SHADES OF GRAY: THE INTERNET MARKET OF COPYRIGHTED GOODS AND A CALL FOR THE EXPANSION OF THE FIRST-SALE DOCTRINE

*Vartan J. Saravia**

"The real price of everything, what everything really costs to the man who wants to acquire it, is the toil and trouble of acquiring it."

— Adam Smith

I. INTRODUCTION

The legal and economic reality of intellectual property is changing at a dramatic pace. This is especially true at the intersection of copyright and the Internet. Although Congress and the courts have struggled to stay afoot of these changes, our laws have not fully succeeded in addressing all of the issues these new realities have brought about. As the only intellectual property right explicitly guaranteed in the U.S. Constitution, copyright has been the subject of copious scholarly work throughout the history of this country.[1] The advent of new technologies and media, which has revolutionized the area of copyright law in the last few decades, has also extended the amount and

* J.D., Southwestern Law School, 2008; B.A., *summa cum laude*, Montclair State University School of Humanities, University of the Republic (Uruguay).

1. U.S. CONST., art. I, § 8, cl. 8.

intensity of attention that copyright has received from scholars, analysts and practitioners.

Coverage of the various copyright developments, however, has been uneven. While some of the newest challenges for copyright law, such as illegal copying or unauthorized digital downloading, fill thousands of pages of specialized publications, legal journals and newspapers, others are almost absent from the conversation. That is clearly the case for the violation of a copyright owner's right of distribution via "parallel imports" or exploitation of the "gray market" of goods by way of millions of unauthorized retail transactions over the Internet.[2]

Essentially, the gray market develops from the ability of third-party distributors, retailers, or other purchasers to exploit arbitrage opportunities. This Note focuses on arbitrage in the context of legally purchasing an asset at a low price in one market in order to sell the product at a higher price in another market to realize a profit.[3] Such arbitrage opportunities are driven by variations in exchange rates between foreign currencies and the U.S. dollar, the availability of largely undifferentiated global products sold by multinational companies at different prices in different markets, and the ability of advanced telecommunications channels to facilitate the sale of those goods.[4] The denomination of these goods as black-market, counterfeit, or phony would be misleading because the goods are original; their questionable legal status derives from the fact that the distribution channels are not controlled by the manufacturer or copyright owner of the goods—hence the term "gray market."[5]

There are essentially two ways in which non-counterfeit goods can become gray market goods. Re-importation is the most classic example.[6] Re-importation occurs when goods are made in the U.S., exported and originally sold for exclusive distribution in a foreign market, and then returned to the United States for distribution without the U.S. manufacturer's authorization.[7] The Supreme Court of the United States has established that re-importation is legal even

2. Lynda J. Oswald, *Statutory and Judicial Approaches to Gray Market Goods: The "Material Differences" Standard*, 95 KY. L.J. 107, 107–08 (2006).

3. *Id.* at 107–08.

4. Michael J. Meurer, *Copyright Law and Price Discrimination*, 23 CARDOZO L. REV. 55, 59–67 (2001).

5. Oswald, *supra* note 2 at 108; *see also* K Mart Corp. v. Cartier, Inc. 486 U.S. 281, 281 (1988).

6. Oswald, *supra* note 2 at 107–08.

7. *Id.*

without the consent of the copyright holder, because of the complementary doctrines of "exhaustion" and "first-sale."[8] Under the first-sale doctrine, a patent, trademark, or copyright owner exhausts her distribution right upon the first sale of the protected work, thereby allowing subsequent purchasers to further transfer the work.[9]

The second situation in which otherwise legitimate copyrighted goods may enter the gray market category occurs when goods legally manufactured abroad under a valid U.S. copyright are introduced into the U.S. without the consent of the holder of that same copyright.[10] The U.S. copyright owner may hold either the entire bundle of rights associated with the product or only the distribution right for the territory of the United States.[11] The practice of unauthorized importation of licit goods manufactured abroad, described by advocates of trademark and copyright law as unfair competition with the copyright interest of a U.S. party in those same goods,[12] has been held a violation of the U.S. copyright holder's distribution rights by several circuit and district courts, and, indirectly, by the Supreme Court.[13] Thus, the first-sale doctrine does not shield an unauthorized importer from liability for copyright infringement under Section 602 of the Copyright Act,[14] if the U.S.-copyrighted goods were not manufactured and first sold in the United States.[15] This means that the U.S., as most other countries, applies a national concept of the exhaustion doctrine.[16] Stated differently, U.S. law dictates that the sale of copyrighted goods within the U.S. exhausts the copyright owner's control over the goods.

8. Quality King Distributors Inc. v. L'Anza Research Int'l. Inc., 523 U.S. 135, 152 (1998).

9. 17 U.S.C. § 109(a) (2004); *see also* Quality Kings Distributors Inc. 523 U.S. 135, 145, 152 (1998).

10. K Mart Corp. v. Cartier Inc., 486 U.S. 281, 286 (1988).

11. COPYRIGHT LAW REVISION, S. REP. No 94–473, at 57 (1975).

12. INTERNATIONAL TRADEMARK ASSOC., POSITION PAPER ON PARALLEL IMPORTS (2007), *available at* http://www.inta.org/images/stories/downloads/PDA/parallelimportspositionpaper.pdf.

13. *See* Columbia Broadcasting System Inc. v. Scorpio Music Distributors Inc., 569 F. Supp. 47 (E.D. Pa. 1983), aff'd, 738 F.2d 421 (3d Cir. 1984); BMG Music v. Perez, 952 F.2d 318 (9th Cir. 1991); Summit Technology, Inc. v. Highline Medical Instruments Co., 922 F. Supp. 299 (C.D. Cal. 1996); Pearson Educ. Inc. v. Liao, No. 07-Civ-2423 (SHS), 2008 WL 2073491 (S.D.N.Y.); Microsoft Corp. v. Citedirect.com LLC, No. 08-60668-CIV, 2008 WL 3162535 (S.D. Fla.); Omega S.A. v. Costco Wholesale Corp. 541 F.3d 982 (9th Cir. 2008).

14. *Quality King Distributors*, 523 U.S. 135, 151–52 (noting that "unauthorized importation [is] an infringement of the distribution right (even when there is no literal 'distribution').").

15. *Id.* at 148 (noting that statutory exceptions to 602(a) are not superfluous because 602(a) "encompasses copies that are not subject to the first sale doctrine—e.g., copies that are lawfully made under the law of another country.")

16. PAUL TORREMANS, COPYRIGHT LAW: A HANDBOOK OF CONTEMPORARY RESEARCH 473–78 (2008).

But if the goods are first marketed and sold abroad, the U.S. copyright owner does not relinquish her rights to control the importation of the goods into the country, and the first-sale limitation of the exclusive right of distribution and importation shall not apply.[17]

The consequences of the application of the first-sale doctrine, or the decision to refrain from applying it, are twofold. First, such determination clearly impacts the rights and liabilities of not only those directly or indirectly involved in the cross-border trade of traditional copyrightable material, such as books, magazines, photographs, phonorecords (CDs), and moving images in all their formats, but also those involved in the cross-border trade of any goods which may have copyrightable elements affixed to them.[18] In addition, there are international implications derived from the way the exhaustion doctrine is applied. Because countries do not have identical distribution right systems in copyright law, and only a few have adopted the principle of international exhaustion, it is common for copyright owners to be able to control the importation of their copyrighted products into certain markets, even without contractual or licensing restrictions.[19] The international treaties that protect the rights of copyright owners have left this decision to the signatories' domestic laws.[20] The economic significance of the lack of international uniformity in the regulation of importation and distribution rights, and the absence of a commonly

17. *Quality King Distributors*, 523 U.S. 135, 152.

18. *See* Sebastian Int'l, Inc. v. Consumer Contact Ltd., 664 F. Supp. 909 (D.N.J. 1987) *vacated by* 847 F.2d 1093 (3d. Cir. 1988) (granting a preliminary injunction for domestic hair care product manufacturer who was attempting to prevent the re-importation of its own products by the "gray market" under a copyright theory, arguing that the text and artwork on the labels affixed to the bottles carried protected copyrighted content).

19. *See generally* Paul Edward Geller, *International Copyright: An Introduction, in* 1 INTERNATIONAL COPYRIGHT LAW AND PRACTICE INT-45 to INT-103 (Paul Edward Geller ed., 2008) (grounds for protection abroad); *see also* PAUL GOLDSTEIN, INTERNATIONAL COPYRIGHT: PRINCIPLES, LAW AND PRACTICE 255 (2001)

> The Diplomatic Conference on the WIPO Copyright Treaty could not agree on a formulation of the most significant exception to the distribution right—the doctrine of exhaustion, or first sale. Thus the treaty prescribes no rules on the nature of the acts respecting copies that will exhaust the distribution right. Nor does the treaty prescribe whether exhaustion will have only domestic effect . . . or a broader, international effect.

20. These treaties include the Berne Convention for the Protection of Literary and Artistic Works, *opened for signature* May 4, 1896, S. TREATY DOC. No. 99-27, 1161 U.N.T.S. 31; Paris Convention for the Protection of Industrial Property, March 20, 1883, 13 U.S.T. 1; the World Intellectual Property Organization, Copyright Treaty, S. TREATY DOC. No. 105-17, 2186 U.N.T.S. 152; World Intellectual Property Organization, Performances and Phonograms Treaty, S. TREATY DOC. No. 105-17 at 18, 2186 U.N.T.S. 245; Universal Copyright Convention, July 24, 1971, 25 U.S.T. 1341, 943 U.N.T.S. 194; Convention for the Protection of Producers of Phonograms Against Unauthorized Duplication of Their Phonograms, Oct. 29, 1971, 25 U.S.T. 309, 888 U.N.T.S. 67.

accepted international exhaustion doctrine, lies in the practice of price discrimination—the practice of pricing the same product differently from one country to another "on the basis of relative demand for a work, and the relative ability of local markets to pay for it."[21] Owners of copyrighted works and their licensees can utilize international market segmentation strategies, dividing the intended audience for a given product by geographic units and tailoring marketing strategies accordingly, with the expectation that consumers will purchase the copyrighted goods within each identified market.

Although the price discrimination practice, as it applies to the retail market of consumer goods, made economic and business sense before the telecommunications and Internet revolutions, it may no longer be feasible today. Consumers in the United States and worldwide have ready access to countless goods offered for sale in the cyber-market via the Internet, often at prices lower than those of the domestic brick and mortar shops.[22] Many of the online alternative sales channels are located outside of the U.S., raising questions as to the legality of Internet transactions where an American consumer purchases a U.S.-copyrighted product from a seller who is located abroad. A strict reading of the latest case law would indicate that such transactions might be in violation of the copyright owner's right of importation and distribution.[23] Although many online shoppers are wary of foreign sellers over the Internet, the guarantees that third-party sites such as eBay or PayPal[24] offer to their users, and the "zero-liability" policies that most credit card companies have in place to promote online shopping,[25] make these cross-border transactions safer, easier, and more reliable than ever before. All other things being equal, if presented with the option of choosing between two practically identical products, one of which is offered at a significantly lower price, the statistics indicate that cyber-shoppers will growingly disre-

21. PAUL GOLDSTEIN, INTERNATIONAL COPYRIGHT: PRINCIPLES, LAW AND PRACTICE 307 (2001).

22. *See generally* DANIEL NISSANOFF, FUTURE SHOP: HOW THE NEW AUCTION CULTURE WILL REVOLUTIONIZE THE WAY WE BUY, SELL, AND GET THE THINGS WE REALLY WANT (2006).

23. Omega S.A. v. Costco Wholesale Corp. 541 F.3d 982, 982 (9th Cir. 2008) (holding that the first-sale doctrine is unavailable to defend against claims of infringing distribution and importation for the unauthorized sale of authentic, imported watches which displayed a design that had been registered in Copyright Office).

24. *See* eBay, Security Center: Buying and Paying, http://pages.ebay.com/securitycenter/buying_paying.html (last visited Mar. 25, 2009); *see also* PayPal, About Us, https://www.paypal-media.com/aboutus.cfm (last visited Mar. 25, 2009).

25. *See* Bankrate.com, Shop Safely On The Web, http://www.bankrate.com/brm/green/cc/basics5-1a.asp (last visited Mar. 25, 2009).

gard the seller's physical location and buy from the cheaper seller, be it in Los Angeles, Shanghai, or Buenos Aires.[26]

These implications justify reexamining the prohibition on parallel imports and reevaluating the limitations on a copyright holder's distribution rights. This Note argues that the first-sale exception to the right of distribution—i.e. the doctrine of exhaustion—should apply equally to all copyrighted goods that are sold, regardless of where they were manufactured. Although courts have been reluctant to extend the exhaustion doctrine internationally and have limited its application only to first sales made inside the United States, no case has yet addressed the effect of such a reading on the growing number of cross-border retail transactions which American consumers enter daily via the Internet. In fact, the application of the current exhaustion scheme potentially places thousands of consumers, and those who facilitate the transactions, at risk of liability for direct or contributory copyright infringement. More than an unintended consequence of the current state of the law, this is actually an example of its anachronistic nature, and of the usual inability of copyright law to keep up with technological advancements. The proposed extension of the first-sale doctrine to include "gray market" imports would place the reality of worldwide Internet commerce within the law by shielding the market participants from copyright infringement actions for violations of importation and distribution rights.

Protecting intellectual property rights is important in promoting innovation and competition. Unless we provide copyright protection, creators and innovators might have little incentive to make their original products available to the public, and corporations and individuals might have too little incentive to invest in artistic expression. However, "if the scope or duration of an intellectual property right 'overcompensates' for the cost of innovation, then the exercise of such rights could inefficiently restrict or distort competition and trade."[27] In fact, if the U.S. protects ownership too much, the country reaches what some leading property experts refer to as "cultural gridlock."[28]

---

26. *See* comScore, 2007 Online Holiday Shopping Season Surpasses $29 Billion in Sales, Up 19 Percent Versus Year Ago (Jan. 7, 2008), http://www.comscore.com/press/release.asp?press=1990; Despite Weak Season, Online Spending Trends Outperform Brick-And-Mortar Across Several Key Retail Categories (Jan. 2, 2009), http://www.comscore.com/press/release.asp?press=2659.

27. ORGANISATION FOR ECONOMIC COOPERATION AND DEVELOPMENT, TRADE AND COMPETITION POLICIES: EXPLORING THE WAYS FORWARD 52 (1999).

28. *See* MICHAEL HELLER, THE GRIDLOCK ECONOMY: HOW TOO MUCH OWNERSHIP WRECKS MARKETS, STOPS INNOVATION, AND COSTS LIVES 19 (2008).

Cultural gridlock arises when ownership rights and regulatory controls are too fragmented.[29] The first-sale doctrine averts cultural gridlock by striking a balance between the rights of the copyright owners and the consumers; it should not be understood as a limitation on rights, but as an essential legal doctrine for the construction of competitive markets driven by intellectual property. That is why the first-sale exception should be extended to purchases of non-counterfeit, legitimately licensed, copyrighted goods that are manufactured abroad.

The e-commerce explosion, emboldened by the decrease in international transaction and shipping costs, is bound to confront domestic retailers with significant competition from abroad and also interfere with manufacturers' international market segmentation. These two developments will likely prompt these two groups to take legal action in order to stop the practice of retail gray market importation. A strict application of the current law could create millions of lawsuits brought by copyright owners against sellers located in foreign jurisdictions, against buyers within the U.S., and arguably against third parties who facilitate, host, and benefit from these transactions. This latter group of defendants could include Internet Service Providers ("ISPs"), online stores, auction websites, and credit cards or other financial institutions. After the fights against pirated copies and illegal downloading, this could be the next big battle against copyright infringement.

Part II of this Note lays out the present legal regime and copyright law analysis of the rights of importation and distribution, as well as the limitation of those rights in the so-called first-sale doctrine. Part III of this Note presents in detail the background and reality of gray market and parallel imports, and the occurrence of price discrimination as its fueling engine. In arguing for the expansion of the first-sale doctrine, this work will illustrate the specific difficulties of applying the current law by analyzing its jurisdictional aspects, the question of assignment of liability on potential infringers, and the international law implications of the issue. Finally, in recognizing the interests of all actors involved, part IV provides possible solutions to the underlying question of the illegality of parallel importation of consumer goods, and will explore the options and alternatives at hand.

29. *Id.*

II. THE IMPORTATION AND DISTRIBUTION RIGHTS

The Copyright Act provides that copyright proprietors enjoy the exclusive right "to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending."[30] This distribution right allows an author to control publication or, more broadly, place copies or phonograms at the disposal of the public.[31] This right is limited in ways that parallel the limitations of the reproduction right.[32] The distribution right is also vital when invoked against a reproducer of infringing counterfeit copies.[33] Its importance in this context arises not because the copyright owner would otherwise be without a cause of action against the infringing reproducer, but rather in the practical consideration that the reproducer may be unavailable or insolvent, leaving the distributor of the infringing copies or phonorecords as the only party against whom the copyright owner may obtain meaningful relief.

In addition to copyright law, a copyright owner may limit the distribution of its work through contract law.[34] Through contractual restrictions a "seller can monitor the distribution chain and punish distributors who cooperate with gray market arbitrageurs."[35] Courts have also recognized that other means exist to protect the integrity of a distributorship network.[36] For example, if a copyright owner has sufficient market power to obtain and enforce them, it can utilize contractual restrictions on resale.[37] Still, copyright law remains the most powerful weapon copyright and even trademark owners have at hand to prevent gray market sales.[38]

---

30. 17 U.S.C. § 106(3) (2006).

31. 2 Eric J. Schwartz, *United States*, *in* INTERNATIONAL COPYRIGHT LAW AND PRACTICE USA-132–33 (Paul Edward Geller ed., 2008).

32. *Id.* at USA-133.

33. *See id.* at USA-133–34.

34. *See* Christine Ongchin, *Price Discrimination in the Textbook Market: An Analysis of the Post-Quality King Proposals to Prevent and Disincentivize Reimportation and Arbitrage*, 15 CARDOZO J. INT'L & COMP. L. 223, 248–49; *see also* Meurer, *supra* note 4, at 146.

35. *Id.* at 248–49 (noting contractual restrictions have been used in the pharmaceutical industry to prevent reimportation from Canada).

36. Disenos Artisticos E Indus. v. Costco Wholesale Corp., 97 F.3d 377, 379–80 (9th Cir. 1996).

37. *Id.* at 380 (holding that there was no violation of Section 602 of the Copyright Act by a buyer of gray market goods because the copyright owner had authorized its licensed manufacturers abroad to export anywhere in the world. The court, however, did not rule on whether the defendant qualified as an infringing "importer" or if the first-sale doctrine applied).

38. However, this is not the case for all countries. Recently, the Supreme Court of Canada reversed a lower court ruling that had awarded damages and an injunction against an importer of Toblerone chocolate bars and its European manufacturer for infringement of the Canadian copyright on the packaging logos. The Court held that the Canadian exclusive distributor may sue

Although the Copyright Act does not have extraterritorial application, there are numerous international treaties concerning the protection of intellectual property, most of which have been ratified by the U.S. government.[39] The Berne Convention for the Protection of Literary and Artistic Works, which the U.S. ratified in 1989, protects distribution rights in three different provisions: Article 14(1) deals mainly with adaptations and reproductions; Article 14ter, which contains the *droit de suite*; and Article 16, which provides for seizure of infringing copies.[40] However, under Article 13(3), phonograms made under a compulsory license in one country and imported without permission "into a country where they are treated as infringing recordings shall be liable to seizure."[41] This provision and Article 13(1)(2), the compulsory license regime for mechanical reproductions, limit the effect of the license to the territory that imposes it, effectively prohibiting export of compulsorily licensed phonograms into another Berne country.[42] Therefore, "a recording of a musical work lawfully made pursuant to a license in country A will not carry its 'lawful charter' with it when it is exported to other countries of the Berne Union without the consent of the person entitled to the copyright in those works in those countries."[43] In such a scenario, "country B is entitled to regard such a recording as an infringing recording."[44] This is because Paragraph (3) does not require country B to treat these recordings as infringing: that matter is left to the law of that country.[45]

Even more to the point is the World Intellectual Property Organization ("WIPO") Performances and Phonograms Treaty:

> (1) Performers shall enjoy the exclusive right of authorizing the making available to the public of the original and copies of their performances fixed in phonograms through sale or other transfer of ownership.
>
> (2) Nothing in this Treaty shall affect the freedom of Contracting Parties to determine the conditions, if any, under which the

---

neither the unauthorized distributor nor the European official manufacturer for infringement under the Canadian Copyright Act. The Canadian copyright owner's only remedy would lie in a breach of contract action. *See* Kraft Canada Inc. v. Euro-Excellence Inc., [2007] S.C.R. 37, 2007 SCC 37 (Can.).

39. *See* Schwartz, *supra* note 31, at USA-9–11.

40. *See* Berne Convention for the Protection of Literary and Artistic Works art. 14(1), 14ter, 16, *opened for signature* May 4, 1896, S. TREATY DOC. No. 99–27, 1972 U.N.T.S. 223.

41. *Id.* art. 13(3).

42. *Id.* art. 13(1)(2).

43. 1 SAM RICKETSON & JANE C. GINSBURG, INTERNATIONAL COPYRIGHT AND NEIGHBOURING RIGHTS: THE BERNE CONVENTION AND BEYOND § 11.48 (2d ed. 2005).

44. *Id.*

45. *Id.*

> exhaustion of the right in paragraph (1) applies after the first-sale or other transfer of ownership of the original or a copy of the fixed performance with the authorization of the performer.[46]

This was "the first time that such a right was explicitly recognized at the international level."[47] The territorial effect of the complementary doctrines of exhaustion and first-sale also remained unsettled under the WIPO copyright treaty.[48] There was no agreement at the WIPO Diplomatic Conference as to these issues.[49] "Thus, the treaty prescribes no rules on the nature of the acts respecting copies that will exhaust the distribution right."[50] Nor does the treaty prescribe whether exhaustion will have only a domestic effect (in which case the first sale doctrine would free the product from resale restrictions only within the country in which the first sale occurred), or a broader, international effect (in which case the first sale doctrine would free the copy from any resale restrictions by the copyright owner in any member state).[51] As in the Berne Convention case, the ultimate decision to those respects was left up to each individual country.[52]

Subject to the specific limitations discussed below, the distribution right is applicable to all copies of a copyrighted work, regardless of whether or not they were lawfully made.[53] This means that a copyright owner's right of distribution would extend to bootlegged copies as well as to gray market goods, which, by definition, are not counterfeit but legitimately manufactured products.[54] It would appear, under

---

46. WIPO Performances and Phonograms Treaty art. 8, Dec. 20, 1996, S. TREATY DOC. NO. 105-17, 2186 U.N.T.S. 245.

47. MIHÁLY FICSOR, THE LAW OF COPYRIGHT AND THE INTERNET: THE 1996 WIPO TREATIES, THEIR INTERPRETATION AND IMPLEMENTATION 626 (2002) (commenting on Article 8 of the WIPO Performances and Phonograms Treaty).

48. *See* GOLDSTEIN, *supra* note 21, at 255–56.

49. *Id.* at 255.

50. *Id.*

51. *Id.*

52. *Id.* A comparative law analysis is beyond the purview of this Note. It is worth noting, as a matter of example only, that when it comes to non-duplicating infringement activities, the copyright law of certain countries may characterize the underlying wrongdoing in manners different from American law. For instance, the infringement of the right of distribution, which is a form of direct infringement under U.S. law, under Canadian law is treated as secondary infringement requiring the showing of knowledge and acts "to such an extent as to affect prejudicially the owner of the copyright." Canada Copyright Act, R.S.C., ch. C-42, § 27(4)(b) (1985). *See* 4 MORAG MACDONALD ET AL., COPYRIGHT: WORLD LAW AND PRACTICE (2006) (giving a general survey of individual countries' intellectual property laws); *see* CATHERINE BARNARD, THE SUBSTANTIVE LAW OF THE EU: THE FOUR FREEDOMS (2d ed. 2007) (giving an overview of the copyright laws in the European Union, including the application of the exhaustion doctrine).

53. *See* GOLDSTEIN, *supra* note 21, at 255.

54. *See id.*

earlier case law, that it is only the unauthorized distributor[55] and not the recipient of such copies or phonorecords, who may be liable for infringement of the distribution right.[56] But post-1976 Copyright Act cases have had a contrary view and opened the possibility of imputing liability to an "unwitting purchaser."[57] In some circumstances, if the seller is an infringer, the buyer may be liable as a contributory infringer.[58] In *Scorpio*, in addition to the first-sale doctrine defense, the defendant argued that it was not the proper defendant because it had not directly imported the phonorecords to which, admittedly, CBS owned full copyright.[59] The phonorecords had allegedly been purchased from a seller in the Philippines by a third party, International Traders, who later sold them to the defendant in the United States.[60] Although the evidence did not allow the court to make a decisive determination as to the defendant's role as an importer, the court concluded that the defendant had "full knowledge of the importation problem."[61] Additionally, the court did not find it necessary to make a determination as to whether the defendant was an importer "in view of the law regarding vicarious and contributory infringement" in copyright law.[62]

The *Scorpio* holding is remarkable because it opens the door to imposing liability on millions of online shoppers who purchase gray market goods over the Internet from foreign sellers. If the retail sale of gray market products is a violation of the copyright holder's exclusive right of distribution, U.S. shoppers could be held liable under the doctrines of vicarious and contributory copyright infringement because of the actions of a foreign distributor, or even an American intermediary, regardless of whether the final consumer is held to be an "importer" for the purpose of Section 602 of the Copyright Act.[63]

---

55. Ford Motor Co. v. B & H Supply, Inc., 646 F. Supp. 975, 989 (D. Minn. 1986) (noting that it is no defense for the unauthorized distributor to disavow responsibility for the wrongful manufacture of the infringing item).

56. Foreign & Domestic Music Corp. v. Licht., 196 F.2d 627, 629 (2d. Cir. 1952) (holding that only the seller, not the buyer, could be held liable for the comparable right to vend under the 1909 Act).

57. Am. Int'l Pictures, Inc. v. Foreman, 576 F.2d 661, 664 (5th Cir. 1978) ("[E]ven an unwitting purchaser who buys a copy in the secondary market can be held liable for infringement if the copy was not the subject of a first-sale by the copyright holder.").

58. *See* Columbia Broad. Sys., Inc. v. Scorpio Music Distribs. Inc., 569 F. Supp. 47, 49 (E.D. Pa. 1983).

59. *Id.* at 48.

60. *Id.* at 47.

61. *Id.* at 48.

62. *Id.*

63. *See Columbia Broad Sys., Inc.*, 569 F. Supp. at 48–49.

In addition to the general distribution right in Section 106(3) noted above, Section 602(a) of the Copyright Act further provides that unauthorized importation of copies or phonorecords of a work that has been acquired outside the United States constitutes an infringement of the distribution right.[64] Thus, a copyright owner may sue civilly for importation of copyrighted goods.[65] In addition, the Customs Service may seize and forfeit counterfeit materials at the border.[66] As enacted, the importation right codified at 17 U.S.C. § 602(a) is an effective means of curbing gray market goods. It states: "[I]mportation into the United States, without the authority of the owner of copyright under this title, of copies or phonorecords 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. . . ."[67] Given that gray market goods come from outside the U.S. and are imported without permission, manufacturers holding copyrights to their products, or to some aspect of their products' packaging, would seem to derive a solid measure of legal protection from Section 602(a).

The importation right can prove particularly potent for manufacturers of a wide array of goods. First, it obviously applies to the importation of works of authorship such as dolls, video games, audiovisual works, music and books.[68] Second, it is useful vis-à-vis the importation even of non-copyrightable manufactured goods.[69] That is indeed why Section 602(a) of the Copyright Act, which bars importation of copyrighted goods, can be so strong.[70] Given that a great number of manufactured goods incorporate a label, a design, instruction sheets, or other material that is subject to copyright protection, copy-

64. Blue Ribbon Pet Prods., Inc. v. Rolf C. Hagen (USA) Corp., 66 F. Supp. 2d 454, 462 (E.D.N.Y. 1999) (citing 17 U.S.C. §§ 106(3), 501(a), 602(a); GB Mktg. USA, Inc. v. Gerolsteiner Brunnen GmbH & Co., 782 F. Supp 763, 772 (W.D.N.Y. 1991)).

65. *See* Microsoft Corp. v. Very Competitive Computer Prods. Corp., 671 F. Supp. 1250, 1251–52 (N.D. Cal. 1987) (citing 17 U.S.C. § 502); Nintendo of Am., Inc. v. Elcon Indus., Inc., 564 F. Supp. 937, 943 (E.D. Mich. 1982) (quoting 17 U.S.C. § 502); *see generally Scorpio*, 569 F. Supp. 47.

66. 19 U.S.C. § 1337(i). Note, however, that in cases where the copies are lawfully made abroad—i.e. non-counterfeit gray market goods—the United States Customs Service has no authority to prevent their importation. The recourse for any person claiming an interest in the copyright in a particular work is, upon payment of a specified fee, to be entitled to notification by the Customs Service of the importation of articles that appear to be copies or phonorecords of the work. 17 U.S.C. § 602(b).

67. 17 U.S.C. § 602(a).

68. *Id.* § 102(a).

69. *See id.* § 106.

70. *Id.* § 602(a).

right law frequently reaches the offending conduct.[71] Having lost in other fields of law, manufacturers realized that copyright may furnish a supplemental vehicle for protection.[72]

III. GRAY MARKET GOODS[73]

The United States Supreme Court has defined a gray market good as "a foreign-manufactured good, bearing a valid United States trademark that is imported without the consent of the United States trademark holder."[74] But the term also encompasses copyrighted goods, manufactured in the U.S. or abroad, imported into this country without the consent of the U.S. copyright holder as described in the examples above.[75] Gray market goods are originally intended for sale in a different geographic market than the one in which they are eventually sold.[76] These goods are not counterfeit; they are genuine products usually manufactured abroad for sale abroad that end up in United States markets.[77] Once the gray market goods arrive in the United States, they compete directly with the intellectual property holder's authorized domestic goods.[78] The controversy over gray market goods centers on whether manufacturers should have to compete against imports of their own products.[79]

---

71. *See, e.g.*, Sebastian Int'l, Inc. v. Consumer Contacts PTY, Ltd. (*Sebastian I*), 847 F.2d 1093, 1098–99 (3d Cir. 1988) (copyrighted label). Note, however, that like gray market trademark goods, gray market copyright goods are subject only to a civil suit, not to Customs seizure at the border.

72. The trial court opinion in *Sebastian International, Inc. v. Consumer Contact Ltd.* (*Sebastian II*) is illustrative both of the application of copyright in an unexpected field and of the belated recognition of that fact by a litigating manufacturer. *Sebastian II*, 664 F. Supp. 909, 922 (D.N.J. 1987) *vacated by* 847 F.2d 1093 ("[G]iven the confusion in the trademark world, it is unclear why plaintiffs continue to rely on those uncertain rights when the copyright law provides such a formidable shield.").

73. Proponents of the positive aspects of the gray market practices often prefer to refer to it as "parallel trade" or "parallel imports," because of the negative connotation the term "gray market" carries with it. All three terms are used indistinctively throughout this Note.

74. K Mart Corp. v. Cartier, Inc., 486 U.S. 281, 285 (1988).

75. *See* Quality King Distribs., Inc. v. L'Anza Research Int'l, Inc., 523 U.S. 135, 153 (1998); *Sebastian I*, 847 F.2d at 1099.

76. *See, e.g.*, Parfums Stern, Inc. v. United States Customs Serv., 575 F. Supp. 416, 418 (S.D. Fla. 1983).

77. Danielle G. Mazur, Note, *The Gray Market After K Mart: Shopping for Solutions*, 8 CARDOZO ARTS & ENT. L. J. 641, 641 (1990) (showing examples of gray market goods also include trademark and patent-protected goods such as cigarettes or computer components, respectively); *see generally* Quanta Computer, Inc. v. LG Elecs., Inc. 128 S. Ct. 2109 (2008); Philip Morris USA, Inc. v. Otamedia, Ltd., 331 F. Supp. 2d 228 (S.D.N.Y. 2004).

78. Mazur, *supra* note 77, at 641–42.

79. *See* Stephen W. Feingold, *Parallel Importing Under the Copyright Act of 1976*, 32 J. COPYRIGHT SOC'Y 211, 212–14 (1985).

Proponents of gray markets assert that gray markets do not harm consumers or trademark and copyright holders and that United States law permits the purchase and importation into the United States of merchandise legally manufactured abroad without permission of the trademark or copyright owners.[80] However, gray market opponents argue the parallel importation of goods impede the efforts of manufacturers with a valid copyright or trademark to create a recognizable mark, and each sale of gray market goods results in an economic loss for those manufacturers and their authorized distributors.[81] Additionally, gray market importers "free ride" on the authorized distributors' substantial investment in goodwill and customer service, enabling importers to take advantage of expensive and established advertising campaigns.[82]

A. Price Discrimination

Sellers practice price discrimination when they charge consumers different prices for the same product and the disparity in price does not stem from a cost difference in supplying the copyrighted work.[83] Given identical versions of a work that have identical production and distribution costs, any price difference amounts to price discrimination.[84] In fact, price discrimination is widely practiced in the U.S. economy.[85] For example, airlines charge higher fares to business travelers, whose demand for travel is less elastic than that of vacationers or casual flyers. Movie theaters charge differently based on the basis of time (when the customer is willing or able to attend the screening) and age (discounts for children and seniors).

---

80. Mazur, *supra* note 77, at 675–76; *see, e.g.*, Fred von Lohman, *You Bought It, You Own It: Quanta v. LG Electronics*, Electronic Frontier Foundation, Nov. 17, 2007, http://www.eff.org/deeplinks/2007/11/you-bought-it-you-own-it-part-iv-quanta-v-lg-electronics.

81. Mazur, *supra* note 77, at 669–70; *see generally*, Christopher Heath, *Position Paper on Parallel Imports*, International Trademark Association, July 2007, *available at* http://www.wipo.int/edocs/mdocs/sme/en/atrip_gva_99/atrip_gva_99_6.pdf; KPMG, THE GREY MARKET: A KPMG STUDY IN COOPERATION WITH THE ANTI-GRAY MARKET ALLIANCE (2003), *available at* www.kpmg.com.cn/redirect.asp?id=6184.

82. Mazur, *supra* note 77, at 679 (quoting *Grey Market Goods and Modern International Commerce: A Question of Free Trade*, 10 FORDHAM INT'L L.J. 308, 331 (1987)).

83. William W. Fisher III, *When Should We Permit Differential Pricing Information?*, 55 UCLA L. REV. 1, 1–3 (2007), *available at* http://www.uclalawreview.org/articles/content/55/ext/pdf/1.1-1.pdf.

84. CAMPBELL R. MCCONNELL & STANLEY L. BRUE, ECONOMICS: PRINCIPLES, PROBLEMS, AND POLICIES, 453 (McGraw-Hill 16th ed. 2005) ("[A] monopolist can increase its profit by practicing price discrimination.... [P]erfect price discrimination ... occurs when the monopolist charges each customer the price that he or she would be willing to pay rather than go without the product.").

85. Fisher, *supra* note 83, at 1–8.

But price discrimination is not feasible unless three conditions are satisfied: 1) the seller has some monopolistic market power; 2) the seller can link prices to individual customer preferences and segment the markets accordingly; and 3) customers cannot arbitrage away price differentials, i.e. sellers do not have the ability to resell the products.[86] Market power is required because otherwise the disfavored customers of a price discriminator would find another supplier who offers a better deal.[87] In cases of copyrighted goods, copyright owners gain a monopolistic position because the law gives them a bundle of exclusive rights over the work being commercialized.[88] For instance, EMI Music has a monopoly on many of The Beatles' recordings because they cannot be reproduced, used, or distributed in certain ways absent EMI's consent.[89] But market power and information are not enough.[90] It must also be unprofitable, or illegal, for favored customers to defeat price discrimination by reselling the product to customers who the seller expects to pay more.[91] Thus, for price discrimination to be effective, it is essential that buyers cannot freely resell their purchases.[92] Otherwise, the lower price buyers will resell the products to other buyers who are unable to access the lower-priced merchandise, thereby destroying the ability of the copyright owner or licensed distributor to charge more to some buyers.[93]

Price discrimination is particularly common in international trade.[94] This is because companies with relative monopolistic power over a product or line of products usually segment the markets geographically, either by country or region.[95] The seller holding a monopolistic position may divide the markets offering different prices to different "classes" of buyers, the "classes" corresponding with the ter-

86. Allen Consulting Group, *Economic Perspectives on Copyright Law* 70–71, *available at* http://www.copyright.com.au/reports%20&%20papers/CCS0203Thorpe.pdf.

87. *Id.* at 70.

88. *See* United States v. Aluminum Co. of Am., 148 F.2d 416, 425 (2d Cir. 1945) (explaining that an example of a lawful monopoly is a copyright, which is not prohibited by the Sherman Act).

89. *Apple Sues Online Music Store Over Beatles Rarities*, WENN, Mar. 21, 2008, *available at* http://www.thefreelibrary.com/APPLE+SUES+ONLINE+MUSIC+STORE+OVER+BEATLES+RARITIES-a01610944954.

90. Economic Perspectives on Copyright Law, *supra* note 86, at 70–71.

91. *See* MCCONNELL & BRUE, *supra* note 84, at 452.

92. WALTER J. WESSELS, ECONOMICS 372 (Barron's Educational Series, Inc. 2000) (1987).

93. *Id.*

94. *See* MCCONNELL & BRUE, *supra* note 84, at 452.

95. *See id.*

ritory where the buyers are located.[96] Additionally, the monopolists may offer volume discounts—i.e, charge different prices in accordance with the quantities purchased from them ("block" or "volume" pricing).[97] With those tools in hand, additional factors such as currency exchange rates, consumer demands and elasticity of demand[98] allow monopolists to charge different prices for the same products in different markets, and presumably increase profits.[99]

Price discrimination is especially feasible in the case of intellectual property because individual works, given their originality, are not perfect substitutes for each other, and because either by law or by contract, the copyright owners may prevent or limit the arbitrage opportunities for resellers.[100] An excellent approach to understanding the relationship between copyright and price discrimination is to note that copyright owners are given rights against three distinct groups: competing producers, distributors, and users.[101] For example, competing producers can disrupt price discrimination by luring away customers who otherwise would have paid a higher price to the copyright holder.[102] Likewise, distributors can interfere with price discrimination by performing intermediary functions in the arbitrage process.[103] Finally, users are able to disrupt price discrimination by hiding their preferences or seeking opportunities for arbitrage.[104] Today's online commerce, with reduced worldwide shipping charges and transaction costs, is the perfect breeding ground for some consumers and distributors to disrupt the price discrimination practices of manufacturers and distributors across international markets.[105] The relationship between consumer rights and price discrimination is simple—broader consumer rights may impede price discrimination.

---

96. HIRSHLEIFER & AMIHAI GLAZER, PRICE THEORY AND APPLICATIONS 238 (Cambridge Univ. Press 2005).

97. *Id.*

98. *See id.* at 240 (noting for example, poorer customers typically have less elastic demands because they may be unable to acquire certain goods beyond certain prices, regardless of the need they may have for the goods).

99. WESSELS, *supra* note 92, at 373; MCCONNELL & BRUE, *supra* note 84, at 453 ("[A] monopolist can increase its profit by practicing price discrimination . . . [P]erfect price discrimination . . . occurs when the monopolist charges each customer the price that he or she would be willing to pay rather than go without the product.").

100. WILLIAM M. LANDES & RICHARD A. POSNER, THE ECONOMIC STRUCTURE OF INTELLECTUAL PROPERTY 39 (The Belknap Press of Harvard Univ. Press) (2003).

101. Meurer, *supra* note 4, at 60.

102. *Id.*

103. *Id.*

104. *Id.*

105. *See id.* (applying stated opportunities of competing producers, distributors, and users to disrupt price discrimination, and market power limitations to the Internet).

B. *First-sale Doctrine*

The first-sale doctrine is a narrow limitation on a copyright holder's rights. The Copyright Act gives a copyright holder the exclusive right to reproduce his copyrighted work,[106] the exclusive right to prepare derivative works based on his copyrighted work,[107] and the exclusive right to distribute copies of his work.[108] When a copyright holder chooses to sell a copy of his work, however, the "exclusive statutory right to control its distribution" is exhausted.[109] The first-sale doctrine is codified in Section 109(a) of the Copyright Act, which provides in pertinent part:

> Notwithstanding 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.[110]

This means that the copyright owner may exercise its distribution right solely with respect to the initial disposition of copies of a work, not to prevent or restrict the resale or other further transfer of possession of such copies.[111] Section 109(a) terminates further application of the distribution right to the affected copy.[112] When a copyright owner parts with title to a particular copy of his copyrighted work, he divests himself of his exclusive right to vend that particular copy.[113] The exclusive right to vend the transferred copy rests with the vendee, who is not restricted by statute from further transfers of that copy.[114] Furthermore, because a first sale exhausts the copyright holder's distribution right, future distributions of the copy no longer implicate the Copyright Act.[115] A first sale does not, however, exhaust other rights, such as the copyright holder's right to prohibit copying of the copy he sells.[116] For example, the first sale doctrine permits a consumer who

106. 17 U.S.C. § 106(1).

107. 17 U.S.C. § 106(2).

108. 17 U.S.C. § 106(3).

109. Quality King Distributors, Inc. v. L'Anza Research Int'l, Inc., 523 U.S. 135, 152 (1998).

110. 17 U.S.C. § 109(a) (2003).

111. U.S. v. Wise, 550 F.2d 1180, 1187 (9th Cir. 1997).

112. *See Wise* 550 F.2d 1180, 1187.

113. *Id.*

114. *Id.*

115. *Id.* (noting that after "first sale," a vendee "is not restricted by statute from further transfers of that copy").

116. *Wise*, 550 F.2d at 1187 (noting that "other copyright rights (reprinting, copying, etc.) remain unimpaired").

buys a lawfully made DVD copy of Coppola's "The Godfather" to resell the copy, but not to duplicate it.

The first-sale doctrine is rooted in the turn-of-the-century Supreme Court case *Bobbs-Merrill Co. v. Straus,* when the Court held that a valid first sale of a copyrighted work bars the copyright owner from controlling the distribution of that copy.[117] The adoption of Section 109(a) is essentially a legislative validation of the doctrine.[118] Indeed, the House of Representative's report on the Act states "as section 109 makes clear . . . the copyright owner's rights under section 106(3) cease with respect to a particular copy or phonorecord once he has parted with ownership of it."[119]

Section 109(a) thus provides a defense to liability under Section 106(3) for lawful purchasers of copies of copyrighted materials, so long as the copies were "lawfully made under this title."[120] But what is not clarified by the statute is the effect on the importation right granted in Section 602(a).[121] One court noted that precluding a copyright owner "from interfering with U.S. distribution of copies manufactured and lawfully sold abroad would be to deprive U.S. copyright holders of the power to authorize or prevent imports of the copies once the copies are sold abroad by the manufacturer."[122] This court rightfully acknowledges that "serious policy considerations weigh on both sides of this debate because of implications for the so-called 'gray market' of imported goods."[123]

The first-sale doctrine prevents a U.S. copyright owner from stopping the unauthorized importation into the U.S. of its copyrighted goods that it previously exported and sold abroad.[124] The Supreme

117. Bobbs-Merrill Co. v. Strauss, 210 U.S. 339, 351 (1908).

118. *Id.* (inferring this conclusion from the court's holding that adding an exclusive right of sale to a copyright owner's rights would "give a right not included in the terms of the statute . . . extend its operation . . . beyond [the meaning of the statute and its] . . . legislative intent in this enactment).

119. H.R. REP. NO. 94–1476, at 62 (1976), reprinted in 1976 U.S.C.C.A.N. 5659, 5675–76. There are two clear exceptions to the first-sale doctrine general rule: The Record Rental Amendment of 1984 provides that rental, lease or lending of a phonorecord, at least if done for profit, may give rise to infringement. Likewise, the Computer Software Rental Amendment of 1990 bars rental of software for profit. *See* 8 Nimmer on Copyright § 12 (MB 2007).

120. 17 U.S.C. § 109(a) (2003).

121. *See* Parfums Givenchy, Inc. v. Drug Emporium, Inc., 38 F.3d 477, 481 (9th Cir. 1994).

122. *Id.* at 481 n.6.

123. *Id.*

124. Quality King Distribs., Inc. v. L'Anza Research Int'l, Inc., 523 U.S. 135, 152 (1998) ("The whole point of the first sale doctrine is that once the copyright owner places a copyrighted item in the stream of commerce by selling it, he has exhausted his exclusive statutory right to control its distribution.").

Court, in *Quality King*, did not rule on the extension of the first-sale doctrine to goods manufactured abroad for which a U.S. copyright owner has exclusive rights.[125] However, *Quality King*'s dicta suggest, and prior and subsequent court decisions confirm, that the first-sale doctrine exception to distribution and importation rights does not apply to goods manufactured outside the United States.[126] Today, the ease of purchasing goods and services via the Internet presents a practical question as to how these copyright law principles should apply to the importation of goods for private-use that are purchased over the Internet from a foreign merchant, and delivered directly to an end-consumer located in the United States.

As explained above, "the first-sale doctrine authorizes a buyer to dispose of the purchased [copyrighted] copy of a work by resale, lease, or gift."[127] The link between the first-sale doctrine and arbitrage is obvious. If favored buyers—those paying less for the same exact product due to their geographic location—can purchase a work and then sell it to disfavored buyers, price discrimination is defeated. Thus, the law posits an apparent conflict between Section 109(a), the first-sale doctrine, and Section 602(a), the importation right.

The first reported clash between the two provisions, which occurred in *Columbia Broadcasting System v. Scorpio Music Distributors*, did not arise until 1983.[128] In *Scorpio*, the plaintiff sued a U.S. music distributor for copyright infringement pursuant to Section 602(a).[129] The distributor purchased records originally produced by a Philippine corporation licensed by the plaintiff to manufacture and sell the records in the Philippines.[130] The defendant replied that the first sale doctrine allowed it to import and distribute the records and contended that a valid first-sale occurred when the licensed Philippine manufacturer sold the records to another Philippine corporation.[131] The court decided that the records at issue were manufactured and sold abroad, and, as a result, the first-sale doctrine was not applicable.[132] The court reasoned that the phrase "lawfully made under this

125. *Id.*

126. Swatch S.A. v. New City, Inc., 454 F. Supp. 2d 1245, 1253–54 (S.D. Fla. 2006); UMG Recordings, Inc. v. Norwalk Distribs., Inc., No. SACV 02-1188, 2003 WL 22722410, at *3 (C.D. Cal. Mar. 13, 2003).

127. Meurer, *supra* note 4, at 83.

128. Columbia Broadcasting Sys., Inc. v. Scorpio Music Distribs., Inc., 569 F. Supp. 47, 47–48 (E.D. Pa. 1983).

129. *Id.* at 48.

130. *Id.* at 47.

131. *Id.* at 48–49.

132. *Id.* at 48.

title" in Section 109 limited the section's protection only to buyers of copyrighted items legally manufactured and sold in the United States.[133] Therefore, as the court determined that the copies of the records were imported without plaintiff's permission, the court held that the defendant was a copyright infringer under Section 602(a).[134] In its most memorable quote, the court noted that construing Section 109 as superseding Section 602(a) would render the importation right "virtually meaningless."[135]

In *BMG Music v. Perez,* the Ninth Circuit Court of Appeals also held that the first-sale doctrine would not provide a defense to a Section 602(a) infringement where the goods in question, non-infringing records— manufactured under a valid license from the copyright owner—sold in the U.S. without the copyright owner's authorization, were manufactured abroad.[136] In *Parfums Givenchy, Inc. v. Drug Emporium, Inc.,* the court held that the availability of Section 602(a) to bar imports of goods survives until there is a valid first sale in the United States.[137]

The most prominent case to hold that Section 602(a)'s provisions were limited by the first-sale doctrine was the Third Circuit Court of Appeals' decision in *Sebastian International Inc. v. Consumer Contacts (PTY) Ltd.*[138] Notably, this case departed from the geographic distinctions employed by *Scorpio*, *BMG*, and *Parfums Givenchy*.[139] In *Sebastian*, the defendant was a South African corporation that agreed to distribute hair products manufactured in the United States only in South Africa, but had in fact re-imported them. The plaintiff alleged that the re-importation of the products back into the United States violated the plaintiff's copyright rights pursuant to section 602(a).[140] Although hair products themselves are not subject to copyright, the labels on the shampoo bottles in this case contained copyrightable material.[141] The court reasoned that the plaintiff, as the copyright owner,

133. *Columbia Broad. Sys., Inc.*, 569 F. Supp. 47, 49.

134. *Id.* at 50.

135. *Id.* at 49.

136. BMG Music v. Perez, 952 F.2d 318, 319 (9th Cir. 1991).

137. Parfums Givenchy, Inc. v. Drug Emporium, Inc., 38 F.3d 477, 481 (9th Cir. 1994), *cert. denied*, 514 U.S. 1004 (1995).

138. Sebastian Int'l, Inc. v. Consumer Contacts (PTY) Ltd., 847 F.2d 1093, 1099 (3rd Cir. 1988).

139. *Id.*

140. *Id.* at 1094–95.

141. *See id.* at 1094 (demonstrating a clear example of how trademark or patent owners may seek protection of their intellectual property rights through copyright law in instances where trademark and patent law offer weaker or no legal recourse).

had already received his due reward for the copyrighted products from the sale to the defendant for the purchase price he charged.[142] Upon the realization of its due reward, the copyright owner could not further control the distribution of the copyrighted products.[143]

To resolve the apparent conflict between the Third and Ninth Circuits, the Supreme Court agreed to hear a case from the latter.[144] Thus, *Quality King Distribs., Inc. v. L'Anza Research Int'l, Inc.* now governs the interplay of the importation right and the first-sale defense.[145] In *Quality King*, the work at issue was the label on L'Anza shampoo bottles.[146] L'Anza sold the product at a relatively high price in the United States and at a relatively low price abroad.[147] A retailer in California was able to undercut authorized distributors by getting a cheaper supply of L'Anza shampoo from outside the U.S.[148] L'Anza challenged the importation of shampoo that, when sold to the South African buyers, was intended for foreign markets.[149] The legal question was whether the copyright owner's exercise of its importation right could withstand the application of the first-sale doctrine, which grants purchasers the right to resell authorized copies of a copyrighted work, even without the copyright owner's consent.[150] The Supreme Court found that re-importation of the copyrighted label, and by extension the shampoo bottle, was allowed under the first-sale doctrine.[151]

Justice Stevens asserted that the "literal text of § 602(a) is simply inapplicable to both domestic and foreign owners of L'Anza's products who decide to import them and resell them in the United States."[152] In a footnote, the Court stated that an owner of goods lawfully made under the 1976 Copyright Act was entitled to the protection of Section 109 even if the first sale occurred abroad, suggesting

142. *Id.* at 1094, 1098–99.

143. *Sebastian*, 847 F.2d 1093, 1096–97.

144. *Compare* Sebastian Int'l, Inc. v. Consumer Contacts (PTY) Ltd., 847 F.2d 1093 (3rd Cir. 1988) *with* L'Anza Research Int'l, Inc. v. Quality King Distribs., Inc., 98 F.3d 1109, 1114 (9th Cir. 1996), *rev'd*, 523 U.S. 135 (1998) (Ninth Circuit's decision later reversed by Supreme Court's landmark decision in *Quality King Distribs., Inc. v. L'Anza Research Int'l, Inc.*, 523 U.S. 135 (1998)).

145. *See generally* Quality King Distribs., Inc. v. L'Anza Research Int'l, Inc., 523 U.S. 135 (1998).

146. *Id.* at 138–40.

147. *Id.* at 138–39.

148. *Id.* at 139.

149. *Id.*

150. *Quality King*, 523 U.S. at 140–43.

151. *See id.* at 151–52.

152. *Id.* at 145

that the location of the first sale is immaterial to a Section 602(a) action.[153] Justice Stevens acknowledged the widespread debate over government regulation of the gray market, but indicated that he was uncertain whether the term appropriately described an American manufacturer who had decided to purposely sell its products abroad at a lower price.[154] Suggesting a certain disapproval of L'Anza's business strategy, the Court stated that "whether or not we think it would be wise policy to provide statutory protection for such price discrimination is not a matter that is relevant to our duty to interpret the text of the Copyright Act."[155]

Justice Ginsburg, in a two-sentence concurrence, added that the case was one involving a "round-trip" flow of copyrighted items, that is, the products in question were sent from the United States abroad and reintroduced to the domestic market.[156] However, she joined the majority only in so far as the Court's decision did not "resolve cases in which the allegedly infringing imports are manufactured abroad."[157] Although the majority opinion does not contain that explicit recognition, Justice Ginsburg's dictum has been interpreted as supporting the position that copyrighted goods manufactured abroad under a valid U.S. copyright license are not sheltered by the first-sale doctrine.[158]

The prevailing view on the issue today is that "sales abroad of foreign manufactured United States copyrighted materials do not terminate the United States copyright holder's exclusive distribution rights in the United States under §§ 106 and 602(a)."[159] Further, that Section 602(a) clearly extends protection to U.S. copyright owners in the "gray market" goods situation—i.e., where a domestic copyright owner's copies, intended for domestic sale, are placed in competition with identical copies manufactured abroad.[160] "In other words, under § 602(a), if a U.S. copyright holder licenses other entities to manufacture and sell copies of its works outside the United States, that copy-

153. *Id.* at 145 n.14.

154. *Id.* at 153 (noting that "gray market" refers to the importation of foreign-manufactured goods bearing a valid United States trademark without the consent of the trademark holder).

155. *Quality King*, 523 U.S. at 140–43.

156. *Id* at 154.

157. *Id.*

158. Omega S.A. v. Costco Wholesale Corp., 541 F.3d 982, 989–90 (9th Cir. 2008).

159. Summit Technology, Inc. v. High-Line Medical Instruments Co., 922 F. Supp. 299, 312 (C.D. Cal.1996) (citations omitted); *see also* Columbia Broadcasting Sys. v. Scorpio Music Dist., 569 F. Supp. 47, 49–50 (E.D. Pa.1983), *aff'd*, 738 F.2d 421 (3d Cir. 1984).

160. *Summit Technology*, 922 F. Supp. 299, 312 (citing Nimmer & Nimmer, Nimmer on Copyright § 8.12[B][6] n. 104 ("[I]t is accurate to state that the Copyright Act bars the importation of gray market goods.")).

right owner can prevent these foreign manufactured and purchased works from being sold and competing in the domestic market."[161] Thus, Section 109(a) does not provide a defense to a copyright infringement claim where the copy in question was manufactured abroad.[162] Since a first-sale defense only applies to the sale of copies that are "lawfully made under this title,"[163] it does not provide a defense to the resale of goods in the United States that are manufactured outside the United States.[164]

The latest application of this view came recently from the Ninth Circuit in *Omega S.A. v. Costco Wholesale Corp.*[165] The appellate court agreed with the copyright owner that the Supreme Court's decision in *Quality King* did not require the court to overrule existing Ninth Circuit decisions that limit the scope of the Copyright Act's first-sale doctrine to works that were either made or previously sold in the United States.[166]

The facts of *Omega* are as follows. Omega is a well-known manufacturer of watches.[167] Engraved on the underside of each watch is a copyrighted "Omega Globe" design that is protected by a registered U.S. copyright.[168] Costco is the largest membership warehouse club in the world.[169] In 2004, Omega filed suit against Costco after it learned that Costco had begun selling authentic, but "gray market" Omega watches in its California stores.[170] Costco had obtained the watches from a third party who had first purchased the watches from authorized Omega distributors overseas.[171] In its complaint, Omega alleged that Costco's acquisition and sale of the watches bearing the Omega Globe design in California constituted copyright infringement, under 17 U.S.C. Sections 106(3) and 602(a), because Omega had not author-

161. *Summit Technology*, 922 F. Supp. 299, 312.

162. *See, e.g.*, BMG Music v. Perez, 952 F.2d 318, 319 (9th Cir.1991) ("The first sale doctrine in 17 U.S.C. § 109(a) does not, however, provide a defense to infringement under 17 U.S.C. § 602 for goods manufactured abroad.").

163. 17 U.S.C. § 109(a).

164. Pearson Education, Inc. v. Liao, 2008 WL 2073491, *3 (S.D.N.Y. May 13, 2008) (citing *Quality King*, 523 U.S. at 148; *Columbia Broadcasting Sys., Inc.*, 569 F. Supp. 47, 49–50).

165. *Omega S.A*, 541 F.3d. 982, 983.

166. *Id.* at 990.

167. *Id.* at 983.

168. *Id.*

169. Business Exchange, Costco Wholesale Corp., http://bx.businessweek.com/costco-wholesale-corp/ (last visited Jan. 25, 2009) ("Costco is the largest membership warehouse club chain in the world based on sales volume. . . .").

170. *Omega S.A.*, 541 F.3d 982, 984.

171. *Id.*

ized the sale of the watches in the United States.[172] Thus, the court had to decide whether the first-sale doctrine applied to watches Costco purchased overseas and sold to its customers in California.

At the center of the debate was, as it usually is when a first-sale challenge is brought in cases of gray market imports, the meaning of "lawfully made under [Title XVII]" as section 109(a) of the Copyright Act reads.[173] The court refused to apply Section 109(a) to products made abroad because doing so would violate the presumption against extraterritoriality in a U.S. statute.[174] "Recognizing the importance of avoiding international conflicts of law in the area of intellectual property, [the court] applied a more robust version of this presumption, holding that the Copyright Act presumptively does not apply to conduct that occurs abroad even when that conduct produces harmful effects within the United States."[175] Although Section 602(a), which allows a copyright owner to prevent the importation of goods manufactured under a valid license abroad, seems inherently extraterritorial, the court reasoned that the Copyright Act "merely acknowledges the occurrence of a foreign event as a relevant fact," but it is not an extraterritorial application of U.S. law.[176] To the court, "something more" than having a lawfully made foreign copy—i.e. with the consent of the U.S. copyright holder—is required for Section 109(a) to apply.[177] "That 'something' is the making of the copies within the United States, where the Copyright Act applies."[178] Thus, the court chose to read "lawfully made under this title" as referring only to copies of U.S.-copyrighted works that are made in the United States.[179]

Even so, the court acknowledged the irony in its reading of Section 109(a), and a criticism long-argued by some proponents of an expansive reading of the first-sale statute: applying the first-sale doctrine only to U.S.-made copies may provide substantially greater copyright protection to foreign-made copies of U.S.-copyrighted works.[180] For example, an American copyright owner could not exercise distribution rights after one lawful domestic sale of a watch lawfully made in New York, but, the same owner could seemingly exercise distribution rights

172. *Id.*
173. *Id.* at 985.
174. *Id.* at 988.
175. *Omega S.A.*, 541 F.3d 982, 988.
176. *Id.*
177. *Id.*
178. *Id.*
179. *Id.* at 989.
180. *Omega S.A.*, 541 982, 989.

after the tenth sale in the United States of a watch lawfully made in Switzerland.[181] Omega dismissed this objection and decided that a lawful domestic sale enables a party accused of infringement to raise Section 109(a) as a defense because the domestic sale was authorized by the U.S. copyright owner.[182]

There are, however, two problems that the court's explanation does not resolve: 1) a policy that encourages U.S. copyright owners to outsource the manufacturing of copies of their work overseas; and 2) the impact on an increasing influx of copyrighted goods manufactured abroad through non-traditional importation channels facilitated by Internet transactions. Admittedly, the United States cannot impose the responsibility of determining and establishing U.S. policy with respect to commercial manufacturing on the Judiciary. That is something society must determine through the democratic process, with scholars and commentators contributing freely. Likewise, courts are not expected to take on a legal question unless a real controversy is brought before them. Thus, the courts will not rule hypothetically and give an advisory opinion on the repercussions of this conundrum unless a legal action is commenced. Given the impact of *Omega* and its followers, the strong repercussions in trade policy decisions and the legal impact on Internet-based consumer transactions, it is important to address these unresolved questions.

The increased practice of U.S. companies off-shoring their manufacturing activity abroad may turn into further circumvention of the application of the first-sale doctrine.[183] In 2008, the trade balance of the U.S. international trade in goods—the difference between the amounts of goods exported and imported—showed a deficit of nearly $820 billion.[184] With almost $1.3 trillion in exports, and roughly $2.2 trillion in imports for all categories of goods, the ratio of imports to exports was almost two to one.[185] But when it comes to consumer goods, where all copyrighted goods are included, the ratio of imports to exports is even more uneven: roughly $3 of imported goods for

181. *Id.*

182. *Id.*

183. *See, generally*, JANET L. NORWOOD ET AL., *Off-Shoring: How Big Is It?*, A Report of the Panel of the National Academy of Public Administration for the U.S. Congress and the Bureau of Economic Analysis, Oct. 2006; *see also* JANET L. NORWOOD ET AL., *Off-Shoring: What Are Its Effects?*, A Report of the Panel of the National Academy of Public Administration for the U.S. Congress and the Bureau of Economic Analysis, Jan. 2007 (noting a policy discussion at the U.S. government level of the manufacturing industry's "off-shoring" practice).

184. U.S. CENSUS BUREAU, U.S. BUREAU OF ECONOMIC ANALYSIS, Exhibit 1 *"U.S. International Trade in Goods and Services, January 2009"* (Mar. 13, 2009).

185. *Id.*

every $1 the U.S. exports.[186] Additionally, U.S. multinational companies ("MNCs") account for a large share of the U.S. trade in goods.[187] Trade associated with U.S. MNC parent companies or their foreign affiliates accounted for thirty-six percent of total U.S. imports of goods in 2005.[188] Although data on the imported content of domestic purchases by U.S. parent companies for the last decades are not available, "the data for the entire U.S. economy indicate a general increase in the reliance on imports."[189] This is especially significant for our analysis because the products that those MNCs import are often goods manufactured by the MNC affiliate in a foreign country, to be distributed in the U.S. by the MNC which holds a valid copyright in the U.S.[190]

While a manufacturer is unlikely to base its decision to relocate its manufacturing operations outside the U.S. solely on the first-sale doctrine, and without suggesting any judgment as to the benefits or evils of such practice, the current application of the first-sale doctrine by the courts certainly favors outsourcing manufacturing to foreign locations in order to strengthen the distribution right of copyrighted products in the U.S. Consider the case of the recording industry. The rise of digital downloading has drawn consumers—attracted by conveniently priced downloads or illegal file-sharing—to obtain music "by the song" on the Internet. However, a great number of consumers, while enjoying the benefits of digital downloading, still reach out to compact discs ("CDs") to satisfy their musical needs.[191] Music enthusiasts may prefer to own a physical copy of a sound recording in a CD form and seek to avoid the sharing limitations imposed by some of the music downloading services, or simply wish to protect themselves

186. *Id.* at Exhibit 6 (showing in the end-use commodity category of consumer goods, the U.S. exported roughly $161 billion, and imported over $482 billion in merchandise).

187. Ray Mataloni, "*Operations of U.S. Multinational Companies in 2005*," U.S. BUREAU OF ECONOMIC ANALYSIS SURVEY OF CURRENT BUSINESS 42, 48 (Nov. 2007) ("[A] multinational company is a company that holds at least a 10-percent equity interest in a foreign business enterprise; that is, any U.S. company that has a direct investment ownership stake in a foreign affiliate . . . is considered to be a U.S. MNC.").

188. *Id.* at 44.

189. Ray Mataloni, "*A Note on Patters of Production and Employment by U.S. Multinational Companies*," U.S. BUREAU OF ECONOMIC ANALYSIS SURVEY OF CURRENT BUSINESS 52, 54 (Mar. 2004).

190. *Id.* at 46 ("The increase in MNC-associated imports of goods reflected increases in both U.S. MNC trade with others and imports shipped by foreign affiliates to their U.S. parents. U.S. imports between U.S. MNCs and others increased 13.5 percent, and imports between U.S. parents and foreign affiliates increased 8.6 percent.")

191. *See* RIAA, *Year-End Shipment Statistics*, (2007) *available at* http://76.74.24.142/81128FFD-028F-282E-1CE5-FDBF16A46388.pdf (indicating the Recording Industry Association of America ("RIAA") reported 511.1 million CD units shipped for a dollar value of $7.452 billion).

against data loss. There is another singularity in the CD as a popular music vehicle. Whereas all past forms of phonorecord technologies made their respective predecessors automatically obsolete, CDs are a digital medium and can therefore coexist and interact with most of the prevailing new media.[192] You could neither play a vinyl record on a cassette player, nor a tape on a CD player. In fact, CD sales still represent almost eighty-three percent of U.S. music sales, against the near eleven percent assignable to digital downloads.[193] Thus, although in steady decline, CDs still constitute a major part of the recording industry's revenue source.

The following hypothetical illustrates the possible impact of some courts deciding to restrict the application of the first-sale doctrine. Assume that Universal Music Group ("UMG"), one of the "big five" in the recording industry,[194] manufactures its CDs for its copyrighted artist B.B. King in two manufacturing plants, one in San Diego, California, and one in Northern Mexico, close to the U.S. border, to later sell throughout the world. UMG sells several thousand of the B.B. King CDs, half of them shipped from their manufacturing plant in San Diego, and the other half from a few miles south of the U.S. border in Mexico, to distributor A, in Canada. Now, assume that UMG usually charges its Canadian distributor about forty percent less than its U.S. distributors for the same exact products. Distributor A, seeking to make a larger profit, sells the CDs to wholesaler B, who promptly brings them into the United States. Wholesaler B sells both the Mexican-made CDs and the San Diego-manufactured CDs in the U.S. market. When UMG finds out, it sues Wholesaler B for copyright infringement based on the unauthorized importation and tries to enjoin Wholesaler B from selling the B.B. King CDs. Under *Quality King*, *Omega*, and their progeny, UMG has no distribution rights as to half of the imported B.B. King CDs because they were manufactured in San Diego. Although the CDs were manufactured under the same license only a few miles from each other, UMG's right to control the distribution and importation into the U.S. of the U.S.-made CDs was exhausted once it sold them to Distributor A. UMG does have rights to prevent the sale of the CDs that originated in Mexico, however, because even though the CDs were manufactured by UMG and UMG

192. *See* RIAA, *The CD: A Better Value Than Ever*, *available at* http://76.74.24.142/F3A24BF9-9711-7F8A-F1D3-1100C49D8418.pdf.

193. RIAA, *Consumer Profile*, (2007) *available at* http://76.74.24.142/44510E63-7B5E-5F42-DA74-349B51EDCE0F.pdf.

194. Ankur Srivastava, *The Anti-Competitive Music Industry and the Case for Compulsory Licensing in the Digital Distribution of Music*, 22 TOURO L. REV. 375, 385 (2006).

authorized the first sale, the CDs were not made or sold in the United States. There is, therefore, an incentive for UMG to manufacture its CDs in Mexico and not in the U.S., if it wants to better control its market segmentation and distribution strategies. Again, whether this is sound policy in terms of international trade, competition, and domestic industry promotion is not a decision for the courts to make. But, one must be cognizant of the implications the courts' determination to restrict the application of the first-sale doctrine have in corporate decisions, consumer behavior, and the markets in general.

The prevailing judicial view on the application of the first-sale or exhaustion doctrine fails to address or acknowledge an additional reality. American consumers have the choice of purchasing legitimate copies of most consumer goods from whichever retailer they prefer, regardless of the seller's physical location.[195] Almost universal computer and Internet access, reduced shipping costs, and global marketplace exchange sites like eBay have made that possible. The market segmentation and price discrimination explained above open countless opportunities for entrepreneurs throughout the world to take advantage of the arbitrage opportunities the price differentials offer.[196]

To continue with the music hypothetical, assume the following facts: copies of a CD of a Latin American major recording artist are manufactured in Argentina by Universal Music Argentina ("UMA") pursuant to a license issued by its parent company, UMG, limiting its distribution to Latin America alone. UMG also manufactures and sells the same CD in the U.S., and is the exclusive U.S. copyright owner of all rights on the work within the United States. Since UMG segments the markets for the sale of CDs, the same Latin artist's CD retails in Argentina thirty percent cheaper than what it sells for in the U.S. market. Logically, UMG has not consented to the importation or distribution of the foreign-made copies of the CDs in question into the United States. However, an Argentine distributor buys a large number of such legitimate copies from UMA, and, unbeknownst to UMA or UMG, sells them directly to consumers in the U.S. over the Internet through the third-party auction site eBay.

This hypothetical is far from imaginary. Either because the products are cheaper, or because their inventory is limited by the manufacturer, thousands of American consumers purchase, via eBay and other Internet auction or direct sale websites, innumerable copyrighted goods from countries where the U.S. copyright holder has issued li-

195. *See generally* NISSANOFF, *supra* note 22.

196. *See generally* LANDES & POSNER, *supra* note 100.

censes for production and commercialization exclusively within a foreign territory.[197] Under the reading courts have made of Section 602(a), the online purchase of the Argentine-made CD may be categorized as an importation into the United States of a work that has been acquired outside the United States. Since neither the buyer nor the seller in the online transaction had the authority of UMG to bring the CD into the country, the sale is unlawful and infringes UMG's exclusive right to distribute copies. Furthermore, under *Omega*, the first-sale doctrine of Section 109(a) would not provide the buyer with a defense against the copyright infringement claims because they would involve goods manufactured and acquired abroad—i.e. not "lawfully made under [Title XVII]."[198]

For the most part, acts of infringement that occur outside of the jurisdiction of the United States are not actionable under the United States Copyright Act. That is, in fact, the rationale courts have used for refusing to extend the exhaustion doctrine to goods manufactured abroad.[199] The rule against international exhaustion stems from concerns that applying Section 109(a) to foreign-made copies would violate the presumption against the extraterritorial application of U.S. law.[200] However, if part of an "act" of infringement occurs within the United States, then the parties who contributed to the act within the U.S. may be liable under American copyright law, even though such act is achieved in part in a foreign jurisdiction.[201] There seems to be agreement that regardless of how much infringing conduct may or may not occur abroad, when violation of one of the exclusive rights in copyrighted works is effectively completed within the United States, the activity becomes actionable under domestic law.[202] Consequently, in addition to the foreign-made CD purchased on eBay, the American Internet shopper in the previous example might have also bought a

197. *See* Michelle Kessler, *Some See Red Over Gray-Market Goods*, USA TODAY (Dec. 11, 2006) *available at* http://www.usatoday.com/tech/products/2006-12-10-gray-market_x.htm.

198. Omega S.A. v. Costco Wholesale Corp. 541 F.3d 982, 990 (9th Cir. 2008).

199. *Id.* at 987.

200. *Id.* at 988.

201. 4 NIMMER ON COPYRIGHT, § 17.02 (MB 2008).

202. *See, e.g.*, Litecubes, L.L.C. v. Northern Light Products, Inc., 523 F.3d 1353, 1372 (Fed. Cir. 2008) (showing sales outside U.S. directed to U.S. customers were sales "in the U.S." for purposes of Copyright Act); *cf.* P & D Int'l v. Halsey Publishing Co., 672 F. Supp. 1429, 1432 (S.D. Fla. 1987) ("[T]o the extent part of an act of infringement occurs within this country, although such act be completed in a foreign jurisdiction, those who contributed to the act in the United States may be liable under United States copyright law."); *see also* 4 NIMMER ON COPYRIGHT, § 17.02 (MB 2006).

lawsuit. But even if the first-sale doctrine does not shield the American consumer from liability, an exception to Section 602(a) should.

Section 602(a) first states the general rule that unauthorized importation is an infringement if the copies or phonorecords "have been acquired outside the United States."[203] But then it enumerates three specific exceptions: 1) importation under the authority or for the use of a governmental body; 2) importation, for the private use of the importer and not for distribution, of no more than one copy or phonorecord of a work at a time; or 3) importation by nonprofit organizations.[204] Thus, not every importation runs afoul of the distribution right.

The reason there is no authority establishing whether online shoppers in the U.S. are liable for copyright infringement in their gray market transactions with foreign vendors is that cases have centered their analyses on the interaction between Sections 602(a) and 109(a), or alternatively, whether the first-sale doctrine exhausts the importation rights of the copyright owner. The "personal use" exception in Section 602(a)(2) has not been scrutinized by the courts yet, at least as applied to the scenario suggested here.[205]

In fact, the Copyright Act does not provide a definition of importation, or whether importing or carrying phonorecords for personal use into the country ceases to fall under the "personal use" category when the individual brings more than one copy into the country. Of course, a strict textual reading would lead one to conclude that bringing or importing two copies of the same identical work violates the statute and thus constitutes infringing activity. But even the strictest reading of the Act should shield the importer "for individual use," provided that the goods are for personal use, and the transaction shall be of no more than one copyrighted item of any one work at any one time.[206] Because the unauthorized importation of copyrighted goods constitutes a violation of the exclusive public distribution right,[207] only

203. 17 U.S.C. § 602(a).

204. *Id.* § 602(a)(1)-(3).

205. *Id.* § 602(a)(2)

> This subsection does not apply to . . . importation, for the private use of the importer and not for distribution, by any person with respect to no more than one copy or phonorecord of any one work at any one time, or by any person arriving from outside the United States with respect to copies or phonorecords forming part of such person's personal baggage.

206. *Id.*

207. *Id.* § 106(3) ("Subject to sections 107 through 122, the owner of copyright under this title has the exclusive rights to do and to authorize any of the following: . . . to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending.").

distributions "to the public" are infringing activities in violation of those rights.[208] That is why the importation right is statutorily limited to exclude "importation, for the *private use* of the importer and *not for distribution*, by any person with respect to *no more than one* [copyrighted good] of any one work *at any one time* . . ."[209] Such activities, as the Internet purchase of end-consumers over the Internet "fall short of wholesale importation" and should be exempted from any copyright liability for violation of the importation or distribution right.[210]

Clearly, the Copyright Act's drafters could not have foreseen in the early 1970s that American consumers could, in a matter of seconds and with the click of a few buttons, enter into virtual transactions with parties in any corner of the world with the ease that it is possible today. As one author notes, "copyright law has been unable to keep up with changing technological possibilities."[211] The digital and information revolution of the last few decades has challenged copyright law because of the numerous new media where copyrighted works may be fixed.[212] But in this case, the technological challenges are indirect. As a recent district court decision put it, "although technology has changed, the question at the core of this case is not technological."[213] In *Vernor*, an eBay seller who purchased authentic, used copies of AutoCAD software at a garage sale and later put it up for auction on eBay, was prevented from Autodesk, the owner of the copyrights on the software, from selling the software packages claiming a violation of its distribution right.[214] eBay eventually suspended Mr. Vernor's account on eBay due to the claims of infringement by Autodesk.[215] He subsequently brought an action for declaratory relief because Autodesk's past actions gave him reason to believe that Autodesk would try to stop his sales again.[216] The court concluded that Mr. Ver-

208. 8 NIMMER ON COPYRIGHT § 11 (1992) ("Note that it is not any distribution of copies or phonorecords that falls within this right, but only such distributions as are made 'to the public.'"); *see also* Hotaling v. Church of Jesus Christ of Latter-Day Saints, 118 F.3d 199, 203 (4th Cir. 1997).

209. 17 U.S.C. 602(a)(2) (emphasis added).

210. 2 NIMMER ON COPYRIGHT § 8.11[B] (1992).

211. HELLER, *supra* note 28, at 15–16.

212. *See* 17 U.S.C. § 102(a) (United States copyright law protection arises automatically when the original work of authorship is "fixed in any tangible medium of expression, known now or later developed, from which they can be perceived, reproduced or otherwise communicated, either directly or with the aid of a machine or device.").

213. Vernor v. Autodesk, Inc., 555 F. Supp. 2d 1164, 1174 (W.D. Wash. 2008).

214. *Id.* at 1165.

215. *Id.*

216. *Id.* at 1166.

nor could invoke the first-sale doctrine and that his resale of the software was not a copyright violation.[217] Further, although the subject matter at stake was computer software, Mr. Vernor was not trying to take advantage of new technology to ease copying or duplicating the copyrighted work.[218]

There is no reason why the same first-sale doctrine should not apply to the eBay transaction. Likewise, the question of copyright liability for "personal use" gray market imports is not a technological one. Despite the myriad technological advancements since the Copyright Act was enacted, the essence of the transaction originally contemplated by Section 602(a)(2) for exception from the copyright owner's right to prevent importation remains unchanged. Technological advancement has simply expanded the availability of channels of commerce such as the Internet; but a sale is a sale.

Other courts have consistently interpreted the first-sale doctrine broadly and rejected the copyright owners' attempt to restrict or prohibit the distribution of the copyrighted works by eBay resellers. For example, a recent California decision, *UMG Recordings, Inc. v. Augusto*, firmly upheld the first-sale defense for an eBay seller who sold promotional CDs previously obtained from music shops and other online auctions.[219] "UMG brought suit against Augusto for copyright infringement, alleging that UMG retained the exclusive right to distribute and sell the promotional CDs that Augusto sold through eBay."[220] The court rejected UMG's argument that the licensing language affixed to the promotional CDs UMG gave to the music industry insiders actually created a license.[221] UMG transferred title of the CDs to the music insiders, thus Augusto's resale of the CDs on eBay was protected by the first-sale doctrine.[222]

Although not addressing the right of importation, a Sixth Circuit case interpreting a different subsection of Section 109 also refused to curtail the first-sale doctrine.[223] At issue in *Brilliance Audio, Inc. v Haights Cross Communs., LLC* was the question of "whether the record rental exception to copyright's first sale doctrine . . . applies to all

217. *Id.* at 1175; *see also* United States v. Wise, 550 F.2d 1180, 1187 (9th Cir.1977) (noting that after "first sale," a vendee "is not restricted by statute from further transfers of that copy").

218. *Id.*

219. UMG Recordings, Inc. v. Augusto, 558 F. Supp. 2d 1055, 1065 (C.D. Cal. 2008).

220. *Id.* at 1058.

221. *Id* at 1060-61.

222. *Id.* at 1065.

223. *See* Brilliance Audio, Inc. v. Haights Cross Communications, Inc., et al., 474 F.3d 365 (6th Cir. 2007).

sound recordings, or only sound recordings of musical works."[224] Section 109(b) of the Copyright Act limits the first-sale doctrine, as codified in Section 109(a), by requiring the permission of both "the owners of a copyright in the sound recording" and "the musical works embodied therein" if renting, leasing, or lending them.[225] Because Section 109(b) limits the first-sale doctrine, the Sixth Circuit concluded that the "statute at issue . . . should be construed narrowly because it upsets the traditional bargain between the rights of copyright owners and the personal property rights of an individual who owns a particular copy."[226] Accordingly, the court ruled in favor of the defendant, noting that it would "not construe this exemption from the first sale doctrine any more broadly than explicitly mandated by Congress."[227]

Although neither *Vernor* nor *Augusto* involved imported gray market products, they were major victories for the proponents of a broad reading of the first-sale doctrine and the implication of these rulings in the first-sale debate is yet to be seen.[228] But even if courts refuse to apply the first-sale doctrine for gray market "personal use" imports manufactured abroad, the exception to the right of importation "with respect to no more than one copy or phonorecord of any one work at any one time" should clearly apply to those transactions.[229]

Cases such as *Augusto* suggest the copyright industry, particularly the music recording industry, may be gearing toward a broader approach in the enforcement of its copyrighted works, by going not only after piracy but also against alleged illegal distribution practices. For example, Universal Republic Records, an affiliate of UMG, threatened to sue music retailers and distributors if they sold an imported version of an album the record label was planning to release later in the fall.[230] Although the recording industry should, as it does, direct its concerns to the dilemmas the new digital media create for

224. *Id.* at 368.

225. 17 USC § 109(b)(1)(A).

226. *Brilliance Audio, Inc.* 474 F.3d 365, 373.

227. *Id.* at 374.

228. Sheppard Mullin's Intellectual Property Law Blog, "*UMG v. Augusto: Allowing the Sale of Promotional CDs Under the First Sale Doctrine Could Affect Much More than the Music Industry*", (Oct. 7, 2008), *available at* http://www.intellectualpropertylawblog.com/archives/copyrights-umg-v-augusto-allowing-the-sale-of-promotional-cds-under-the-first-sale-doctrine-could-affect-much-more-than-the-music-industry.html.

229. 17 U.S.C. § 602(a)(2).

230. Ed Christman, *An Amy Winehouse Album Reignites an Old Debate Over Imports*, BILLBOARD (Aug. 11, 2007).

enforcing their bundle of rights, their efforts in curbing resale and, presumably, reimportation of CDs may do nothing but further alienate its relationship with consumers.[231]

Furthermore, the failure that copyright owners have recently encountered in finding secondary liability infringement against Internet service providers ("ISPs"), may translate into a push for stricter enforcement of the distribution rights against the end-consumers. Whether a copyright owner may pursue legal actions against a potential infringer depends greatly on the size of the defendant's pocket. Section II of the Digital Millennium Copyright Act ("DMCA") attempts to limit the liability of ISPs for copyright infringement where the service provider is unaware of the infringing materials or otherwise acts promptly to remove the infringing material upon notice.[232] The mechanism by which the DMCA attempts to limit Internet service provider liability is through the creation of safe harbor provisions.[233]

Plaintiffs have typically relied on two main theories when trying to hold service providers liable. The first theory, vicarious liability, does not have a knowledge requirement.[234] To prove vicarious liability, a plaintiff must show that a defendant: 1) has the right and ability to control the infringer's actions; and 2) receives a direct financial benefit from the infringement.[235] The second theory, contributory infringement, will be found when a defendant, "with knowledge of the infringing activity, induces, causes or materially contributes to the infringing conduct of another."[236] *Hendrickson v. eBay, Inc.*, specifically addresses the applicability of the safe harbor provisions of the DMCA to protect the operator of the major online auction site.[237] Plaintiff, a copyright holder, sought to hold the auction secondarily liable for copyright infringement by an online seller utilizing the auction services.[238] The court held that eBay did not have actual or constructive knowledge and did not have the right or ability to control the

231. *See, e.g.*, Joseph Menn, *Music-sharing Verdict a Milestone for Record Labels*, L.A. TIMES, Oct. 5, 2007, at A18; Larisa Mann, *Download a Song, Loose Your Loan*, THE NATION, Nov. 29, 2007.

232. Codified at 17 U.S.C. § 512.

233. *Id.*

234. Religious Tech. Ctr. v. Netcom On-Line Commun. Servs., 907 F. Supp. 1361, 1375 (N.D. Cal. 1995).

235. *Id.*

236. *Id.* at 1373.

237. Hendrickson v. eBay, Inc., 165 F. Supp. 2d 1082, 1083–84 (C.D. Cal. 2001).

238. *Id.* at 1093–94.

infringing activity.[239] Since virtually any ISP may fall within the online service provider definition provided in the DMCA, *Hendrickson* gives other online service providers solid protection from copyright infringement liability.

IV. CONCLUSION

Gray markets pose a number of competing policy concerns. Gray marketers argue that their activities are legal because the goods they sell are genuine and bear lawful marks. Thus, they contend, consumers are not confused as to the source or origin of these goods. Consumer advocates also argue in favor of gray markets, asserting that gray markets allow consumers to purchase goods at a lower cost, thereby preventing price gouging by manufacturers and promoting consumer welfare. It is also true that geographic segmentation may impede the development of free and open markets, and is inconsistent with the basic philosophy of information sharing that underlies the Internet.

Contrarily, those who support expanded copyright protection of authors, publishers, and manufacturers are inclined to praise price discrimination and facilitating policies thereto. They make the strong argument that price discrimination raises profit to copyright owners and attracts more investment to copyright dependent industries. Manufacturers and copyright owners' groups argue that gray markets harm their goodwill and brand image. They complain that gray marketers are able to reap the benefits of the manufacturers' expensive manufacturing and advertising campaigns without incurring any of the accompanying costs. Companies that hold exclusive rights to distribute and sell products in the United States do not want to face unanticipated competition from importers and sellers of gray market goods.

The issue of parallel importation or gray market goods in retail e-commerce presented in this Note would not have arisen without the revolutionary growth of the Internet and development of third-party websites such as eBay. But the same striving economic force has also left a number of legal holes for consumers and copyright owners that copyright law may soon need to fill. As the volume of international Internet-based consumer transactions continues to grow, it will become imperative to determine whether end-consumer purchases of copyrighted goods, manufactured and sold abroad under a valid license, are a violation of the copyright owner's right of distribution and

239. *Id.* at 1082, 1093.

importation. The logical extension by the courts of the exceptions in Section 602(a)(2) to these transactions would easily dispose of this question. An unlikely clarification of Sections 109(a) and 602(a) of the Copyright Act by Congress could also resolve the uncertainty and apparent conflict between the two provisions. The first-sale doctrine in copyright law rests on a carefully constructed balance between property and contract rights. Therefore, limitations imposed in the subsequent sale of a copyrighted good, except for the few exceptions already contemplated by the statute guaranteeing the copyright owner's primary rights, should be a matter of contract, not copyright law.

The purchaser of a copyrighted good and all subsequent parties in the chain of distribution should be guaranteed that the work is being transferred free of copyright claims in terms of the distribution of the work. If any contract claims or restrictions remain on the goods, those can be more realistically imposed on subsequent purchasers. Copyright owners should require restrictive contract clauses when they first dispose of their products or enter into licensing agreements to avoid competition against their own products in their own backyard. Understandably, copyright owners and manufacturers would like to have a vertically imposed territorial division of their markets, but "why should an antitrust issue be brought into the copyright law?"[240]

The Supreme Court hinted at a guiding principle to assist us in answering this and the underlying questions presented here: one must remember that the principal purpose of the constitutional guarantee of copyright was to promote the progress of the "useful Arts" by rewarding creativity; its principal function is the protection of original works, rather than ordinary commercial products that use copyrighted material as a marketing aid.[241] With that premise in mind, the next court to interpret the importation of gray market products will be better-positioned to positively contribute toward a much needed balance of a well-functioning private property system.

240. Quality King Distribs., Inc. v. L'Anza Research Int'l, Inc., 523 U.S. 135 (1998) (quoting question of Justice O'Connor in Oral Argument).

241. *Id.* at 151 (1998) (citing U.S. CONST., Art. I, § 8, cl. 8).