3. Unauthorized Importation and the First Sale Doctrine

An important adjunct of the distribution right is the right to prevent the unauthorized importation of copies of the copyrighted work into the U.S. *See* 17 U.S.C. §602. As discussed in Chapter 1, copyright law has always been concerned with the territorial origin of copies of protected works. Recall the Manufacturing Clause, page 34 *supra*, which required that copyrighted works be printed within the U.S. The purpose of the Manufacturing Clause, however, was to protect U.S. printers, not U.S. copyright owners. Modern copyright law, in contrast, is concerned with whether the copies are infringing, and whether the importation is authorized by the copyright owner. For example, copies made without the authority of any copyright owner (U.S. or foreign) clearly violate the importation right.

Copyrights can be divided geographically, however. Sometimes, the foreign copyright holder is completely unrelated to and unaffiliated with the U.S. copyright owner of the same work. This might happen, for example, when the author of the work sells or licenses the U.S. rights and the foreign rights (or, more likely, the European rights, the Asian rights, and so on) to different publishers. It might also happen if a U.S. company owns the entire copyright, but sells or licenses the rights to exploit the work outside the U.S. to a foreign company, or vice versa. In other cases, the U.S. and foreign copyright holders have a parent/subsidiary relationship or are sibling companies.

Foreign licensees or affiliates typically agree not to distribute the work within each other's territory, and also agree to impose these geographic restrictions on their distributors. However, the temptation to violate such restrictions is strong. Copyrighted products (like most other products) command much higher prices in the U.S. and other industrialized countries than they do in developing countries. In an era of global trade and currency fluctuation, this is a recipe for arbitrage (buying in one country at a low price that the seller set in expectation that the buyer would distribute in that country and reselling in another country for a higher price). Recall, moreover, that the first sale doctrine allows the owner of a lawfully made copy of a work to resell it. Under these circumstances, just what is an unauthorized copy for purposes of the importation right is an important question.

Quality King Distributors, Inc. v. L'anza Research International, Inc.
523 U.S. 135 (1998)

Stevens, J.: . . .

I

Respondent, L'anza Research International, Inc. (L'anza), is a California corporation engaged in the business of manufacturing and selling shampoos, conditioners, and other hair care products. L'anza has copyrighted the labels that are affixed to those products. In the United States, L'anza sells exclusively to domestic distributors who have agreed to resell within limited geographic areas and then only to authorized retailers such as barber shops, beauty salons, and professional hair care colleges. L'anza has found that the American "public is generally unwilling to pay the price charged for high quality products, such as L'anza's products, when they are sold along with the less expensive lower quality products that are generally carried by supermarkets and drug stores." App. 54 (declaration of Robert Hall). . . .

L'anza also sells its products in foreign markets. In those markets, however, it does not engage in comparable advertising or promotion; its prices to foreign distributors are 35% to 40% lower than the prices charged to domestic distributors. . . .

[Three shipments of hair care products manufactured by L'anza were purchased by a distributor in Malta. The goods subsequently "found their way back to the United States," where they were purchased by petitioner Quality King and sold to "unauthorized retailers." L'anza sued Quality King and others in the chain of distribution for copyright infringement. The district court granted summary judgment to L'anza, and the Court of Appeals for the Ninth Circuit affirmed. Several years earlier, the Third Circuit had reached the opposite result, holding that the first sale doctrine supplied a complete defense to conduct like Quality King's. The Supreme Court granted certiorari to resolve the circuit conflict.]

II

This is an unusual copyright case because L'anza does not claim that anyone has made unauthorized copies of its copyrighted labels. Instead, L'anza is primarily interested in protecting the integrity of its method of marketing the products to which the labels are affixed. Although the labels themselves have only a limited creative component, our interpretation of the relevant statutory provisions would apply equally to a case involving more familiar copyrighted materials such as sound recordings or books. Indeed, we first endorsed the first sale doctrine in a case involving a claim by a publisher that the resale of its books at discounted prices infringed its copyright on the books. *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339 (1908). . . .

The *Bobbs-Merrill* opinion emphasized the critical distinction between statutory rights and contract rights. In this case, L'anza relies on the terms of its contracts with its domestic distributors to limit their sales to authorized retail outlets. Because the basic holding in *Bobbs-Merrill* is now codified in §109(a) of the Act, and because those domestic distributors are owners of the products that they purchased from L'anza (the labels of which were "lawfully made under this title"), L'anza does not, and could not, claim that the statute would enable L'anza to treat unauthorized resales by its domestic distributors as an infringement of its exclusive right to distribute copies of its labels. L'anza does claim, however, that contractual provisions are inadequate to protect it from the actions of foreign distributors who may resell L'anza's products to American vendors unable to buy from L'anza's domestic distributors, and that §602(a) of the Act, properly construed, prohibits such unauthorized competition. . . .

III

The most relevant portion of §602(a) provides:

> "Importation 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, actionable under section 501. . . ."[11]

11. The remainder of §602(a) reads as follows: "This subsection does not apply to—(1) importation of copies or phonorecords under the authority or for the use of the Government of the United States or of any State or political subdivision of a State, but not including copies or phonorecords for use in schools, or copies of any audiovisual work imported for purposes other than archival use; (2) 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

It is significant that this provision does not categorically prohibit the unauthorized importation of copyrighted materials. Instead, it provides that such importation is an infringement of the exclusive right to distribute copies "under section 106." Like the exclusive right to "vend" that was construed in *Bobbs-Merrill*, the exclusive right to distribute is a limited right. The introductory language in §106 expressly states that all of the exclusive rights granted by that section—including, of course, the distribution right granted by subsection (3)—are limited by the provisions of §§107 through 120 [now 122—Eds.]. One of those limitations, as we have noted, is provided by the terms of §109(a), which expressly permit the owner of a lawfully made copy to sell that copy "[n]otwithstanding the provisions of section 106(3)."

After the first sale of a copyrighted item "lawfully made under this title," any subsequent purchaser, whether from a domestic or from a foreign reseller, is obviously an "owner" of that item. Read literally §109(a) unambiguously states that such an owner "is entitled, without the authority of the copyright owner, to sell" that item. Moreover, since §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 L'anza's products who decide to import them and resell them in the United States.[14] . . .

IV

L'anza advances two primary arguments based on the text of the Act: (1) that §602(a), and particularly its three exceptions, are superfluous if limited by the first sale doctrine; and (2) that the text of §501 defining an "infringer" refers separately to violations of §106, on the one hand, and to imports in violation of §602. . . .

The Coverage of §602(a)

Prior to the enactment of §602(a), the Act already prohibited the importation of "piratical," or unauthorized, copies. Moreover, that earlier prohibition is retained in §602(b) of the present Act.[17] L'anza therefore argues (as do the Solicitor General and other *amici curiae*) that §602(a) is superfluous unless it covers nonpiratical ("lawfully made") copies sold by the copyright owner, because importation nearly always implies a first sale. There are several flaws in this argument.

First, even if §602(a) did apply only to piratical copies, it at least would provide the copyright holder with a private remedy against the importer, whereas the enforcement of §602(b) is vested in the Customs Services. Second, because the protection afforded by §109(a) is available only to the "owner" of a lawfully made copy (or someone authorized by

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personal baggage; or (3) importation by or for an organization operated for scholarly, educational, or religious purposes and not for private gain, with respect to no more than one copy of an audiovisual work solely for its archival purposes, and no more than five copies or phonorecords of any other work for its library lending or archival purposes, unless the importation of such copies or phonorecords is part of an activity consisting of systematic reproduction or distribution, engaged in by such organization in violation of the provisions of section 108(g)(2)."

14. Despite L'anza's contention to the contrary . . . the owner of goods lawfully made under the Act is entitled to the protection of the first sale doctrine in an action in a United States court even if the first sale occurred abroad. Such protection does not require the extraterritorial application of the Act any more than §602(a)'s "acquired abroad" language does.

17. Section 602(b) provides in relevant part: "In a case where the making of the copies or phonorecords would have constituted an infringement of copyright if this title had been applicable, their importation is prohibited. . . ." The first sale doctrine of §109(a) does not protect owners of piratical copies, of course, because such copies were not "lawfully made."

the owner), the first sale doctrine would not provide a defense to a §602(a) action against any nonowner such as a bailee, a licensee, a consignee, or one whose possession of the copy was unlawful. Third, §602(a) applies to a category of copies that are neither piratical nor "lawfully made under this title." That category encompasses copies that were "lawfully made" not under the United States Copyright Act, but instead, under the law of some other country.

The category of copies produced lawfully under a foreign copyright was expressly identified in the deliberations that led to the enactment of the 1976 Act. . . . In a report to Congress, the Register of Copyrights stated, in part:

> "When arrangements are made for both a U.S. edition and a foreign edition of the same work, the publishers frequently agree to divide the international markets. The foreign publisher agrees not to sell his edition in the United States, and the U.S. publisher agrees not to sell his edition in certain foreign countries. It has been suggested that the import ban on piratical copies should be extended to bar the importation of the foreign edition in contravention of such an agreement." Copyright Law Revision: Report of the Register of Copyrights on the General Revision of the U.S. Copyright Law, 87th Cong., 1st Sess., 125-126 (H. R. Judiciary Comm. Print 1961).

Even in the absence of a market allocation agreement between, for example, a publisher of the United States edition and a publisher of the British edition of the same work, each such publisher could make lawful copies. If the author of the work gave the exclusive United States distribution rights — enforceable under the Act — to the publisher of the United States edition and the exclusive British distribution rights to the publisher of the British edition, however, presumably only those made by the publisher of the United States edition would be "lawfully made under this title" within the meaning of §109(a). . . .

The argument that the statutory exceptions to §602(a) are superfluous if the first sale doctrine is applicable rests on the assumption that the coverage of that section is coextensive with the coverage of §109(a). But since it is, in fact, broader because it encompasses copies that are not subject to the first sale doctrine — *e.g.*, copies that are lawfully made under the law of another country — the exceptions do protect the traveler who may have made an isolated purchase of a copy of a work that could not be imported in bulk for purposes of resale. . . .

Section 501's Separate References to §§106 and 602

The text of §501 does lend support to L'anza's submission. In relevant part, it provides:

> "(a) Anyone who violates any of the exclusive rights of the copyright owner as provided by sections 106 through 118 or of the author as provided in section 106A(a), or who imports copies or phonorecords into the United States in violation of section 602, is an infringer of the copyright or right of the author, as the case may be. . . ."

The use of the words "*or* who imports," rather than words such as "*including* one who imports," is more consistent with an interpretation that a violation of §602 is distinct from a violation of §106 (and thus not subject to the first sale doctrine set out in §109(a)) than with the view that it is a species of such a violation. Nevertheless, the force of that inference is outweighed by other provisions in the statutory text.

Most directly relevant is the fact that the text of §602(a) itself unambiguously states that the prohibited importation is an infringement of the exclusive distribution right "under section 106, actionable under section 501." . . .

Of even greater importance is the fact that the §106 rights are subject not only to the first sale defense in §109(a), but also to all of the other provisions of "sections 107 through 120."

If §602(a) functioned independently, none of those sections would limit its coverage. For example, the "fair use" defense embodied in §107 would be unavailable to importers if §602(a) created a separate right not subject to the limitations on the §106(3) distribution right. Under L'anza's interpretation of the Act, it presumably would be unlawful for a distributor to import copies of a British newspaper that contained a book review quoting excerpts from an American novel protected by a United States copyright. Given the importance of the fair use defense to publishers of scholarly works, as well as to publishers of periodicals, it is difficult to believe that Congress intended to impose an absolute ban on the importation of all such works containing any copying of material protected by a United States copyright. . . .

V

The parties and their *amici* have debated at length the wisdom or unwisdom of governmental restraints on what is sometimes described as either the "gray market" or the practice of "parallel importation." In *K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281 (1988), we used those terms to refer to the importation of foreign-manufactured goods bearing a valid United States trademark without the consent of the trademark holder. . . . We are not at all sure that those terms appropriately describe the consequences of an American manufacturer's decision to limit its promotional efforts to the domestic market and to sell its products abroad at discounted prices that are so low that its foreign distributors can compete in the domestic market. But even if they do, 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.

Equally irrelevant is the fact that the Executive Branch of the Government has entered into at least five international trade agreements that are apparently intended to protect domestic copyright owners from the unauthorized importation of copies of their works sold in those five countries.[30] The earliest of those agreements was made in 1991; none has been ratified by the Senate. Even though they are of course consistent with the position taken by the Solicitor General in this litigation, they shed no light on the proper interpretation of a statute that was enacted in 1976.

Ginsburg, J., concurring: This case involves a "round trip" journey, travel of the copies in question from the United States to places abroad, then back again. I join the Court's opinion recognizing that we do not today resolve cases in which the allegedly infringing imports were manufactured abroad. . . .

NOTES AND QUESTIONS

1. Are you satisfied with the Court's explanation of the coverage of §602(a)? Are you satisfied with its interpretation of §501?

2. Review the brief excerpt from Justice Ginsburg's concurrence. If a copy is lawfully made abroad, is §109(a) a defense to a claim of unlawful importation under §602? According to the Ninth Circuit, the answer is "no." *See Omega S.A. v. Costco Wholesale Corp.*, 541 F.3d 982 (9th Cir. 2008), *cert. granted*. No. 08-1423, 559 U.S. (Apr. 19, 2010). Omega manufactured watches in Switzerland with a copyrighted design engraved on the underside, and sold them

30. The Solicitor General advises us that such agreements have been made with Cambodia, Trinidad and Tobago, Jamaica, Ecuador, and Sri Lanka.

to authorized distributors overseas. Some of the watches made their way to Costco, which sold them to consumers at discount prices. Ruling that Costco could not invoke §109(a), the court reasoned that ". . . the application of §109(a) to foreign-made copies would impermissibly apply the Copyright Act extraterritorially in a way that the application of the statute after foreign sales does not." *Id.* at 988.

Is the *Omega* decision consistent with *L'anza*? Consistent with the wording of §§109 and 602? Note that in the PRO-IP Act of 2008, Congress revised and reorganized §602. It amended the language in §602(b), concerning what the Court terms "piratical" copies, to focus more narrowly on interception of such copies at the U.S. border. It then created a new §602(a)(2)(B) encompassing those "piratical" copies within the subsection defining acts of infringement. Review the portion of the *L'anza* opinion discussing the scope of §602(a), and read the current version of §602. Do the PRO-IP Act amendments strengthen Omega's position on what §602(a) prohibits?

3. Should Omega, as the copyright owner and manufacturer of the watches at issue, be able to use copyright law to prevent their resale in the U.S.? Should copyright law respect market allocation agreements between domestic and foreign copyright holders? Consider, for example, the popular *Harry Potter* series of children's books. The American editions of these books differ from the original British editions. The spelling is Americanized — e.g., "color" instead of "colour" and "realize" instead of "realise" — and the language altered to reflect American terminology and usage — e.g., "vacation" for "holiday" and "bathroom" for "toilet" or "loo." If a market exists within the U.S. for the "authentic" British editions of the *Harry Potter* books, why not allow an enterprising importer to satisfy the demand?

4. If a fan of the *Harry Potter* series purchases copies of the British editions while visiting London and brings them back with her to the U.S., has she committed copyright infringement? Study §602 carefully before you answer. If after finishing the books, the *Harry Potter* fan decides to resell her copies of the British editions on eBay, does §109(a) allow her to do so? May someone who purchases a Swiss-made Omega watch from an authorized U.S. distributor resell it pursuant to §109(a)? To avoid providing "greater copyright protection to foreign-made copies than to their domestically-made counterparts," the Ninth Circuit had earlier held that "the copyright owner's voluntary sale of the copies within the United States exhausted the exclusive right of distribution." *Omega S.A.*, 541 F. 3d at 986. Because the facts before it did not implicate that judicially-created rule, the *Omega* court declined to disturb it. Can the exhaustion rule that the court describes be reconciled with an interpretation of §109(a) that prohibits extraterritorial application?

5. The rules that apply in trademark cases involving gray market goods are similar to those that apply in copyright cases, but not identical. In trademark cases, the statute that proscribes unauthorized importation is the Tariff Act of 1930 (as amended), which provides in relevant part: "[I]t shall be unlawful to import into the United States any merchandise of foreign manufacture if such merchandise . . . bears a trademark owned by a citizen of, or by a corporation or association organized within, the United States." 19 U.S.C. §1526(a). In its implementing regulations, the Customs Service interpreted this language to allow importation of goods manufactured by the foreign parent of the U.S. trademark holder, on the reasoning that in this case the mark is "owned by" the foreign parent. It also interpreted the statute to permit importation of goods manufactured abroad for the U.S. trademark holder or its foreign subsidiary, on the reasoning that in these cases the merchandise is not "of foreign manufacture." In a rather confusing plurality opinion, the Supreme Court declined to hold the Customs Service's reading of the statute unreasonable. *K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281 (1988). The result is that gray market imports are prohibited under the Tariff Act only if the U.S. and foreign trademark owners lack common ownership or control — e.g., if

the U.S. trademark holder has licensed the use of the mark abroad by an independent foreign manufacturer, or vice versa. (In another part of the *K Mart* decision, a majority of the Court struck down other provisions of the Customs regulations that allowed importation as long as the U.S. trademark holder had authorized the use of the mark.)

U.S. trademark owners were bitterly unhappy with the common ownership or control aspects of the *K Mart* decision, but were unable to secure relief in Congress. Subsequently, however, the federal courts of appeals have interpreted the domestic trademark law, the Lanham Act, to afford some relief against imported goods manufactured by foreign affiliates. Section 42 of the Lanham Act, 15 U.S.C. §1124, prohibits the importation of goods "which shall copy or simulate the name of any domestic manufacture, or manufacturer, or trader." Courts have held that this provision bars the importation of goods that bear an identical trademark to the valid U.S. trademark, but that are physically different from the U.S. trademark holder's goods, regardless of the trademark's genuine character abroad and regardless of any affiliation between the U.S. and foreign trademark holders. The rationale for this rule is that "[t]rademarks applied to physically different foreign goods are not genuine from the viewpoint of the American consumer." *Lever Bros. v. United States*, 981 F.2d 1330, 1338 (D.C. Cir. 1993) (holding that Sunlight brand detergent originally manufactured for use in the United Kingdom was not genuine, and therefore could not be imported, because it produced fewer suds than the version of Sunlight marketed in the U.S.); *see also Societe des Produits Nestle, S.A. v. Casa Helvetia, Inc.*, 982 F.2d 633 (1st Cir. 1992) (holding that Perugina brand chocolate bars intended for sale in Venezuela and containing different ingredients than the Perugina brand chocolate bars ordinarily imported for sale in the U.S. were materially different from U.S. bars, and therefore could not be imported into, and sold in, the U.S.).

L'anza did not pursue any trademark claims against Quality King under either the Tariff Act or the Lanham Act. Why not?

6. Internationally, rules regarding the effect of exhaustion principles on gray market imports vary. (Recall that the TRIPS Agreement does not mandate that countries adopt rules on exhaustion.) In *Silhouette International Schmied GmbH & Co. KG v. Hartlauer Handelgesellschaft mbH*, 2 C.M.L.R. 953 (1998), a trademark case, the European Court of Justice (ECJ) interpreted the governing law as requiring pure territoriality. The plaintiff, Silhouette, an Austrian company, produces high-end eyeglasses. Silhouette sold a consignment of eyeglass frames in a discontinued style to a Bulgarian company, which agreed that the frames would be sold only in Bulgaria or other former Eastern bloc countries. Instead, the frames were purchased by Hartlauer, a discount retailer operating within Austria. The Austrian courts ruled that under traditional principles of Austrian law, Silhouette's sale of the frames would have exhausted its trademark rights. However, they referred to the ECJ (the high court of the then European Community) the question whether an intervening European trademark directive, now incorporated into Austrian law, had altered the operation of exhaustion principles. The ECJ concluded that under the directive, exhaustion applied only if the goods were sold within the countries of the European Community, but not if they were sold in a country outside the Community.

The language of the more recent EU directive on copyright harmonization suggests that the same principles will apply to exhaustion of rights under copyright law. Directive 2001/29/EC of the European Parliament and of the Council of 22 May 2001 on the harmonisation of certain aspects of copyright and related rights in the information society, 2001 O.J. (L. 167) 10, art. 4(2).

7. Some academics argue that gray markets in copyrighted and/or trademarked goods can be efficient because they promote the acquisition of these goods by more consumers and at lower prices. *See, e.g.*, Nancy T. Gallini & Aidan Hollis, *A Contractual Approach to the*

Gray Market, 19 Int'l Rev. L. & Econ. 1 (1999); Shubha Ghosh, *An Economic Analysis of the Common Control Exception to Gray Market Exclusion*, 15 U. Pa. J. Int'l Bus. L. 373 (1994). Other commentators respond that copyright and trademark protection are territorial by design, and that this is appropriate because the price discrimination that territoriality enables — that is, charging relatively affluent consumers in the U.S. and other industrialized countries more for the same goods — enables producers and distributors to provide consumers in these countries with "extras" such as warranty service, and increases incentives to produce, distribute, and promote products. Copyright owners also argue that gray-market goods unfairly constrain their profit margins by forcing them to compete against their own products. *See, e.g.*, Richard S. Higgins & Paul H. Rubin, *Counterfeit Goods*, 29 J.L. & Econ. 211 (1986); William M. Landes & Richard A. Posner, *Trademark Law: An Economic Perspective*, 30 J.L. & Econ. 265 (1987); Elin Dugan, Note, *United States of America, Home of the Cheap and the Gray: A Comparison of Recent Court Decisions Affecting the U.S. and European Gray Markets*, 33 Geo. Wash. Int'l L. Rev. 397, 409-11 (2001) (summarizing manufacturers' arguments). Who has the better argument? If you agree with the gray-market critics, are you more persuaded by territoriality concerns or by the price discrimination argument? (If the latter, have you ever shopped at a discount store like Costco, Sam's Club, or Price Club?)

8. How should copyright law respond to distribution of copies across national borders via the Internet? Digital delivery is increasingly the mechanism of choice for distribution of a wide variety of types of works. Does §602(a) as currently worded allow such distribution by foreign copyright holders? Should it?

9. In the digital era, some of the copyright industries have taken matters into their own hands and are selling "region-coded" entertainment goods. The technology for region-coding was developed by the video game industry to combat large-scale counterfeiting that was perceived as particularly acute in Southeast Asia and China. The industry reasoned that if video game cartridges purchased in Asia would not play on video game consoles sold in North America or Europe, counterfeiters would have more difficulty gaining a foothold in the industry's most lucrative markets. Subsequently, a number of the copyright industries implemented region-coding technologies more widely to control gray-market imports. The movie industry, for example, sells region-coded DVDs and Blu-ray discs under a series of cooperative licensing agreements with manufacturers of home DVD and Blu-ray players. Under the region-coding agreements, regions perceived as harboring counterfeiters are no longer the exclusive targets. DVDs manufactured in Europe will not work on DVD players sold in North America, and vice versa.

What do you think of these arrangements? If copyright law does not prohibit the imports, is it good policy to allow the affected industries to adopt technological protections that have that effect?

10. In addition to the amendments described in Question 2 *supra*, the PRO-IP Act amended §602(a) to provide that unauthorized *exportation* of copies or phonorecords is an infringement of copyright actionable under §501. Why do you think Congress made this change? Is it good policy?