

CHEAPER WATCHES AND COPYRIGHT LAW:  
NAVIGATING “GRAY MARKETS” AFTER THE SUPREME  
COURT’S SPLIT IN *COSTCO V. OMEGA, S.A.*

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Cite as: 7 Wash J.L. Tech. & Arts 237 (2012)<sup>†</sup>  
<http://digital.law.washington.edu/dspace-law/handle/1773.1/1113>

ABSTRACT

*Some manufacturers seek to prevent unauthorized importation and sale of their foreign-made products, called “gray market” goods or “parallel imports,” through copyright law. U.S. copyright law prohibits importation of copyrighted works without the copyright owner’s permission. At least one manufacturer, Omega, sought to extend this protection to its watches, a useful product, by affixing copyrighted logos. In Costco v. Omega, S.A., Omega claimed Costco violated its distribution right by selling the watches in the U.S., while Costco contended that a first sale abroad had extinguished Omega’s rights. The case reached the U.S. Supreme Court, which affirmed by an evenly divided court the Ninth Circuit’s holding that the first-sale doctrine does not apply when products are initially made and sold abroad. The Court’s decision suggested that copyright law might offer businesses a potent method to fight parallel importation. However, on remand the district court granted summary judgment to Costco on the rationale that applying a copyrighted logo to an otherwise useful product constituted copyright*

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<sup>†</sup> Originally published April 10, 2012. Revised April 19, 2012.

*“misuse.” While Omega has appealed, the district court’s decision suggests a critical limitation on producers’ use of copyright to protect utilitarian goods from unauthorized importation and sale.*

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## INTRODUCTION

Authentic, name-brand goods acquired abroad and sold domestically at a discount have found their way into (or onto) the hands of U.S. consumers for decades—undercutting companies’ attempts to maintain separate pricing structures for their products in domestic and foreign markets. Globalization and the historical strength of the U.S. dollar have fueled the trend of retailers relying on these “parallel imports,” also known as “gray market” goods, as a cost-effective way to source products.<sup>1</sup>

Although federal tariff and trademark laws prohibit certain parallel imports, these doctrines offer limited remedies. For example, trademark law only forbids unauthorized importation of products that bear material differences from their domestic counterparts. Some companies have turned to copyright law in an attempt to stop parallel imports.

In one high-profile case, Swiss watch maker Omega S.A. probed the boundaries of the statutory copyright distribution right by attempting to create a backdoor trademark.<sup>2</sup> Omega affixed copyrighted logos to its foreign-made wristwatches and claimed copyright infringement when wholesaler Costco, an unauthorized Omega retailer, sold the watches in the U.S. In the ensuing litigation in federal court, Costco claimed two defenses: the first-sale doctrine and copyright “misuse.” Although Costco lost on the first argument before the U.S. Supreme Court in *Costco Wholesale Corp. v. Omega S.A.*,<sup>3</sup> it prevailed on the latter upon remand.<sup>4</sup>

First, the Supreme Court voted 4-4 to affirm without explanation that the first-sale defense does not apply when goods are made abroad and imported into the U.S.<sup>5</sup> The first-sale doctrine

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<sup>1</sup> See *Weil Ceramics & Glass, Inc. v. Dash*, 878 F.2d 659, 662 n.1 (3d Cir. 1989) (noting that the term “gray market” implies “a nefarious undertaking by the importer” but has become “commonly accepted and employed”).

<sup>2</sup> *Omega S.A. v. Costco Wholesale Corp.*, 541 F.2d 982 (9th Cir. 2008), *aff’d sub nom. by an equally divided court*, *Costco Wholesale Corp. v. Omega S.A.*, 131 S.Ct. 565 (2010).

<sup>3</sup> *Costco Wholesale Corp. v. Omega S.A.*, 131 S.Ct. 565 (2010).

<sup>4</sup> *Omega S.A., v. Costco Wholesale Corp.*, No. 04-05443, slip op. at 4 (C.D. Cal. Nov. 9, 2011).

<sup>5</sup> *Costco*, 131 S.Ct. 565.

generally prevents a copyright owner from restricting later resale or distribution by a purchaser or recipient of a lawful copy of a work.<sup>6</sup> Prior to the *Omega* case, it was unsettled whether the U.S. first-sale doctrine provided a defense to claims of infringement arising from importation or sale of foreign-made goods without the copyright holder's permission. At least one federal appeals court had suggested that the statutory defense generally limits producers' rights,<sup>7</sup> while other federal courts ruled that an initial, lawful sale abroad did not exculpate a later seller.<sup>8</sup> Most of these cases involved "traditional" copyrighted works—products that fixed creative expression in a tangible form, such as textbooks.<sup>9</sup>

Many commentators expected the United States Supreme Court to resolve this issue when it granted certiorari to the Ninth Circuit.<sup>10</sup> However, the Court did not provide an explanation of its decision. The Second Circuit in *John Wiley & Sons, Inc. v. Kirtsaeng*, an analogous case, subsequently reached a similar conclusion, construing the first-sale defense as inapplicable to foreign-made products, even after a lawful U.S. sale.<sup>11</sup> These decisions suggested that importers and retailers should not rely on a first-sale defense to allegations of copyright infringement stemming from parallel imports. The Supreme Court has granted certiorari in *John Wiley & Sons*.<sup>12</sup>

Second, Costco later prevailed with a different argument—copyright misuse—revealing a key potential limit on the extent of copyright protection against parallel importation for certain useful

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<sup>6</sup> See 17 U.S.C. § 109(a) (2011).

<sup>7</sup> See *Sebastian Int'l, Inc. v. Consumer Contacts (PTY) Ltd.*, 847 F.2d 1093, 1098 n.1 (3d Cir. 1988).

<sup>8</sup> See, e.g., *Omega S.A. v. Costco Wholesale Corp.*, 541 F.2d 982, 987 (9th Cir. 2008); *Pearson Educ. v. Liu*, 656 F. Supp. 2d 407, 412 (S.D.N.Y. 2009); *CBS v. Scorpio Music Distrib.*, 596 F. Supp. 47, 49 (E.D. Pa. 1983), *aff'd without opinion*, 738 F.2d 424 (3d Cir. 1984).

<sup>9</sup> See, e.g., *Pearson*, 656 F. Supp. 2d 407 (textbooks). Cf. *Quality King Distributors, Inc. v. L'anza Research Int'l, Inc.*, 523 U.S. 135 (1998) (copyrighted hair product labels).

<sup>10</sup> *Costco Wholesale Corp. v. Omega S.A.*, 131 S.Ct. 2089 (2010).

<sup>11</sup> *John Wiley & Sons, Inc. v. Kirtsaeng*, 654 F.3d 210 (2d Cir. 2011), *cert. granted*, 2012 WL 1252751 (U.S. April 16, 2012) (No. 11697).

<sup>12</sup> *Id.*

goods. On remand, the district court granted summary judgment based on Omega's "misuse" of copyright doctrine.<sup>13</sup> Today, it remains unclear to what extent, if any, U.S. copyright law forbids unauthorized importation and sale of useful goods bearing such copyrighted designs.

This Article discusses the background of parallel importation and the legality of parallel importation under both trademark and copyright regimes. It examines how courts have analyzed whether the first-sale defense applies to unauthorized importation of foreign-made products, culminating with the *Costco* and *John Wiley & Sons* decisions. This Article also explores the implications of the *Omega* district court's grant of summary judgment against Omega based on the doctrine of copyright misuse. This Article suggests that trademark law, not copyright, is the proper analytical paradigm for addressing gray market goods. Further, this Article argues that goods merely adorned with a copyrighted logo, such as the watches at issue in *Omega*, are improper subjects for copyright import restrictions; applying copyright law to these products raises antitrust concerns and creates an undesirable form of backdoor trademark that may be remedied by application of the copyright misuse doctrine.<sup>14</sup>

## I. BACKGROUND ON GRAY MARKET PRODUCTS

The propriety of gray market products has become the subject of both legal and economic debate over the last three decades. The Supreme Court defines a gray market product as a "foreign-manufactured good, bearing a valid United States trademark that is imported without the consent of the United States trademark

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<sup>13</sup> *Omega S.A., v. Costco Wholesale Corp.*, No. 04-05443, slip op. at 4 (C.D. Cal. Nov. 9, 2011).

<sup>14</sup> Courts and commentators have used the term "backdoor" to describe perceived attempts to create intellectual property protection for a work that would not otherwise qualify for that type of protection. *See, e.g., Smith & Hawken, Ltd. v. Gardendance, Inc.*, No. 04-1664, 2005 WL 1806369, at \*3 (N.D. Cal. July 28, 2005). *See generally* Viva R. Moffat, *Mutant Copyrights and Backdoor Patents: The Problem of Overlapping Intellectual Property Protection*, 19 BERKELEY TECH. L.J. 1473, 1515 (2004).

holder.”<sup>15</sup> The term also applies to genuine copyrighted goods imported without authorization.<sup>16</sup> At least three situations may create incentives to import gray market goods: currency fluctuations, production and cost differences between nations, and price discrimination in different markets and territories.<sup>17</sup> The ease of international Internet commerce further aids such transactions.<sup>18</sup> Parallel imports today may represent billions of dollars’ worth of trade in the U.S. economy.<sup>19</sup> One industry estimate pegged the value of gray market information technology products sold in 2007 at \$58 billion or more.<sup>20</sup>

The prevalence of parallel importation springs from producers’ natural inclination toward price discrimination.<sup>21</sup> By selling products at different prices in different geographic markets, a business can attempt to maximize profits by charging a higher price in wealthier nations. This strategy may backfire, however, when third parties take advantage of price discrepancies by buying products cheaply in a poorer market and reselling them in a richer area—a process known as “arbitrage.”<sup>22</sup>

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<sup>15</sup> *K Mart Corp. v. Cartier*, 486 U.S. 281, 285 (1988).

<sup>16</sup> See generally 2 MELVILLE B. NIMMER & DAVID NIMMER, *NIMMER ON COPYRIGHT* § 8.12(B)(6) (Matthew Bender, rev. ed. 2011).

<sup>17</sup> Joseph Karl Grant, *The Graying of the American Manufacturing Economy: Gray Markets, Parallel Importation, and a Tort Law Approach*, 88 OR. L. REV. 1139, 1142-45 (2009).

<sup>18</sup> See Vartan J. Saravia, *Shades of Gray: The Internet Market of Copyrighted Goods and A Call for the Expansion of the First-Sale Doctrine*, 15 SW. J. INT’L L. 383, 383-84, 413 (2009).

<sup>19</sup> Andrew B. Chen, *Shopping the Gray Market: The Aftermath of the Supreme Court’s Decision in Quality King Distributors, Inc. v. L’anza Research International, Inc.*, 19 LOY. L.A. ENT. L.J. 573 (1999).

<sup>20</sup> KPMG LLP, *EFFECTIVE CHANNEL MANAGEMENT IS CRITICAL IN COMBATING THE GRAY MARKET AND INCREASING TECHNOLOGY COMPANIES’ BOTTOM LINE* 30 (2008), available at <http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Documents/Effective-channel-management-gray-market.pdf>.

<sup>21</sup> Michael Stockalper, Note and Comment, *Is There A Foreign "Right" of Price Discrimination Under United States Copyright Law? An Examination of the First-Sale Doctrine As Applied to Gray-Market Goods*, 20 DEPAUL J. ART, TECH. & INTELL. PROP. L. 513, 518-21 (2010); see also Saravia, *supra* note 18, at 387.

<sup>22</sup> Stockalper, *supra* note 21, at 518-21; see also Saravia, *supra* note 18, at

Depending on one's perspective, this phenomenon may represent large-scale savings for U.S. consumers or a loss of potential revenue by producers who desire to engage in market segmentation.<sup>23</sup> Proponents of gray market goods argue that sale of products obtained at lower prices to U.S. consumers at prices below what authorized retailers would charge "prevent[s] price gouging by manufacturers and promot[es] consumer welfare."<sup>24</sup> Critics, primarily producers who believe they lose revenues through parallel importation, contend that gray market products "harm their goodwill and brand image," allowing gray marketers to free ride on their advertising and marketing.<sup>25</sup> Whether to allow manufacturers protection against parallel importation under various intellectual property theories thus reflects the underlying theme of IP law as a "balance between providing incentives through exclusive rights and encouraging use of information through free access to creative works."<sup>26</sup>

## II. LEGAL REGIMES FOR CONTROL OF PARALLEL IMPORTATION

Business interests have turned to a variety of legal doctrines in an effort to prevent unauthorized importation of products. Federal tariff and trademark law provide the traditional lines of defense, as discussed in Section A.<sup>27</sup> However, U.S. copyright law might offer companies like Omega an additional tool to control unauthorized importation of products, as discussed in Section B. Section C describes how courts have taken different approaches as to whether the U.S. first-sale doctrine limits copyright protection against unauthorized importation of copyrighted works when those

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<sup>23</sup> See generally Saravia, *supra* note 18, at 396; Grant, *supra* note 17, at 1187.

<sup>24</sup> Lynda J. Oswald, *Statutory and Judicial Approaches to Gray Market Goods: The "Material Differences" Standard*, 95 KY. L.J. 107, 109 (2007).

<sup>25</sup> *Id.*

<sup>26</sup> See David W. Barnes, *The Incentives/Access Tradeoff*, 9 NW. J. TECH. & INTELL. PROP. 96 (2010).

<sup>27</sup> In addition, companies may have remedies under state law, such as tortious interference with contracts and unfair competition. See Grant, *supra* note 17, at 1184-86.

products are made abroad.

*A. Traditional Lines of Defense: Tariff and Trademark Law*

Although both the federal Tariff Act of 1930<sup>28</sup> and the Lanham Act<sup>29</sup> offer businesses some protection against parallel importation, these doctrines provide limited remedies. Both laws allow manufacturers to stop infringing goods at the border.<sup>30</sup>

The Tariff Act bars unauthorized importation of a good “that bears a trademark owned by a citizen of . . . the United States and is registered in the U.S. Patent and Trademark Office.”<sup>31</sup> But this “extraordinary protection” is limited to U.S. trademark owners that have no corporate affiliation with the foreign manufacturer of a given product.<sup>32</sup> Thus, a company cannot stop importation of its own products on the gray market.

Trademark law provides another avenue of protection, although it also does not bar unauthorized importation of every product. The Lanham Act prohibits importation of merchandise that is likely to cause confusion among consumers about who produced a product or where it was made.<sup>33</sup> Trademark law “has been an effective legal means for businesses to ban gray market goods.”<sup>34</sup> However, the Act only applies to products that are “physically and materially different” from domestic products.<sup>35</sup> Thus, trademark law generally does not apply when a company sells or authorizes distribution of identical versions of its trademarked good in

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<sup>28</sup> Tariff Act of 1930 (Smoot-Hawley Act), § 526, 19 U.S.C. § 1526 (2006).

<sup>29</sup> Lanham Act, § 42, 15 U.S.C. § 1124 (2006).

<sup>30</sup> See 5 J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 29:37 (4th ed. 2011).

<sup>31</sup> 19 U.S.C. § 1526 (2006).

<sup>32</sup> *K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281, 295 (1988) (Brennan, J., concurring).

<sup>33</sup> See 15 U.S.C. § 1124. See also *American Circuit Breaker Corp. v. Oregon Breakers Inc.*, 406 F.3d 577 (9th Cir. 2005).

<sup>34</sup> 2 CORPORATE COUNSEL’S GUIDE TO DISTRIBUTION COUNSELING § 19:3 (2011).

<sup>35</sup> *Id.*



different markets, some of which become parallel imports.<sup>36</sup> Some producers turn to copyright law in an attempt to stop parallel importation of products lacking material differences.

*B. Attempts to Use Copyright Law as a Means to Prevent Parallel Importation*

Following a string of federal court decisions, copyright law may hold the greatest promise for producers of traditional copyrighted works, such as books, and for a small subset of companies that make utilitarian products yet want to maintain international market segmentation (*i.e.*, Omega).<sup>37</sup> Provisions of U.S. copyright law prohibit the importation of unauthorized copyrighted goods, offering producers a method to circumvent the market-differentiation requirement of trademark law. Under the Copyright Act, the unauthorized sale of imported products “probably is copyright infringement if the imported work was originally manufactured abroad, even if such manufacture were done with the permission of the copyright proprietor.”<sup>38</sup> The reasons for this, however, are complex: they involve the Act’s ambiguous statutory language and judicial concerns about applying U.S. copyright law extraterritorially.

Unlike the source-identification function of trademark law, copyright law aims to foster scientific progress by giving creators limited rights to their works.<sup>39</sup> In order to qualify for copyright protection, goods must be original works of authorship exhibiting a modicum of creativity that have been fixed in a tangible medium.<sup>40</sup>

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<sup>36</sup> See, *e.g.*, *Dan-Foam A/S v. Brand Named Beds, LLC*, 500 F. Supp. 2d 296, (S.D.N.Y. 2007); *Swatch S.A. v. New City, Inc.*, 454 F. Supp. 2d 1245, 1249 (S.D. Fla. 2006) (“Under what has been called the ‘first sale’ or ‘exhaustion’ doctrine, the trademark protections of the Lanham Act are exhausted after the trademark owner’s first sale of its product.”); *Iberia Foods Corp. v. Romeo*, 150 F.3d 298 (3d Cir. 1998).

<sup>37</sup> See Saravia, *supra* note 18, at 394-95.

<sup>38</sup> 4 LOUIS ALTMAN & MALLA POLLACK, CALLMANN ON UNFAIR COMPETITION, TRADEMARKS & MONOPOLIES § 22:53 (4th ed. 2010).

<sup>39</sup> See *Sony Corp. of America v. Universal City Studios, Inc.*, 464 U.S. 417, 429 (1984).

<sup>40</sup> See 17 U.S.C. § 102 (2011).

Works of craftsmanship, such as watches, that are “useful” are not protectable, although separable ornamental features may be copyrightable.<sup>41</sup> While the most commonly discussed right is against unapproved copying, the Act also prohibits unauthorized public *distribution* of works.<sup>42</sup>

Congress amended the Copyright Act in 1976 to prohibit importation of copyrighted works into the country under certain circumstances.<sup>43</sup> Section 602 states that importing copies or phonorecords “acquired outside” the U.S. “without the authority of the owner of copyright” constitutes “infringement of the exclusive right to distribute copies or phonorecords” under § 106.<sup>44</sup> Yet while copyright law provides a variety of benefits for a potential litigant concerned about parallel imports,<sup>45</sup> alleged infringers have claimed a defense: the first-sale doctrine.

### *C. Courts Reach Different Conclusions about the Contours of the First-Sale Doctrine as Applied to Parallel Imports*

Debate among courts and commentators centers on whether and to what extent Congress intended the first-sale doctrine of

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<sup>41</sup> 2 WILLIAM F. PATRY, PATRY ON COPYRIGHT § 3:148 (2011). *See, e.g.*, *Severin Montres, Ltd. v. Yidah Watch Co.*, 997 F. Supp. 1262, 1265 (C.D. Cal. 1997), *aff'd*, 165 F.3d 917 (9th Cir. 1998).

<sup>42</sup> *See* 17 U.S.C. § 106(3) (2011); *see generally* 2 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 8.11-.12 (Matthew Bender, rev. ed. 2011). The distribution right “is a necessary supplement to the production right in order fully to protect the copyright owner”; otherwise, a creator could control production of copies but not the initial release of the work. *Id.*

<sup>43</sup> *See* 17 U.S.C. § 602 (2011).

<sup>44</sup> *Id.* Section 602 makes violations actionable under 17 U.S.C. § 501 (2011). The law provides exemptions for single copies imported for personal use and importation for scholarly, educational, or religious purposes rather than for private gain. § 602(3). U.S. Customs and Border Protection lacks authority to stop importation of “lawfully made” copies at the border, but people claiming a copyright interest in a particular work may pay a fee to be notified of the importation of articles that appear to be copies of the work. § 602(b).

<sup>45</sup> Copyright infringers are subject to joint and several liability, allowing a copyright owner to decide which infringer to sue. Chen, *supra* note 19, at 598. A copyright claim does not hinge on an infringer’s actual knowledge of the violation. *Id.* And a plaintiff need not show intent to infringe. *Id.*

§109 to limit §§ 106(3) and 602(a). The first-sale doctrine generally provides that the initial sale of a creative work exhausts the copyright holder's interest in controlling subsequent sales of that product.<sup>46</sup> This gives creators a say in how their works are initially sold while fostering free enterprise by removing such restrictions for later sales. Courts have specifically wrestled with whether goods must be manufactured in the U.S. in order to be "lawfully made" for purposes of the statute and thus to take advantage of the defense, as described in Section 1.<sup>47</sup> Section 2 describes the influential concurring opinion of Justice Ginsburg that limited the first-sale defense to U.S.-made copies. The Supreme Court in *Costco* ultimately affirmed without explanation that the first-sale doctrine is limited to U.S.-made copies, as described in Section 3.

#### 1. Early Decisions Suggest a Distinction in Application of the Doctrine to U.S.- and Foreign-Made Goods

In a series of early decisions considering application of the first-sale doctrine to parallel imports, federal courts distinguished between U.S.- and foreign-made products. The U.S. District Court for the Eastern District of Pennsylvania held that the first-sale doctrine did not extinguish copyright owners' interest in foreign-made imported goods.<sup>48</sup> In *Columbia Broadcasting System, Inc. v. Scorpio Music Distributors, Inc.*, Columbia Broadcasting sued after Scorpio purchased from a third-party importer approximately 6,000 audio recordings. Columbia Broadcasting owned the copyrights to the recordings, which were only authorized for production and sale in the Philippines.<sup>49</sup> The defendant pleaded the first-sale doctrine. But the court held that allowing the defense

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<sup>46</sup> See 17 U.S.C. § 109(a) (2011). See generally 4 WILLIAM F. PATRY, PATRY ON COPYRIGHT § 13:16 (2011).

<sup>47</sup> See, e.g., *John Wiley & Sons, Inc. v. Kirtsaeng*, 654 F.3d 210, 219 (2d Cir. 2011), cert. granted, 2012 WL 1252751 (U.S. April 16, 2012) (No. 11-697).

<sup>48</sup> *Columbia Broadcasting System, Inc. v. Scorpio Music Distributors, Inc.* 569 F. Supp. 47, 49 (E.D. Pa. 1983), *aff'd sub nom.* *CBS, Inc. v. Scorpio Music Distributors, Inc.*, 738 F.2d 421 (3d Cir. 1984).

<sup>49</sup> *Id.* at 47.

would conflict with explicit Congressional will.<sup>50</sup> On appeal, the Third Circuit affirmed without discussion.<sup>51</sup>

However, in *Sebastian Int'l, Inc. v. Consumer Contacts (PTY) Ltd.*,<sup>52</sup> the Third Circuit held that a beauty supply manufacturer, “having sold its goods with copyrighted labels to foreign distributors . . . is barred by the first sale doctrine from establishing infringement through an unauthorized importation.”<sup>53</sup> As products bearing copyrighted labels—rather than objects themselves protected by copyright—the goods at issue in *Sebastian* were more like the watches at issue in *Omega* than the phonorecords sold in *Scorpio*. The court vacated a preliminary order “enjoining defendants from distributing within the United States products that plaintiff had manufactured *in this country* and then exported.”<sup>54</sup> While the court discussed cases from other circuits that limited the application of the first-sale defense to U.S.-made copies, it “confess[ed] some uneasiness with this construction of ‘lawfully made’ because it does not fit comfortably within the scheme of the Copyright Act.”<sup>55</sup> The court reasoned that “[w]hen Congress considered the place of manufacture to be important, . . . the statutory language clearly expresses that concern.”<sup>56</sup>

## 2. Justice Ginsburg Suggests in Dicta that the First-Sale Doctrine Applies Only to “Round-Trip” Importation, a Position Adopted by Subsequent Courts

Nearly a decade later, the Supreme Court held in the landmark case of *Quality King Distributors, Inc. v. L'anza Research International, Inc.* that the first-sale doctrine limits §§ 106 and 602

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<sup>50</sup> *Id.* at 49.

<sup>51</sup> *CBS*, 738 F.2d 421.

<sup>52</sup> *Sebastian Int'l, Inc. v. Consumer Contacts (PTY) Ltd.*, 847 F.2d 1093 (3d Cir. 1988) (emphasis added).

<sup>53</sup> *Id.* at 1094.

<sup>54</sup> *Id.* (emphasis added).

<sup>55</sup> *Id.* at 1098 n.1.

<sup>56</sup> *Id.* The court pointed to 17 U.S.C. § 601(a) (2011), which prohibits importation or distribution in the U.S. of copies consisting of certain English literary material unless the material was “manufactured in the United States or Canada.” *Id.*

when goods are made in the U.S. with copyrighted labels, shipped abroad, and later re-imported.<sup>57</sup> Respondent L'anza, a hair-care product manufacturer, charged foreign distributors significantly less for the same products bearing copyrighted labels than it charged in the U.S. The products themselves were not copyrighted, only the labels. Petitioner Quality King Distributors purchased L'anza products made in the U.S. and imported from a distributor in Malta, and L'anza sued for copyright infringement. The Ninth Circuit affirmed a judgment finding that Quality King had infringed L'anza's copyright under § 602(a) by importing the products without authorization, deciding that § 109 provided no defense.<sup>58</sup>

The Supreme Court reversed, ruling that § 602 did not categorically bar unauthorized importation of copyrighted materials.<sup>59</sup> The Court held:

[S]ince § 602(a) merely provides that unauthorized importation is an infringement of an exclusive right “under section 106,” and since that limited right does not encompass resales by lawful owners, the literal text of § 602(a) is simply inapplicable to both domestic and foreign owners of [copyrighted] products who decide to import them and resell them in the United States.<sup>60</sup>

However, in a brief (though now well-known) concurring opinion, Justice Ruth Bader Ginsburg, joined by no other justice, noted that *Quality King* “involves a ‘round trip’ journey, travel of the copies in question from the United States to places abroad, then back again.”<sup>61</sup> Justice Ginsburg stated that the Court did not “resolve cases in which the allegedly infringing imports were manufactured abroad” and then imported into the U.S.<sup>62</sup> She cited

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<sup>57</sup> *Quality King Distributors, Inc. v. L'anza Research Int'l, Inc.*, 523 U.S. 135 (1998).

<sup>58</sup> *Id.* at 135.

<sup>59</sup> *Id.* at 154 (Ginsburg, J., concurring).

<sup>60</sup> *Id.* at 145.

<sup>61</sup> *Id.* at 154 (Ginsburg, J., concurring).

<sup>62</sup> *Id.*

a treatise for the proposition that “provisions of Title 17 do not apply extraterritorially unless expressly so stated, hence the words ‘lawfully made under this title’ in the ‘first sale’ provision, 17 U.S.C. § 109(a), must mean ‘lawfully made in the United States.’”<sup>63</sup>

Courts in later cases have relied on this concurrence to support their view that the first-sale doctrine does not limit § 602 when copies are produced abroad. For example, in 2009 the U.S. District Court for the Southern District of New York looked to the *Quality King* dicta to hold that the first sale doctrine does not protect importers of foreign-made textbooks designated for sale abroad and later imported into the U.S.<sup>64</sup> The plaintiffs in *Pearson Education, Inc., v. Liu*, copyright holders who published textbooks throughout the world and to whom authors had granted exclusive rights to reproduce and distribute the works within the U.S., sued the defendant importers for importing textbooks without authorization and selling them online.<sup>65</sup> The *Pearson* court noted that “nothing in § 109(a) or the history, purposes, and policies of the first-sale doctrine, limits the doctrine to copies of a work” made in the U.S.<sup>66</sup> The court would likely have held that the first-sale doctrine provides a defense for works made abroad and imported, if the district court “were to limit its consideration to the traditional tools of statutory interpretation.”<sup>67</sup> However, the court concluded the dicta in *Quality King* addressing a similar situation required it to defer to the Supreme Court.<sup>68</sup> The court reasoned that “[w]hen the Supreme Court addresses an unsettled question of federal law in unanimous dicta, respect for the Supreme Court as an institution and the dedicated jurists who serve on it mandates deference in all but the most exceptional circumstances.”<sup>69</sup>

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<sup>63</sup> *Id.* at 154 (Ginsburg, J., concurring) (citing WILLIAM F. PATRY, COPYRIGHT LAW AND PRACTICE 166-170 (1997 Supp.)).

<sup>64</sup> *Pearson Education, Inc. v. Liu*, 656 F. Supp .2d 407 (S.D.N.Y. 2009).

<sup>65</sup> *Id.* at 408-09.

<sup>66</sup> *Id.* at 410.

<sup>67</sup> *Id.* at 411.

<sup>68</sup> *Id.* at 416.

<sup>69</sup> *Id.*

### 3. The Ninth Circuit Adopts a Restrictive Interpretation of the First-Sale Doctrine in *Omega*, which the Supreme Court Affirms

The *Omega* case again propelled gray market goods before the Supreme Court, resulting in the Court's split affirmance that the first-sale defense does not apply to foreign-made goods. The case began with sale of Swiss-made, Omega-brand watches by Costco, a privately held warehouse club based in Washington State, without Omega's authorization. Costco purchased Seamaster watches bearing the copyrighted "Omega Globe Design" logo engraved on the back from a New York company.<sup>70</sup> That company had purchased the watches from unidentified third parties, who had bought them from authorized distributors abroad. Costco sold the watches for just \$1,299.99, compared with a suggested retail price of \$1,995.00.<sup>71</sup> Omega's legal department had suggested adding the design, copyrighted in 2003, after authorized U.S. dealers complained about Costco's sale of the watches.<sup>72</sup> The watchmaker stated in a newsletter that "the purpose of this lawsuit was to 'stem the tide of the grey market.'"<sup>73</sup>

Omega sued Costco in 2004 for copyright infringement under 17 U.S.C. §§ 106(2) (right to prepare derivative works) and 106(3) (right to distribute works) and moved for summary judgment.<sup>74</sup> In a cross-motion, Costco claimed the first-sale defense. The district court ruled for Costco without explanation.<sup>75</sup>

The Ninth Circuit reversed, holding that § 109(a) provided no defense because the first-sale doctrine only applies to copyrighted goods made in the U.S.<sup>76</sup> The court distinguished its decisions prior to *Quality King* by stating that *Quality King* applied only to

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<sup>70</sup> *Omega S.A. v. Costco Wholesale Corp.*, 541 F.3d 982, 983-84 (9th Cir. 2008).

<sup>71</sup> *Omega S.A., v. Costco Wholesale Corp.*, No. 04-05443, slip op. at 1 (C.D. Cal. Nov. 9, 2011).

<sup>72</sup> *Id.* at 2.

<sup>73</sup> *Id.*

<sup>74</sup> *Omega*, 541 F.3d at 984.

<sup>75</sup> *Id.*

<sup>76</sup> *Id.* at 990.

“‘round trip’ importation.”<sup>77</sup> The court’s rationale centered on concerns that reading “lawfully made” to include copies made outside the U.S. would apply U.S. copyright law extraterritorially.<sup>78</sup> The *Omega* court reasoned that for the first-sale doctrine to apply, copies of a work must be “lawfully made” under the Act; hence, applying the doctrine to foreign-made works would “ascribe legality” under the Act to “conduct that occurs entirely outside the United States, notwithstanding the absence of a clear expression of congressional intent in favor of extraterritoriality.”<sup>79</sup>

The *Omega* court did not reach the issue of whether, as pre-*Quality King* Ninth Circuit decisions held, a lawful U.S. sale enables the first-sale defense for later transactions.<sup>80</sup> The court reasoned that there was no question the foreign-made copies were sold in the U.S. without Omega’s authorization.<sup>81</sup>

The Supreme Court granted certiorari in April 2010. International companies ranging from Amazon.com to Intel signed on in support of Costco’s position as amici.<sup>82</sup> Although commentators expected the High Court to settle this issue, an equally divided Court affirmed the Ninth Circuit without explanation. The split occurred because of the recusal of newly appointed Justice Elena Kagan, who had argued against certiorari while serving as solicitor general for the Obama Administration.<sup>83</sup>

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<sup>77</sup> *Id.* at 985-87 (citing *Denbicare U.S.A. Inc. v. Toys “R” Us, Inc.*, 84 F.3d 1143 (9th Cir. 1996); *Parfums Givenchy, Inc. v. Drug Emporium, Inc.*, 38 F.3d 477 (9th Cir. 1994); *BMG Music v. Perez*, 952 F.2d 318 (9th Cir. 1991)).

<sup>78</sup> *Id.* at 988-99.

<sup>79</sup> *Id.* at 988 (citations omitted).

<sup>80</sup> *Id.* at 990 (citing *Denbicare*, 84 F.3d 1143, 1145-46 (9th Cir. 1996)).

<sup>81</sup> *Id.*

<sup>82</sup> *See, e.g.*, Brief for eBay, Inc., et al. as Amici Curiae Supporting Petitioners, *Costco Wholesale Corp. v. Omega, S.A.*, 130 S.Ct. 2089 (2010), 2010 WL 2770102.

<sup>83</sup> *See* Brief of the United States as Amici Curiae Supporting Respondents, *Costco Wholesale Corp. v. Omega, S.A.*, 130 S.Ct. 2089 (2010), 2010 WL 3512773.



### III. IMPLICATIONS OF THE *COSTCO* COURT'S SPLIT AFFIRMANCE FOR THE SCOPE OF THE FIRST-SALE DEFENSE

While some commentators opine that the Supreme Court's lack of concrete language on whether the first-sale defense applies to foreign-made copyrighted goods creates uncertainty for businesses,<sup>84</sup> the affirmance follows a decades-long trend post-*Quality King* of reading the doctrine narrowly. The Supreme Court's ruling implicitly validates the Ninth Circuit's rationale—that extraterritoriality concerns prevent application of the first-sale defense to infringement claims involving certain foreign-made goods. However, the absence of a written decision by the Court leaves unanswered the justices' current views on the limits of § 109(a), especially on whether a lawful sale in the U.S. extinguishes a copyright owner's distribution right.

While it is possible that other circuits to consider this issue might diverge from the Ninth Circuit's interpretation that the first-sale doctrine is inapplicable to certain foreign-made goods, such an event seems unlikely following the Supreme Court's action.<sup>85</sup> For example, the Supreme Court's split decision in *Lotus Dev. Corp. v. Borland Int'l, Inc.*, affirmed that copyright law does not cover menu command hierarchy for computer software because it is a "method of operation," effectively deciding that issue.<sup>86</sup>

Nonetheless, importers and retailers who may deal in parallel imports should be cautious about importing, purchasing, and selling "traditional" copyrighted works, such as books or phonorecords. As discussed in Section A below, such caution is especially warranted in light of a recent Second Circuit opinion

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<sup>84</sup> See, e.g., Joe Mullin, *Patent Litigation Weekly: Costco v. Omega — The Patent Angle*, CORPORATE COUNSEL (ONLINE), Sept. 13, 2010.

<sup>85</sup> But see BRIAN T. YEH, APPLICABILITY OF THE COPYRIGHT LAW'S FIRST SALE DOCTRINE TO IMPORTED GOODS MANUFACTURED ABROAD: *COSTCO WHOLESALE CORP. v. OMEGA S.A.* (Jan. 6, 2011) (suggesting that "other circuits are free to issue opinions that agree or conflict with the Ninth Circuit"), available at [http://ipmall.info/hosted\\_resources/crs/R41422\\_100921.pdf](http://ipmall.info/hosted_resources/crs/R41422_100921.pdf).

<sup>86</sup> *Lotus Dev. Corp. v. Borland Int'l, Inc.*, 49 F.3d 807, 807 (1st Cir. 1995) *aff'd by an equally divided court*, 516 U.S. 233 (1996).

mirroring, and perhaps extending, the Ninth Circuit's reasoning.<sup>87</sup> However, as discussed in Section B, analysis of the rationales underlying copyright law suggests that trademark law would be better suited to govern parallel importation. Furthermore, the district court's holding on remand in *Omega* suggests that there may be important limits to the application of copyright law to certain useful articles, as discussed below in Section IV.

*A. The Second Circuit Follows Costco by Limiting  
the First-Sale Defense*

In a 2011 case analogous to *Pearson*, the Second Circuit in *John Wiley & Sons, Inc. v. Kirtsaeng* ruled squarely that the language of § 109(a)—“lawfully made under this title”—limits the first-sale doctrine to cases where the good in question was manufactured within the U.S.<sup>88</sup> This decision reinforces the Supreme Court's ruling in *Costco*, although the Court will have another opportunity to speak on this issue following its grant of certiorari in April 2012.

The plaintiff, a publisher of textbooks, sued a student who sold textbooks obtained abroad in the U.S. on commercial sites such as eBay.com, alleging copyright infringement.<sup>89</sup> Kirtsaeng argued the first-sale doctrine as a defense, but the trial court held that the doctrine did not apply because the goods were made abroad.<sup>90</sup>

The Second Circuit affirmed, relying primarily on the *Quality King* dicta.<sup>91</sup> The court “freely acknowledge[d] that this is a particularly difficult question of statutory construction in light of the ambiguous language of § 109(a),” but stated that its “holding is supported by the structure of Title 17 as well as the Supreme Court's opinion in *Quality King*.”<sup>92</sup> The court noted that “Congress

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<sup>87</sup> See *John Wiley & Sons, Inc., v. Kirtsaeng*, 654 F.3d 210 (2d Cir. 2011), cert. granted, 2012 WL 1252751 (U.S. April 16, 2012) (No. 11-697)

<sup>88</sup> *Id.* at 221.

<sup>89</sup> *Id.* at 213.

<sup>90</sup> *Id.* at 214.

<sup>91</sup> *Id.* at 220-22.

<sup>92</sup> *Id.* at 222.

is of course able to correct our judgment.”<sup>93</sup> Notably, the court explicitly stated that the first-sale doctrine *never* applies to sales of foreign-made copies in the U.S., even after a lawful domestic sale; it distinguished contrary Ninth Circuit precedent.<sup>94</sup> In his petition for certiorari, Kirtsaeng argues that *John Wiley & Sons* thus represents “*Costco* on steroids.”<sup>95</sup>

In a dissenting opinion reminiscent of the Third Circuit’s reasoning in *Sebastian*, District Judge J. Garvan Murtha argued that the first-sale defense should apply because “[t]he statutory text does not refer to a place of manufacture” and instead focuses on “whether a particular copy was manufacture[d] lawfully under [T]itle 17.”<sup>96</sup> Hence, Judge Murtha reasoned, “a copy authorized by the U.S. rightsholder is lawful under U.S. copyright law.”<sup>97</sup> Judge Murtha also argued that such a reading of § 109(a) does not render § 602 meaningless because it will apply to “copies of a work not lawfully manufactured under [T]itle 17 but lawfully manufactured under some other source of law . . . and to copies not in the possession of the ‘owner.’”<sup>98</sup>

Despite the arguments raised by this dissent, the Second Circuit’s decision in *John Wiley & Sons* further demonstrates that federal appeals courts are unwilling to contradict the *Quality King* dicta, taking the first-sale defense off the table when foreign-made products are imported without the U.S. copyright owner’s authorization. However, it remains unclear how the Supreme Court will view the applicability of the first-sale doctrine following a lawful U.S. sale, an issue not addressed in *Costco*.

#### *B. Congressional Revision of Federal Intellectual Property Law Would Alleviate Doctrinal Uncertainty*

Court decisions allowing the first-sale defense against even

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<sup>93</sup> *Id.*

<sup>94</sup> *Id.* at 221.

<sup>95</sup> Petition for Writ of Certiorari, *John Wiley & Sons*, 654 F.3d 210 (No. 11-697), 2012 WL 6098030 at \*6.

<sup>96</sup> *John Wiley & Sons*, 654 F.3d at 226 (citation omitted).

<sup>97</sup> *Id.*

<sup>98</sup> *Id.* at 228.

foreign-made goods would better accord with the policies underlying copyright law and would likely have beneficial economic effects. However, any changes in this area should be left to Congress, not the federal courts.

A ruling contrary to *Omega* and *John Wiley & Sons* would best fit with copyright doctrine, as pointed out by Judge Murtha, the dissenter in the latter case: “Once the copyright holder has controlled the terms on which the work enters the market, i.e., the purpose of the distribution right, ‘the policy favoring a copyright monopoly for authors gives way to the policy opposing restraints of trade and restraints on alienation.’”<sup>99</sup> Judge Murtha aptly states that “[g]ranting a copyright holder unlimited power to control all commercial activities involving copies of her work would create high transaction costs and lead to uncertainty in the secondary market.”<sup>100</sup> However, federal courts are constrained by valid competing concerns about extraterritorial application of U.S. copyright law, as demonstrated by the Ninth Circuit’s *Omega* decision.<sup>101</sup>

A high court ruling allowing the first-sale defense to claims of unauthorized importation of foreign-made goods also could reduce incentives for producers to move manufacturing abroad. The Ninth Circuit conceded that its interpretation might “encourage U.S. copyright owners to outsource the manufacturing of copies.”<sup>102</sup>

This incongruity derives from the fact that copyright law is the incorrect doctrine for use in preventing parallel importation—at least for utilitarian products—because it is meant to grant creators a limited monopoly over their works, not to serve the source-identification function of trademarks. Revision of the Lanham Act would be a better means to accomplish checks on the gray market, if Congress desires.<sup>103</sup>

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<sup>99</sup> *Id.* at 227 (Murtha, J., dissenting) (quoting *Pearson Educ., Inc. v. Liu*, 656 F. Supp. 2d 407, 409 (S.D.N.Y. 2009)).

<sup>100</sup> *Id.*

<sup>101</sup> *See generally* 7 WILLIAM F. PATRY, PATRY ON COPYRIGHT § 25:86 (2011).

<sup>102</sup> *Omega S.A. v. Costco Wholesale Corp.*, 541 F.3d 982, 989 (9th Cir. 2008).

<sup>103</sup> *Cf. Chen*, *supra* note 19, at 598 (arguing for revision of the Copyright Act).

Enacting legislative reform to intellectual property regimes may be difficult. Yet Congress has acted to remedy such intellectual property issues with international implications following high-profile cases. For example, Congress enacted a statute prohibiting shipping components of a patented invention abroad to avoid patent protection in the wake of *Deepsouth Packing Co. v. Laitram Corp.*<sup>104</sup>

#### IV. HOW FAR WILL COURTS EXTEND PROTECTION TO COPYRIGHTED LOGOS ON UTILITARIAN ARTICLES?

Despite Omega's victory in the Supreme Court, on remand the district court suggested that there are limits to the applicability of the copyright distribution right as a mechanism to prevent parallel importation. The U.S. District Court for the Central District of California in November 2011 granted summary judgment for defendant Costco, reasoning that Omega's strategy of emblazoning its watches with a copyrighted logo to segment international markets constituted "misuse" of its copyright.<sup>105</sup> Omega has appealed this decision to the Ninth Circuit.<sup>106</sup> Thus, it remains unclear to what extent producers may subject otherwise utilitarian products, such as watches, to import and distribution restrictions by adorning them with copyrighted designs. The district court's decision, while perhaps extending the misuse doctrine, arrives at the proper result: copyright law should not be employed as a form of backdoor trademark.

As discussed in Section A, copyright import protection based on designs added to otherwise utilitarian goods raises antitrust concerns. Section B discusses the *Omega* district court's application of the copyright misuse doctrine. Section C argues that such application of the misuse doctrine will remedy overreaching

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<sup>104</sup> *Deepsouth Packing Co. v. Laitram Corp.*, 406 U.S. 518 (1972). See 35 U.S.C. § 271(f)(1) (2006).

<sup>105</sup> *Omega S.A., v. Costco Wholesale Corp.*, No. 04-05443, slip op. at 3-4 (C.D. Cal. Nov. 9, 2011).

<sup>106</sup> Notice of Appeal, *Omega S.A. v. Costco Wholesale Corp.*, No. 11-57137 (Dec. 9, 2011).

by a subset of copyright holders who seek to prevent parallel importation.

A. *Extension of Copyright Protection to Otherwise Utilitarian Articles Implicates Antitrust Concerns*

Depending on how the Ninth Circuit views the district court's application of the copyright misuse doctrine, producers might restrict importation after *Costco* by affixing copyrighted logos to a host of everyday items that otherwise would not qualify for copyright protection. Granting the owners of copyrighted logos attached to otherwise non-copyrightable articles exclusive distribution rights in the U.S. implicates antitrust concerns because it gives copyright holders a broader monopoly than allowed by Congress.<sup>107</sup> This is evident from comparing the facts of *Omega* to cases involving traditional copyrighted works.

In general, many consumer products do not qualify for copyright protection because they are not "original works of authorship" for purposes of 17 U.S.C. § 101.<sup>108</sup> In addition, certain three-dimensional products with designs that might qualify for protection as "pictorial, graphic, or sculptural" works, such as watches, are not protectable unless the aesthetic aspects are separable from the utilitarian aspects.<sup>109</sup> *Omega* added the copyrighted design, which was about 1/8 of an inch in size, to the *underside* of its watches specifically to combat parallel

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<sup>107</sup> See Andrew Spillane, *Combatting Gray Markets: A Copyright-Protected Distribution Right or a Sherman Act Violation?*, MARQUETTE UNIVERSITY LAW SCHOOL FACULTY BLOG (July 20, 2011), <http://law.marquette.edu/facultyblog/2011/07/20/combating-gray-markets-a-copyright-protected-distribution-right-or-a-sherman-act-violation>.

<sup>108</sup> See 1 MELLVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 2.03 (Matthew Bender, rev. ed. 2011).

<sup>109</sup> For pictorial, graphic, or sculptural works, a "'useful article' is an article having an intrinsic utilitarian function that is not merely to portray the appearance of the article or to convey information." 17 U.S.C. § 101 (2006). See generally 2 WILLIAM F. PATRY, PATRY ON COPYRIGHT § 3:124-3:154 (2011).

importation.<sup>110</sup> The watches themselves did not qualify for copyright protection because they were useful articles.<sup>111</sup>

While the Ninth Circuit in *Omega* and the Second Circuit in *John Wiley & Sons* reached similar results, the cases are distinguishable based on the nature of the products at issue. The imported textbooks in *John Wiley & Sons* were copyrighted works in their entirety. However, in *Omega*, the watches merely bore a copyrighted logo. The Ninth Circuit's decision arguably blurred the line between copyright and trademark law by validating Omega's strategy of bringing a useful product within the protective embrace of § 602(a) by placing a small copyrighted logo on it. The Supreme Court granted certiorari on the narrow question of the applicability of the first-sale doctrine, leaving lower courts to address the issue of copyright misuse.

A similar issue arose in the pharmaceutical industry. Drug companies whose products had been protected by patent sued makers of generic versions of the drugs for using copyrighted language on their ingredient labels.<sup>112</sup> The Second Circuit stated:

[C]ommercial labeling is clearly copyrightable . . . it has been recognized that the “danger lurking in copyright protection for labels is that the tail threatens to wag the dog—proprietary owners at times seize on copyright protection for the label in order to leverage their thin copyright protection over the text . . . on the label into a monopoly on the typically uncopyrightable product to which it is attached.”<sup>113</sup>

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<sup>110</sup> See *Omega S.A., v. Costco Wholesale Corp.*, No. 04-05443, slip op. at 3-4 (C.D. Cal. Nov. 9, 2011).

<sup>111</sup> See generally *Severin Montres Ltd. v. Yidah Watch Co.*, 997 F. Supp. 1262, 1265 (C.D. Cal. 1997) (stating watches are “useful article[s] with an intrinsic utilitarian function” not entitled to copyright protection unless the design is “separable from the utilitarian aspects”).

<sup>112</sup> See *SmithKline Beecham Consumer Healthcare, L.P. v. Watson Pharmaceuticals, Inc.*, 211 F.3d 21, 23-24 (2d Cir. 2000).

<sup>113</sup> *Id.* at 29 n.5 (citations omitted). The Second Circuit ultimately concluded that the Food and Drug Administration requirements that the labels bear certain information precluded a copyright infringement action, but noted that copyright holders may still pursue copyright claims against potential

In similar fashion, businesses that pursue Omega's copyright strategy circumvent the Lanham Act's requirement that products sold abroad bear material differences from their domestic counterparts to qualify for import protection.

Proponents of such increased copyright protection might point to both the *Omega* decision and the Supreme Court's willingness to extend import control rights to holders of copyrighted hair product labels in *Quality King*. The Supreme Court called *Quality King* an "unusual copyright case" because the plaintiff did not claim "anyone has made unauthorized copies of its copyrighted labels."<sup>114</sup> Rather, the plaintiff was "primarily interested in protecting the integrity of its method of marketing the products to which the labels are affixed."<sup>115</sup>

Yet critics could cite the same passage, in which the *Quality King* Court stated that the "labels themselves have only a *limited creative component*."<sup>116</sup> Consumers might "suffer from this disparity, as it allows the copyright owner to charge them higher prices for a copyrighted logo that may add nothing to the value of the goods."<sup>117</sup>

*B. On Remand, the District Court Grants Summary Judgment for Costco Based on Omega's Copyright "Misuse"*

The *Omega* district court on remand employed the misuse doctrine to prevent such an unjust result. The court took issue with Omega's legal strategy to protect its authorized distributors of the watches, stating that Omega "used the defensive shield of copyright law as an offensive sword."<sup>118</sup>

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infringers in other circumstances, such as the use of the copyrighted material in non-labeling advertisements.

<sup>114</sup> *Quality King Distributors, Inc. v. L'anza Research Int'l, Inc.*, 523 U.S. 135, 140 (1998).

<sup>115</sup> *Id.*

<sup>116</sup> *Id.* (emphasis added).

<sup>117</sup> James L. Bikoff, David K. Heasley & Michael T. Delaney, *Costco v. Omega: The 'Foreign First Sale' Debate*, 28 NO. 17 WESTLAW J. COMPUTER AND INTERNET 1, 3 (2011).

<sup>118</sup> *Omega S.A., v. Costco Wholesale Corp.*, No. 04-05443, slip op. at 2 (C.D. Cal. Nov. 9, 2011).



In general, copyright misuse is a defense to claims of infringement premised on a plaintiff's attempts to "extend the scope of [the copyright] monopoly" that constitutes a "violation of the antitrust laws."<sup>119</sup> Applying the Ninth Circuit's copyright misuse test, the court stated that misuse occurs when a "copyright is being used in a manner violative of the public policy embodied in the grant of copyright."<sup>120</sup> In addition, the misuse defense "prevents copyright holders from leveraging their limited monopoly and allow[s] them to control areas outside of their monopoly."<sup>121</sup> The court held that Omega, having conceded that a purpose of the design was to control importation, "misused its copyright . . . by leveraging its limited monopoly in being able to control the importation of that design to control the importation of its Seamaster watches."<sup>122</sup>

The court found unpersuasive that the design might have multiple purposes, such as promoting "creativity and aesthetics" and increasing the value of the watches.<sup>123</sup> The court held that "those aspects of the design are protected by its copyright and are not a defense to copyright misuse."<sup>124</sup> Ultimately, copyright misuse is an "equitable defense to copyright infringement, the contours of which are still being defined."<sup>125</sup> The doctrine of copyright misuse, although controversial, presents an avenue for courts to address this doctrinal rift.<sup>126</sup>

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<sup>119</sup> 4 MELLVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 13.09(A)(1)(a) (Matthew Bender, rev. ed. 2011).

<sup>120</sup> *Omega*, No. 04-05443, slip op. at 3 (citing *Lasercomb Am., Inc. v. Reynolds*, 911 F.2d 970, 978 (4th Cir. 1990)).

<sup>121</sup> *Id.* at 4.

<sup>122</sup> *Id.*

<sup>123</sup> *Id.*

<sup>124</sup> *Id.*

<sup>125</sup> *Id.* (citing *MDY Industries, LLC, v. Blizzard Entertainment, Inc.*, 629 F.3d 928, 941 (9th Cir. 2010)).

<sup>126</sup> Compare Defendant Costco Wholesale Corporation's Memorandum of Points and Authorities in Opposition to Omega's Motion for Partial Summary Judgment, *Omega S.A v. Costco Wholesale Corp.*, No. 04-5443 (C.D. Cal. Sept. 1, 2011), 2011 WL 5122927, with Plaintiff's Memorandum of Points and Authorities in Opposition to Defendant's Motion for Summary Judgment, *Omega S.A v. Costco Wholesale Corp.*, No. 04-5443 (C.D. Cal. Sept. 1, 2011), 2011 WL 5122926. See generally 5 WILLIAM F. PATRY, PATRY ON COPYRIGHT

*C. The Copyright Misuse Doctrine Offers a Remedy to Overbroad Use of Copyright in the Parallel Importation Context*

The analytical mismatch between the policies underlying copyright law and efforts to control parallel importation is evidenced by extension of import protection in *Costco* to utilitarian goods bearing contrived copyrighted works. Omega likely did not (or could not) bring a trademark claim because there was no evidence that Swiss-made Omegas sold by Costco would cause confusion among consumers about the watches' origin or producer. While the copyrighted logo may have served as an indication of the watches' source, this consumer-protection function should be left to trademark law.

In the absence of misuse doctrine, “overlapping” copyright and trademark protection “implicates the ‘delicate balance’ of the copyright bargain by interfering with the incentive structure established by Congress.”<sup>127</sup> Overlapping protection contradicts the rationale underlying copyright law—fostering creativity by giving authors limited-duration rights to control reproduction and distribution of their creations—and creates a form of backdoor trademark.<sup>128</sup> In contrast, federal trademark law aims to protect consumers by helping them to identify the source (and thus the quality) of goods and to protect businesses by reducing the potential for confusion among competing products.<sup>129</sup> Furthermore, “patent and copyright law confer certain exclusive property rights, whereas trademark law protects only against similar uses that are likely to cause confusion.”<sup>130</sup>

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§ 17:128 (2011).

<sup>127</sup> Moffat, *supra* note 14, at 1516 (quoting *Stewart v. Abend*, 495 U.S. 207, 230 (1990)).

<sup>128</sup> *See, e.g., Mazer v. Stein*, 347 U.S. 201, 219 (1954). *See also SmithKline Beecham Consumer Healthcare v. Watson Pharmaceuticals, Inc.*, 211 F.3d 21, 29 n.5 (2d Cir. 2000).

<sup>129</sup> *See Moseley v. V Secret Catalogue, Inc.*, 537 U.S. 418, 428 (2003) (citations omitted).

<sup>130</sup> Curtis A. Bradley, *Territorial Intellectual Property Rights in an Age of Globalism*, 37 VA. J. INT'L L. 505, 538 (1997).

Prior to the district court's order, it appeared producers could supplement their trademarks with copyrighted logos, a situation that could ultimately harm consumers by granting broad exclusive import rights not limited by the necessity of showing likelihood of consumer confusion. Application of the misuse doctrine would prevent companies from unfairly extending copyright protection to maintain parallel distribution arrangements.

#### CONCLUSION

The law governing parallel imports remains in flux, presenting a challenge both for businesses looking to maintain their international pricing strategies and importers and retailers who wish to supply products obtained at a discount overseas. The Supreme Court in *Costco* effectively decided that the copyright first-sale doctrine does not provide a defense to claims of infringement related to unauthorized *importation* of foreign-made copyrighted works. Yet it is unresolved whether the Supreme Court in *John Wiley & Sons* will follow past Ninth Circuit decisions in allowing the first-sale defense after a lawful U.S. sale of a copyrighted work. Furthermore, the *Omega* district court's application of the copyright misuse doctrine offers a limitation on businesses' ability to restrict importation merely by affixing small copyrighted designs to otherwise utilitarian products. It remains to be seen whether higher federal courts accept this application of the misuse doctrine.

#### PRACTICE POINTERS

*For Defendants:*

- Importers and retailers should carefully source products and take steps to verify their supply chains to avoid unexpected copyright liability for selling gray market goods. The first-sale doctrine probably will not provide a defense against infringement claims arising from importation of goods made abroad, although it is unclear whether a lawful U.S. sale enables the first-sale doctrine for later transactions.

- Retailers should avoid purchasing directly from unknown foreign distributors. Purchase from a third-party importer in the U.S. might insulate a party from liability under § 602(a), at least in the Ninth Circuit. For example, Costco waived an argument that its purchase of the watches from a third-party supplier (who had in turn purchased the watches from an importer) shielded it from *import* liability by failing to raise the issue in its opening brief before the Ninth Circuit. Yet a retailer still might face §106(3) liability for unauthorized distribution.

*For Plaintiffs:*

- Manufacturers who want to enforce price discrimination should consider a variety of legal theories to stop parallel importation, such as trademark, contract, and tort. However, they should be aware that making foreign copies “materially different” may be difficult, and perhaps considered anticompetitive.
- Producers who want to enforce price discrimination might consider marking products with copyrighted logos, like the Omega symbol on the watches sold by Costco, in order to potentially bring those products under U.S. copyright law’s import restrictions. This strategy is not proven, however, especially in light of the *Omega* district court’s application of the equitable doctrine of copyright “misuse” to grant summary judgment for Costco.
- When possible under antitrust laws, manufacturers who want to enforce price discrimination should include prohibitions on resale in licensing and distribution agreements to create a breach of contract claim against suppliers of parallel imports.