

## The Seconds Tick on the Copyright “First Sale” Doctrine? Not So Much...

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On or about April, 19, 2010, the Supreme Court granted certiorari in *Costco Wholesale Corporation v. Omega, S.A.* to hear the appeal of a decision from the Ninth Circuit Court of Appeals that sent shivers through the online retail community – even librarians in the United States – and for good reason. For anyone who has ever bought or sold a CD or DVD, a second-hand book or any number of items through eBay, the Ninth Circuit’s ruling strikes a dissonant chord in an otherwise fairly harmonious line of precedent regarding the “first sale” doctrine under copyright law.

The Wall Street Journal touches upon some of these issues in an entertaining opinion piece [here](#). This case interesting for a number of reasons – not just for the Ninth Circuit’s rationale and impact, but for the creative way in which Omega attempts to control distribution of its watches within its channels of trade where other areas of intellectual property law failed to “deliver the goods” so to speak.

The underlying case stems from Costco’s suppliers taking advantage of an international arbitrage opportunity in legitimate Swiss watches to sell them in the U.S. at discounted prices. As the Ninth Circuit court noted in its opinion (emphasis added):

Omega manufactures watches in Switzerland and sells them globally through a network of *authorized* distributors and retailers. Engraved on the underside of the watches is a U.S.-copyrighted “Omega Globe Design.”

Costco obtained watches bearing the copyrighted design from the “gray market” (footnote omitted) in the following manner: Omega first sold the watches to authorized distributors overseas. Unidentified third parties eventually purchased the watches and sold them to ENE Limited, a New York company, which in turn sold them to Costco. Costco then sold the watches to consumers in California. Although Omega authorized the initial foreign sale of the watches, it did not authorize their *importation* into the United States or the sales made by Costco.

“Gray market” goods (also known as “parallel imports”) are not counterfeit goods – they are genuine articles bearing applicable trademarks and/or may be protected by other intellectual property rights of the producer of the goods. They are usually manufactured abroad, yet end up being sold outside the normal distribution channels intended by the producer of the goods. Why? It’s capitalism at work — as you can see, opportunities can arise that permit retailers to take advantage of geographic pricing disparities and/or currency fluctuations to purchase and resell such products at a discount, and pocketing the difference. Obviously, Omega wants to sell its watches at a price it believes the market will bear in a specific territory. Unfortunately, this “wristwatch arbitrage” resulted in Costco being able to sell legitimate Omega watches for

hundreds of dollars less than other “authorized” retailers through Omega’s U.S. distribution channels.

Omega was faced with an additional dilemma – limited recourse to stem the losses under U.S. intellectual property laws. As aforementioned, the watches at issue are not counterfeits, but *authentic* goods manufactured by Omega in Switzerland. Therefore, Omega could not avail itself of protections available under U.S. trademark law. Safe to say that no issued U.S. patents were at issue regarding the watches (otherwise they likely would have formed the basis of an infringement action), and no misappropriation of trade secrets had occurred. Undaunted, Omega decided to apply a different strategy going forward – place a *new* design on the backplate of the watches at issue, register the copyright for the *entire watch* in the U.S. and then seek to claim copyright infringement against Costco for sale of the watches under U.S. copyright law. Slick. Costco counter-sued with a defense known as the “first sale” doctrine- bringing us to where the Ninth Circuit ruling has caused a real stir.

The “first sale” doctrine under copyright law is a concept that was first recognized by the Supreme Court in the early 20<sup>th</sup> century and later codified in the Copyright Act of 1976 (the “1976 Act”). Essentially, it permits a purchaser to transfer a lawfully made copy of a copyrighted work to a third party without the permission of the copyright owner – or put another way, it “exhausts” the rights of the copyright owner to control the sale of a copyrighted work downstream. In codifying the “first sale” doctrine under the 1976 Act, Congress limited the doctrine to articles “lawfully made” under the 1976 Act. The trial court ruled in favor of Costco based upon the “first sale” doctrine; however, the Ninth Circuit ruled that since the watches were made outside the U.S., and were not otherwise sold in the U.S. with the blessing of Omega, then they cannot be “lawfully made” under the 1976 Act and the “first sale” doctrine does not apply. In essence, the Ninth Circuit held that “lawfully made under this Act” means “lawfully made in the United States”.

As a private practitioner, I can’t help but admire the creativity of Omega’s counsel in structuring a strategy that is pushing the boundaries of existing law; however, we don’t need to enter into a drawn out analysis of the Ninth Circuit’s holding to see that the rationale strains any common sense interpretation of prior Supreme Court precedent and the legislative history of the 1976 Act. Under the court’s rationale, reselling, lending and even gifting a lawful copy of a work that was manufactured outside the U.S. would require the permission of the copyright owner. Taking it a step further, this decision would arguably incentivize manufacturers to push manufacturing operations abroad to more tightly control their distribution channels – as long as the first sale is to a foreign distributor and there is no authorized sale of such goods in the United States. In one fell swoop, this decision could effectively eliminate secondary markets for works that have been permissible under the law for over 100 years, *and* prompt even *more* outsourcing of manufacturing operations for the United States. Impressive...and most likely unintended. The Electronic Frontier Foundation outlines this problem quite eloquently in its [amicus curiae brief](#) to the Supreme Court in favor of granting certiorari, portions of which I excerpt below to make the point:

In an increasingly interconnected world, where the manufacturing of tangible products and knowledge goods can be distributed easily and widely, consumers

should be confident that they retain the same rights to their belongings regardless of where those goods or their labeling were produced. The decision below provides a recipe for ensuring that all goods – consisting of copyrighted content or not – can no longer be lawfully resold, given away, or imported after a lawful sale abroad.

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Given this newly-extended liability, a reseller of copyrighted works, whether a massive used bookstore or a neighborhood yard sale, would be barred from the simplest transaction, if the copy of the work at issue had been manufactured outside the United States. Readers will suddenly require the consent of a publisher or author before lending their favorite foreign books to a friend. Libraries and archives stand to suffer particular harm under this interpretation. In many cases, the secondary market is the *only* source for out-of-print books and other copyrighted works or goods containing these works. With the elimination of § 109's protections, libraries and archives will no longer be able to add to their collections unless both they and the seller can be entirely sure that the works in question were not manufactured abroad and that they will not face extensive damages as a result of the sale.

Imagine not being able to get an old CD for your collection from a used CD store, or otherwise get an out-of-print book you desperately want to read from the library, all because the consent of the publisher/author/ copyright owner cannot be obtained. Traditional classified ads involving sales of copyrighted works become problematic, potentially resulting in a substantial loss of advertising revenue that is the mainstay of already struggling newspapers. We haven't even touch upon the significant impact upon on online businesses such as eBay and Craigslist that rely on the "first sale" doctrine to permit registered users to buy and resell such works in the secondary market. Enough said.

Going forward, I remain optimistic that the Supreme Court's grant of certiorari to hear this case signals it desire to overturn this decision and realign the law in this area so that the original intent and codification of the "first sale" doctrine is maintained. I'm keeping my fingers crossed that they'll get it right – but in the interim, I better unload some items in the next garage sale...

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