



Intellectual Property Litigation Advisory

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Divided Supreme Court Affirms Copyright Law as a Weapon Against Gray Market Activity

The trafficking of genuine goods outside of official distribution channels exploits price differences—either by geographic region or between customers who are sold differently priced products at different times. This illicit practice, known as the gray market, is a big business because almost any product can be diverted. According to an analysis by Deloitte LLP, the gray market each year accounts for as much as \$63 billion of sales in the United States.

When filing a court action to stop diverted sales in the United States, brand owners traditionally rely on trademark law. The Lanham Act, however, requires a trademark owner to show that the goods do not meet the owner's quality standards or are materially different from those the owner has sold in the market. Therefore, to prevent the importation of identical or near-identical gray market products, some brand owners have turned to copyright law.

The Copyright Act of 1976 (17 U.S. § 102(a)) protects "original works of authorship fixed in any tangible medium of expression." If a design such as a logo is protected by copyright, then the product bearing the design is protected. Consequently, the Copyright Act is potentially a very attractive weapon against gray market activity.

On Dec. 13, 2010, a deadlocked Supreme Court affirmed *Omega, S.A. v. Costco Wholesale Corporation*, 541 F.3d 982 (9th Cir. 2008), *aff'd per curiam*, No. 08-1423, 562 U.S. ___ (U.S. Dec. 13, 2010), a decision by the Ninth Circuit Court of Appeals applying the Copyright Act to prevent diverted sales of foreign-made products. The Ninth Circuit's decision rested on the "first-sale" doctrine, which is codified in Section 109(a) of the Copyright Act and provides that the owner of a particular copy "lawfully made under this title" can sell or otherwise dispose of that copy.

Over a decade ago, in *Quality King Distributors, Inc. v. L'Anza Research International, Inc.*, 523 U.S. 135 (1998), the Supreme Court determined that the first-sale doctrine was a defense to trademark infringement in cases of "round-trip" importation—*i.e.*, goods made in the U.S., sold abroad, and brought back to the U.S. *Omega* differed from *Quality King* in that the case involved goods manufactured and sold overseas prior to being imported into the United States.

In *Omega*, the products at issue were watches bearing the U.S.-copyrighted "Omega Globe Design" that Omega made in Switzerland and sold to its authorized dealers overseas. Costco subsequently obtained the watches from third parties and sold them in California for \$700 below the suggested retail price. Although Omega authorized the initial foreign sale, it did not authorize

the importation of the watches into the U.S. or Costco's sales.

Omega filed suit in the Central District of California alleging that Costco's acquisition and sale of the watches constituted copyright infringement, and subsequently moved for summary judgment. Costco filed a cross-motion, arguing that, under the first-sale doctrine, Omega's initial foreign sale precluded claims of copyright infringement in connection with later sales. The district court ruled without explanation in favor of Costco on both motions, and Omega appealed. The Ninth Circuit reversed and held that the first-sale doctrine provides no defense under the Copyright Act with respect to foreign-made copies of a U.S. copyrighted work.

Costco then appealed to the Supreme Court, which granted certiorari despite Solicitor General Elena Kagan filing a brief that urged the high court not to hear the case because the Ninth Circuit had reached the right conclusion. Oral argument was on November 8, 2010. Only eight justices heard the case because newly appointed Justice Kagan recused herself.

On December 13, 2010, the Supreme Court issued a one-sentence decision stating: "The judgment is affirmed by an equally divided Court." The high court, as is its practice in 4-4 rulings, did not reveal which justices voted on which side of the issue. Not surprisingly, however, speculation is rife that Justice Kagan's participation would have given Omega a 5-4 majority.

The Supreme Court did not issue a written opinion and the Ninth Circuit's decision stands. The ruling thus provides a remedy for copyright owners to prevent the sale in the U.S. of gray market goods made abroad and intended for sale outside this country. At the same time, however, the 4-4 split does not set nationwide precedent and is only binding in the Ninth Circuit. Therefore, a brand owner wishing to assert the Copyright Act should consider bringing its case in the Ninth Circuit. In the future, the holding may be adopted by other circuits and the Supreme Court (including Justice Kagan) may revisit the issue.

ABOUT THE AUTHORS

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