product distribution and promotion, which benefits consumers.<sup>74</sup> Because the watches in question were manufactured in Switzerland and intended for sale outside the United States, Omega received no compensation for the value of selling the watches in the

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66. Brief for Respondent, *supra* note 10, at 12.

67. *Id.* at 13 (emphasis omitted); *see id.* at 15 (describing the use of the phrase "owner of copyright under this title" in §§ 106 and 602(a) to refer to rights and conduct governed by U.S. law).

68. *See id.* at 13 (approving the Ninth Circuit's geographical limitation on "under this title").

69. *Id.* at 14–15 ("Omega's rights to reproduce and distribute copies in Switzerland are governed by the law of Switzerland—not by Title 17.").

70. *Id.* at 18.

71. *Quality King Distribs., Inc. v. L'anza Research Int'l, Inc.*, 523 U.S. 125, 147 (1998).

72. Brief for Respondent, *supra* note 10, at 23. Omega does not explain the source of its right to sue under U.S. law if U.S. copyright law does not apply to its copies.

73. Market segmentation is the phenomenon under which companies charge one price for a product in one market and a different price for the same good in another market based on variances in demand and distribution strategy. *See* Wendell R. Smith, *Product Differentiation and Market Segmentation as Alternative Marketing Strategies*, 4 *MARKETING MGMT.*, Winter 1995, at 63, 64–65 (defining market segmentation as the division of one heterogeneous market into several smaller homogenous markets).

74. Brief for Respondent, *supra* note 10, at 43 (citing *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 731 (1988)).



United States.<sup>75</sup> Finally, Omega pointed to the lack of adverse effects on U.S. manufacturing in the more than twenty-five years since the district court in *Scorpio* refused to apply the first-sale defense to foreign-manufactured goods and maintained that any shift to foreign manufacturing already would have taken place.<sup>76</sup>

## VI. ORAL ARGUMENT AND RULING

At oral argument, the Justices focused on two aspects of the case: (1) the lack of a textual basis for either side's position, and (2) the troubling incentives for foreign manufacture that would result from a territorial limitation of the first-sale doctrine.

Generally, the Justices expressed concern with the lack of a textual basis for either party's interpretation of § 109(a).<sup>77</sup> They found Costco's view (that there is no geographical limitation on the first-sale doctrine) logical but lacking a clear textual hook.<sup>78</sup> Likewise, the Court questioned Omega's definition of "made" as including not only the physical making of the copy, but also "the addition of any necessary intellectual property rights that would permit distribution in the United States."<sup>79</sup> When the issue of the interplay between § 602(a)(1) and § 109(a) arose at oral argument,<sup>80</sup> the Justices disagreed about whether Costco's interpretation would render § 602(a)(1) a nullity, or would apply when an American copyright holder gives exclusive territorial rights to two different parties.<sup>81</sup>

*Quality King* lurked in the background of many of the arguments, but did not rear its head until Justice Ginsburg alluded to her own concurring opinion.<sup>82</sup> Counsel for Costco noted that the majority

75. Brief for Respondent, *supra* note 10, at 32.

76. *Id.* at 44–46 (noting that neither Costco nor its amici provide any example where such a shift overseas has occurred).

77. At one point, Justice Scalia told counsel for Omega: "That's just not in the text . . . [L]ike the other side, in order to make your theory of the text appear reasonable, you have to bring in a skyhook with a limitation that finds no basis in the text." Transcript of Oral Argument at 29, *Costco Wholesale Corp. v. Omega S.A.*, 131 S. Ct. 565 (2010) (No. 08-1423).

78. Justice Breyer seemed the most comfortable with Costco's interpretation since it required only that the Court reiterate a general rule that § 109(a) does not apply until there is a U.S. sale. *Id.* at 8, 26. Justice Scalia noted that he found this approach logical, but remained highly concerned that the statute itself provided no basis for discriminating between exclusive and nonexclusive rights abroad. *Id.* at 11–12.

79. *Id.* at 22.

80. *See id.* at 12, 15 (Justice Ginsburg asked counsel for Costco about this.).

81. *Id.* at 10.

82. *Id.* at 16.

opinion in *Quality King* paid little attention to place of manufacture.<sup>83</sup> Justice Ginsburg did not pursue this issue, nor did she indicate how the discrepancy between her narrow understanding of the holding in *Quality King* and Justice Stevens's broad wording for the majority arose.<sup>84</sup>

The Justices noted the incentives for foreign manufacturing that might result from Omega's interpretation of § 109(a). Justice Ginsburg put the Court's policy concern most succinctly in a question to counsel for Omega: "[W]hat earthly sense would it make to prefer goods that are manufactured abroad over those manufactured in the United States?"<sup>85</sup> Even the U.S. Government, which joined Omega as amicus curiae, acknowledged "that this creates something of [a] potential incentive to manufacture abroad."<sup>86</sup> Justice Sotomayor pointed out that if foreign manufacturers are concerned about receiving compensation for the right to sell their goods in the United States, they could address this using contract law.<sup>87</sup>

On December 13, 2010, an equally divided Court issued a per curiam opinion affirming the Ninth Circuit's decision to limit the first-sale doctrine to goods manufactured in the United States.<sup>88</sup> This one-line opinion provided no explanation for the Court's decision.

## VII. ANALYSIS

Under the rule upheld by the Supreme Court, manufacturers who produce their goods abroad can sue under the U.S. Copyright Act without facing the same array of defenses that would confront them had they manufactured their goods within the United States.<sup>89</sup> The ability to bypass the first-sale defense by manufacturing abroad while maintaining the full panoply of rights under the Copyright Act encourages foreign manufacturing and upsets the congressionally apportioned balance of rights afforded to copyright holders.<sup>90</sup> *Costco*

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83. *Id.* at 16–17.

84. *Id.* at 17.

85. *Id.* at 33–34.

86. *Id.* at 40.

87. *Id.* at 46 ("Why don't we let contract law control the violations of any agreements with foreigners?").

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

89. *See Omega*, 541 F.3d at 988–89 (holding that the first-sale defense is available only when the goods were manufactured in the United States or imported by the manufacturer).

90. *See* Brief for the Petitioner, *supra* note 9, at 48–49 (discussing the implications of the Ninth Circuit's ruling).

v. *Omega* presented the Supreme Court with two main problems: (1) determining the meaning of the phrase “lawfully made under this title” and (2) explaining the economic consequences that would result from their interpretation.<sup>91</sup> Both of these issues would have been better addressed by reversing the ruling of the Ninth Circuit. Instead, the per curiam decision in this case not only upheld a muddled and inconsistent rule, but provided no indication of the reasons for doing so.

#### A. *Statutory Interpretation*

A close reading of § 109(a) and the other statutes at issue suggests that the phrase “lawfully made under this title” means in legal compliance with the Copyright Act.<sup>92</sup>

The use of “lawfully made under this title” elsewhere in Title 17 and the ease with which Congress could have specified a place of manufacture imply that the phrase means in legal compliance with the Copyright Act.<sup>93</sup> For example, § 110, which provides an educational-use exception to § 106, uses the phrase “lawfully made under this title” but does not implicate manufacture, importation or distribution.<sup>94</sup> As Costco argued, there is little reason to assume that the phrase would have a different meaning in § 109 than in § 110.<sup>95</sup> If “under this title” implies a geographical limitation, Congress could have made this clear by using the phrase “in the United States,” or “where this Act applies,” as it did in the Audio Home Recording Act.<sup>96</sup> Moreover, Omega argued that § 106 does not apply to foreign-made goods—yet, this is the very provision under which it brought suit. If its

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91. *Id.* at 15, 46.

92. The textual dispute in this case centered on whether “under” means within the geographical boundaries of the United States or in legal compliance with the Copyright Act. Compare Brief for the Petitioner, *supra* note 9, at 15 (defining the phrase as “lawfully made according to . . . this title” (quotation marks omitted)), with Brief for Respondent, *supra* note 10, at 13 (defining the phrase as “governed by and consistent with the Copyright Act”). Though Justice Alito conceived of the dispute as centered on the term “made,” Transcript of Oral Argument, *supra* note 77, at 22, neither party specifically addressed the meaning of the word “made” in its brief.

93. “A standard principle of statutory construction provides that identical words and phrases within the same statute should normally be given the same meaning.” *Powerex Corp. v. Reliant Energy Servs., Inc.*, 551 U.S. 224, 232 (2007).

94. 17 U.S.C.A. § 110(a) (West 2010).

95. Brief for the Petitioner, *supra* note 9, at 17.

96. Audio Home Recording Act, 17 U.S.C.A. § 1004(b) (West 2010).

interpretation were correct, Omega arguably had no grounds to sue in the first place.

The direct genesis of this dispute is Justice Ginsburg's concurrence in *Quality King*, in which she stated that that case did not resolve whether the first-sale defense applies to foreign-manufactured goods.<sup>97</sup> The *Quality King* majority was not nearly so explicit; rather, the Court set forth a general rule that § 109(a) applies to imported copies.<sup>98</sup>

The *Quality King* majority described a syllogistic structure to the three key provisions of the Copyright Act at play here.<sup>99</sup> First, since the § 106(3) distribution right is “subject to sections 107 through 122,” § 109(a) applies to § 106(3).<sup>100</sup> Second, § 602(a)(1) (addressing infringing importation) states that it is a subcategory of “infringement of the exclusive right to distribute copies or phonorecords under [§] 106.”<sup>101</sup> Therefore, if § 109(a) applies to § 106(3), then it also applies to § 602(a).<sup>102</sup> If Congress intended to limit the first-sale doctrine based on where goods are manufactured, one would expect to find an explicit statement to this effect in § 602.

The primary critique of the structural syllogism and the broad application of the first-sale doctrine is that they allow § 109(a) to write § 602(a)(1) out of existence.<sup>103</sup> If copies are acquired outside the United States and the first-sale doctrine applies, those copies may be resold in the United States with impunity. In such a case, the copyright holder seems to lack control over importation, contrary to the right guaranteed in § 602(a)(1).<sup>104</sup> This, however, is an incomplete reading of § 602(a)(1) because this section serves at least four other purposes.

First, even if § 602(a)(1) applies only to piratical or unlawful copies, it still gives the copyright owner a private remedy in

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97. See *Quality King Distribs., Inc. v. L'anza Research Int'l, Inc.*, 523 U.S. 135, 154 (1998) (Ginsburg, J., concurring) (“[W]e do not today resolve cases in which the allegedly infringing imports were manufactured abroad.”).

98. See *id.* at 152 (refusing to specifically limit the holding to cases of reimportation and noting the “broad scope” of § 109(a)).

99. *Id.* at 143–44.

100. 17 U.S.C.A. § 106(3) (West 2010) (emphasis added).

101. 17 U.S.C.A. § 602(a)(1) (West 2010).

102. *Quality King*, 523 U.S. at 143; see *Omega S.A. v. Costco Wholesale Corp.*, 541 F.3d 982, 985 (9th Cir. 2008) (summarizing the Court's reasoning in *Quality King*).

103. This argument was raised by Omega and discussed at oral argument. *E.g.*, Brief for Respondent, *supra* note 10, at 24; Transcript of Oral Argument, *supra* note 77, at 12, 15 (Justice Ginsburg asked “what, if anything, 602(a)(1) does.”).

104. Brief for Respondent, *supra* note 10, at 25.

conjunction with enforcement by the Customs Service specified in § 602(b).<sup>105</sup> Second, it protects the right to preclude importation of copies before they are sold.<sup>106</sup> Third, because § 109(a) is only available to *owners* of lawfully made copies, § 602(a)(1) would still provide a basis for suit against a licensee, bailee, or unlawful possessor of a foreign-made copy.<sup>107</sup> Fourth, § 602(a)(1) provides a cause of action against the importation of copies lawfully made under the copyright law of another country.<sup>108</sup> For instance, if Omega held a U.S. copyright for watches sold in the United States and a Swiss copyright for watches sold in Europe, any Swiss-copyrighted watches imported to and sold in the United States directly contravene § 602(a)(1).<sup>109</sup> This, in fact, provides a perfectly reasonable means by which Omega could price its watches for different world markets. It simply must give up the protection of U.S. copyright for those foreign copies it wishes to keep out of the United States.

Based on the plain meaning of the phrase and the syllogistic relationship between §§ 109(a), 106(3), and 602(a)(1), “lawfully made under this title” most likely means manufactured in legal compliance with the Copyright Act. Moreover, § 602(a)(1) remains necessary for several purposes, negating the major criticism of this interpretation.

### B. Policy Implications

Copyright law provides exclusive rights in exchange for making creative works public after a term of years.<sup>110</sup> It is axiomatic that copyright is not absolute, but based on a balancing of economic costs and benefits with the overall goal of stimulating intellectual productivity.<sup>111</sup> Maintaining the interests of both copyright owners and

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105. *Quality King*, 523 U.S. at 145–47.

106. 17 U.S.C.A. § 602(a)(1) (West 2010) (protecting against unauthorized importation).

107. *Quality King*, 523 U.S. at 145–47.

108. *Id.*

109. This is based on an example given by the Register of Copyrights to the U.S. House of Representatives Judiciary Committee and discussed in *Quality King*, 523 U.S. at 145–49. See COPYRIGHT LAW REVISION: REPORT OF THE REGISTER OF COPYRIGHTS ON THE GENERAL REVISION OF THE U.S. COPYRIGHT LAW, 87TH CONG., 1ST SESS., 125–26 (H.R. Judiciary Comm. Print 1961) (discussing an example of U.S. and British editions of a literary work).

110. *Twentieth Century Fox Music Corp. v. Aiken*, 422 U.S. 151, 156 (1975) (“The limited scope of the copyright holder’s statutory monopoly . . . reflects a balance of competing claims upon the public interest; creative work is to be encouraged and rewarded, but private motivation must ultimately serve the cause of promoting broad public availability of literature, music, and the other arts.”).

111. See *Goldstein v. California*, 412 U.S. 546, 555 (1973) (“[T]o encourage people to devote themselves to intellectual and artistic creation, Congress may guarantee to authors and

the public calls for a balancing act, sometimes favoring the copyright monopoly and sometimes restricting it. Reversing the Ninth Circuit's decision would have upheld the constitutionally-mandated bargain between copyright holders and the public.

In *Costco v. Omega*, manufacturers' ability to segregate markets conflicted with the free flow of goods into the United States where retailers would compete to sell them to U.S. consumers. Price discrimination may maximize investment in different markets in terms of advertising and distribution and may allow manufacturers to eke every last cent out of their goods,<sup>112</sup> but it is unlikely to benefit U.S. consumers or retailers.<sup>113</sup> That the goods are available for less in other countries does not lead to lower prices in the United States unless someone can import the low-priced copies. To preserve the economic bargain between the American public and U.S. copyright holders, the Court should have held that the first-sale doctrine applies to all copies, regardless of their place of manufacture.

Providing manufacturers with greater protection for foreign-made copies than for U.S.-made copies undoubtedly favors those who produce their goods abroad. There are four basic ways a product like a watch can be made and distributed: (1) made in the United States and sold domestically; (2) made in the United States and sold abroad; (3) made in the United States, sold abroad and reimported; and (4) made abroad and imported into the United States. Because the first-sale doctrine applies to the first three scenarios, refraining from applying it to the fourth category biases copyright protection in favor of foreign-made goods.

If Congress intended to distinguish between goods based on place of manufacture, surely it would have favored U.S.-made goods. Thus, the most likely category to be excluded from first-sale protection is actually category (3) and not category (4). Because category (3)—foreign-made goods—is already eligible for the first-sale defense

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inventors a reward in the form of control over the sale or commercial use of copies of their works.”).

112. See Smith, *supra* note 73, at 65 (noting that “segmentation often involves substantial use of advertising and promotion”).

113. Because U.S. prices in a segmented world market are often higher than prices in other countries, U.S. consumers benefit from lower prices when grey market importers resell goods originally sold abroad. See Brief for Retail Industry Leaders Association et al. as Amici Curiae Supporting Petitioner at 8, *Costco Wholesale Corp.*, 131 S. Ct. 565 (2010) (No. 08-1423) (describing the effects of parallel importation).

under *Quality King*,<sup>114</sup> the defense must also extend to category (4)—U.S.-made goods. Even if Congress did not contemplate effects on manufacturing in enacting § 109(a), it is most logical to treat all goods the same regardless of where they are made.

If the first-sale doctrine ordinarily applied no matter where the goods are made, manufacturers would be on notice that they must rely on contracts to limit distribution of their goods to a certain market. As Justice Sotomayor pointed out during oral argument, this is an ideal role for contract law.<sup>115</sup> To the extent that subsequent sales may be controlled at all, a manufacturer should have to negotiate to restrict distribution when it makes the first sales of its goods. If the first-sale doctrine does not apply to foreign-made goods, a manufacturer has no reason to reveal its desire to restrict future sales since it can exert control merely on the strength of its copyright. Thus, applying the first-sale doctrine when a foreign manufacturer fails to indicate its desire to keep its goods out of the United States serves as a penalty default rule which a manufacturer may contract around, but which forces it to reveal critical information to the other contracting party.<sup>116</sup> Forcing manufacturers to disclose their distribution plans ensures the bargained-for price reflects the actual value of the good. A breach of contract action provides a remedy against the first purchaser of a good who distributes it in a manner contrary to the terms of the contract.

## VIII. CONCLUSION

When a copyrighted work is sold for the first time, “the policy favoring a copyright monopoly for authors gives way to the policy opposing restraints of trade and restraints on alienation.”<sup>117</sup> Though *Costco v. Omega* presented a difficult interpretive issue, there are good reasons, both textual and policy-based, why the Court should have concluded that the first-sale doctrine applies no matter where a U.S. copyright holder produces its goods. Without guidance as to how

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114. *Quality King*, 523 U.S. at 152.

115. Transcript of Oral Argument, *supra* note 77, at 46.

116. See Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 91 (1989) (“Penalty defaults are designed to give at least one party to the contract an incentive to contract around the default rule and therefore to choose affirmatively the contract provision they prefer. . . . [P]enalty defaults are purposefully set at what the parties would not want—in order to encourage the parties to reveal information to each other or to third parties.”).

117. NIMMER, *supra* note 4, at § 8.12[A].

the deadlocked Court approached the issue, there is instead a de facto endorsement of the Ninth Circuit's ruling. The decision in this case leaves this area of law without a clear rule. Justice Ginsburg joined the Court in *Quality King* with the proviso that "we do not today resolve cases in which the allegedly infringing imports were manufactured abroad."<sup>118</sup> This description seems equally applicable to *Costco v. Omega*.

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118. *Quality King Distribs., Inc. v. L'anza Research Int'l, Inc.*, 523 U.S. 135, 154 (1998) (Ginsburg, J., concurring).