Applying Copyright Theory to Secondary Markets: An Analysis of the Future of 17 USC § 109(a) Pursuant to Costco Wholesale Corp. v. Omega S.A.

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ABSTRACT: The U.S. Copyright Act grants copyright owners the exclusive right to distribute their copyrighted works. The first sale doctrine, codified in § 109(a) of the Copyright Act, curtails these distribution rights by exhausting the owner’s exclusive right after the copyrighted item is placed in the stream of commerce. However, it is not clear whether the language used in the Act, “copies made under this title,” is inclusive of copies manufactured abroad or limited to copies manufactured in the United States. The Supreme Court recently interpreted § 109(a) in Costco Wholesale Corp. v. Omega S.A.; yet, the Court’s holding did little to clarify the ambiguity surrounding the application of the first sale doctrine. The Court’s failure to resolve the issue has the potential to cause significant harm to the U.S. economy and eliminate the rights of consumers and small business.

This Article suggests that the solution to determining whether the first sale doctrine is, in fact, applicable to copies manufactured abroad, is to incentivize Congress to amend § 109(a) and bring it into conformity with the true aims of copyright law - to promote knowledge via creation and distribution. In doing so, Congress should redraft this portion of the Act broadly to accommodate the domestic sale of copyrighted goods lawfully manufactured and sold abroad. This proposed expansion of first sale doctrine will yield new discoveries and stimulate learning in accordance with the aims of copyright law.

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I. **Introduction**

The U.S. Copyright Act provides copyright owners with the exclusive right to distribute their copyrighted works “by sale or other transfer of ownership, or by rental, lease, or lending.”¹ The exception to this rule, known as the first sale doctrine, curtails the owner’s distribution rights by entitling the downstream owner of a copy to sell or otherwise dispose of the copy without the authority of the copyright owner.² In other words, once the copyright owner sells the work, by placing it in the stream of commerce, the original owner loses his or her statutory right to exclusively distribute the work.³ Pursuant to § 109(a) of the Copyright Act, the first sale doctrine is limited to copies “lawfully made under this title . . . .”⁴ However, it is not clear whether this phrase is inclusive of copies lawfully manufactured and sold abroad or limited to copies lawfully manufactured and sold in the U.S. It is undisputed that the initial sale of goods, produced within the confines of the United States, exhausts the copyright owner’s control over the goods.⁵ Yet, much debate has taken place over the exact meaning of the four words articulated in § 109(a) and whether the statutory language extends to goods manufactured abroad or produced domestically and sold overseas.

Section 109(a) recently came up for interpretation by the Supreme Court in *Costco Wholesale Corp. v. Omega S.A.* There, copies of Omega’s copyrighted works were produced abroad and the first sale took place in a foreign country; thus, the Court addressed the question of whether § 109(a) applied and whether it would immunize the reseller (Costco) from liability for infringing Omega’s copyright. *Costco v. Omega* presented the Court with the opportunity to resolve, once and for all, the ambiguity surrounding § 109 of the Copyright Act. However, a

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⁵ See generally Quality King, 523 U.S. 135.
divided Court released its decision on December 13th, 2010, affirming the lower court’s holding in a *per curiam* opinion and providing no explanation for its judgment.  

This article contends that the Court’s holding, finding in favor of Omega, is contrary to the philosophical objectives underlying copyright law, namely the utilitarian interests in creation and dissemination of knowledge. Moreover, the *Costco v. Omega* decision may detrimentally affect the economy and disadvantage both consumers and businesses alike. That being said, the holding has little precedential value and the Court should take the soonest possible opportunity to reverse its decision. Alternatively, Congress should attempt to rewrite or clarify § 109(a). This would preclude manufacturers from retaining overall control over the distribution chain, but still incentivize authors to continue their creative efforts to produce copyrighted works and encourage the distribution of and access to copyrighted works.

This article is divided into seven parts. Part II will discuss the factual background behind the *Costco v. Omega* case. Part III sheds light on the judicial and legislative record of the first sale doctrine. Part IV seeks to explain the philosophical justifications underlying § 109(a). Part V describes the public policy concerns implicit in this issue. Part VI proposes alternatives to the status quo and Part VII concludes this article.

**II. The Omega Case**

Omega S.A., a subsidiary of Swatch Group AG., is a Swiss watch manufacturer. It sells Omega brand watches through a worldwide network of authorized distributors and retailers. “Costco Wholesale Corporation operates an international chain of membership warehouses . . . that carr{ies] quality, brand name merchandise at substantially lower prices than are typically

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8 Omega, S.A. v. Costco Wholesale Corp., 541 F.3d 982, 983 (9th Cir. 2008).
found at conventional wholesale or retail sources.”⁹ Prior to this suit, Costco allegedly sold Omega watches obtained through third party importers without objection from Omega.¹⁰

One of Omega’s products is a watch known as the “Seamaster.” Watches sold under this label bear a copyrighted symbol on their underside, “a small emblem, less than one-half centimeter in diameter, referred to as the ‘Omega Globe Design.’”¹¹ Omega sold a shipment of Seamaster watches, manufactured in Switzerland, to one of its authorized distributors overseas, at which point the watches were redistributed to a series of third parties.¹² The watches ultimately made their way through the stream of commerce to Costco, which resold the Seamaster from one of its California warehouse stores.¹³

Since the Seamaster watches were intended for sale in foreign markets, they were sold to third party distributors for significantly less than the suggested retail price of the watch in the United States.¹⁴ Thus, Costco had the opportunity to buy the watches at a substantial discount and sell them for “more than one-third less than Omega’s suggested retail price” of the watch.¹⁵ Omega did not give Costco express authorization to sell the Seamaster watches.¹⁶

Omega filed suit against Costco, “alleging that Costco's acquisition and sale of the watches constitute[d] copyright infringement under 17 U.S.C. §§ 106(3) and 602(a).”¹⁷ The district court granted summary judgment in Costco’s favor.¹⁸ Omega appealed this ruling and the

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¹¹ Petition for a Writ of Certiorari at 5, Costco, No. 08-1423, slip op. (U.S. Dec. 13, 2010) (per curiam) (No. 08-1423).
¹² Omega, 541 F.3d at 984.
¹³ Id.
¹⁴ Id.
¹⁵ Petition for Writ of Certiorari, supra note 11, at 5.
¹⁶ Id.
¹⁷ Omega, 541 F.3d at 984.
¹⁸ Id.
internationally manufactured watches. The U.S. Supreme Court granted Costco’s petition for certiorari and released a *per curiam* decision affirming the Ninth Circuit’s ruling. The divided court (a 4-4 split, with Justice Kagan having recused herself) elected not to provide an explanation for its decision, consequently providing almost no guidance for lower courts and leaving the issue open to further interpretation.

**III. Background Information**

The U.S. Copyright Act grants copyright owners the exclusive right “to distribute copies . . . of [] copyrighted work[s] to the public by sale or other transfer of ownership, or by rental, lease, or lending.” Pursuant to § 602(a)(1) of the Act, any person who imports copies of copyrighted works into the U.S. without the authority of the copyright owner infringes the copyright owner’s exclusive right to distribute. Section 109(a) carves out an exception to this ban on unauthorized importation, providing that “the owner of a particular copy . . . lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord.” Thus, the Copyright Act creates an exception to § 602’s limitations on distribution, once the copyright owner sells a copy of his or her work, the owner is barred from exercising their § 106(3) distribution rights with regard to those copies. The problem with the statutory language in § 109(a) is determining exactly what “lawfully made under this title”

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19 *Omega*, 541 F.3d at 990.
means. To date, the vast majority of courts interpret this phrase to mean that the copy must be lawfully manufactured and sold in the United States, or lawfully manufactured abroad and first sold in the United States, with the copyright owner’s authorization. 27

A. “Gray Market” Goods

A “gray market” good or “parallel import”28 is a product that is generally created for sale in international markets, but is sold in the U.S. without the copyright owner’s permission.29 These products are lawfully manufactured; they are not pirated versions of the good.30 Gray market goods are often the result of a manufacturer producing two sets of merchandise, “a U.S. edition and a foreign edition of the same work.”31 However, the foreign version, while similar in terms of appearance, may be of an inferior quality, might contain slightly dissimilar (and cheaper) elements or contents, and will likely be sold for a lower price.32 The copyright owner will sell the respective editions to different markets, often imposing geographical limitations on the sale of the version produced specifically for foreign markets.33 For example, the company’s foreign subsidiary or distributor will be precluded from selling its version in the United States,

30 The distinction between “gray market” sales and “piracy” or “black market” sales is that the former consists of unauthorized sales of a lawfully manufactured product, whereas the latter is the result of unauthorized manufacture of a good. See William Richelieu, Gray Days Ahead?: The Impact of Quality King Distributors, Inc. v. L'anza Research International, Inc., 27 PEPP. L. REV. 827, 828 (2000). See also James Michael, A Supplemental Distribution Channel?: The Case of U.S. Parallel Export Channels, 6 MULTINATIONAL BUS. REV. 24 (1998).
32 Id. at *1.
33 See id.
while the U.S. manufacturer will limit the sale of its higher end good solely to U.S. markets.\textsuperscript{34} When these contractual or license agreements are not enforced, or when the agreements’ restrictions do not bind downstream buyers of a product, the goods end up on the gray market.

As evidenced by the facts of \textit{Costco v. Omega}, once a downstream seller acquires a batch of merchandise, and assuming they are not contractually bound, they may elect to sell a product, made for a foreign market, in the U.S.\textsuperscript{35} Because of the substandard quality or lower price of this gray market good, the downstream seller will make a profit when it introduces the good into the U.S. market. However, there are several problems with this practice; the chief concern being that copyright owners lose profits because consumers are more likely to spend money on cheaper, but comparable versions of the same product.\textsuperscript{36} Lost profits correlate to a diminished incentive to create, thus defying one of the main justifications undergirding copyright law.\textsuperscript{37}

Nevertheless, the benefits of alternative distribution channels outweigh the potential harms for consumers. Gray markets prevent price discrimination by manufacturers, generate price decreases, supply domestic markets with a greater availability of products, and, consequently, allow copyrighted material to be distributed to a wider cross section of the U.S. population.\textsuperscript{38} As discussed \textit{infra}, distribution and the accompanying proliferation of knowledge is one of the main goals of copyright law.\textsuperscript{39} “[I]t might be objected that a copyright owner who sells her work abroad receives less than the ‘full’ value of the work measured by the prices charged in more affluent markets.”\textsuperscript{40} Yet, this argument is unpersuasive because the initial sale by the copyright owner is voluntarily negotiated and “the seller could have exacted a higher

\textsuperscript{34} See id. at *6-7 (citing COPYRIGHT LAW REVISION, supra note 31).
\textsuperscript{35} See generally Omega S.A. v. Costco Wholesale Corp., 541 F.3d 982 (9th Cir. 2008).
\textsuperscript{36} Richelieu, supra note 30, at 832.
\textsuperscript{37} See infra Part IV.
\textsuperscript{38} Richelieu, supra note 30, at 833.
\textsuperscript{39} See infra Part IV.
\textsuperscript{40} Pearson Educ., Inc. v. Liu, 656 F. Supp. 2d 407, 413 (S.D.N.Y. 2009).
price” should he or she have so desired.\textsuperscript{41} Moreover, copyright owners have the advantage of being able to budget in anticipation of diminished returns for products sold at lower prices; as a result, they retain their incentive to continue creating. Consequently, allowing the sale of gray market goods via the first sale doctrine is an important aspect of promoting the goals of copyright law.

B. Legislative History

The first sale doctrine was codified in the Copyright Acts of 1909, 1947, and 1976. It is currently embodied in § 109(a) of the Act. Its corollary, § 602, regarding the exclusive right to importation, was reorganized by Congress in 2008 and “the existing provisions of Section 602 . . . formerly codified at 17 U.S.C. 602(a), was redesignated as Section 602(a)(1).”\textsuperscript{42} Despite these recent amendments to the legislation, the history behind §§ 109 and 602 is fairly muddled and does not serve to clarify Congress’ intentions regarding the first sale doctrine. However, there are strong indications that the drafters of the Act intended for the first sale doctrine to apply to copies lawfully manufactured and sold abroad prior to entering the U.S. market.

If Congress had intended to limit § 109(a) to products based on their place of manufacture, it would have specifically articulated this desire, as it has done in most of the other sections of the Copyright Act. For instance, in drafting § 601(a) of the Act, Congress made reference to an actual geographical limitation: The “so-called ‘manufacturing requirement,’ provides that . . . the importation into or public distribution . . . of copies of a work consisting preponderantly of nondramatic literary material . . . is prohibited unless the portions consisting of

\textsuperscript{41} Id.
\textsuperscript{42} Brief for the United States as Amicus Curiae Supporting Respondents at 2, Costco Wholesale Corp. v. Omega, S.A., No. 08-1423, slip op. (U.S. Dec. 13, 2010) (per curiam) (No. 08-1423).
such material have been manufactured in the United States or Canada. Arguably, “[t]he structure of the statute confirms what its text suggests.” In drafting the Act, Congress utilized the words “under this title” to describe the scope of the rights created by the Act, not the place of manufacture.

Another indication that Congress anticipated that the first sale doctrine would apply to copies lawfully manufactured abroad is the fact that Congress perceived the enforcement of distribution agreements to be a contractual issue. The 1976 House Report states that disputes regarding restrictions on the downstream sale of a product are grounded in contract law and cannot be enforced by a copyright infringement action. From a contract law perspective, the first sale doctrine need not be based on the geographical origins of a product. At “common law and in the Uniform Commercial Code, the validity of sales of goods does not depend upon place of manufacture.” A limitation on the sale of a watch crafted in Switzerland is just as restrictive as a ban on the sale of watches manufactured in the United States, in terms of trade and alienation. In fact, earlier adaptations of the Copyright Act spoke to this principle; the 1909 and

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43 Pearson, 656 F. Supp. 2d at 413 (emphasis in original) (citing 17 U.S.C. § 601(a)). Other examples include “[section] 1001, added by the Audio Home Recording Act of 1992, Pub. L. No. 102-563, 106 Stat. 4237 (1992), [which] likewise refers to a copy's place of manufacture. 17 U.S.C. § 1001(8) (‘To ‘manufacture’ means to produce or assemble a product in the United States.’)” Id. Congress was also explicit in drafting sections 102 and 103 of the Copyright Act. “[T]he works specified by sections 102 and 103 [i.e., works covered by the Act] are subject to protection under this title if . . . (2) the work is first published in the United States or in a foreign nation that, on the date of first publication, is a treaty party . . . .” 17 U.S.C. § 104(b).” John Wiley & Sons, Inc. v. Kirtsaeng, No. 08 Civ 7824(DCP), 2009 WL 3364037, *6 (S.D.N.Y., Oct. 19, 2009). Similarly, “[w]hen Congress considered the place of manufacture to be important, as it did in the manufacturing requirement of section 601(a), the statutory language clearly expresses that concern.” Sebastian Int'l, Inc. v. Consumer Contacts (PTY), Ltd., 847 F.2d 1093, 1098 n.1 (3d Cir. 1988).

44 Pearson, 656 F. Supp. 2d at 412.

45 Id.


47 Kirtsaeng, 2009 WL 3364037, at *8.
1947 Acts applied the first sale doctrine to “any copy of a copyrighted work the possession of which has been lawfully obtained.”

Admittedly, it is odd that Congress amended the language of the 1947 Act to the current provision used in the 1976 Act. Perhaps the addition of the words “lawfully made under this title” says something about the drafter’s intentions. It is conceivable that Congress included this phrase in an effort to strengthen the safeguards afforded to copyright owners and to make up for the loopholes inherent in contract law. After all, contract law does not account for downstream sellers of a copyrighted product; the owner of a U.S. copyright may sue a foreign manufacturer for violating geographically limiting provisions in a contract, but the copyright owner does not have privity of contract with “the subsequent buyer of the goods.” This means that a thriving gray market can exist despite the contractual provisions associated with the sale of a good. Thus, it is possible that Congress, foreseeing this, incorporated the geographical limitation into the Act. However, it is difficult to see why Congress would have taken this path. This interpretation only benefits copyright owners; it does not reflect the needs of consumers.

It is more likely that the judiciary misinterpreted Congress’ intentions in including the words “lawfully made under this title” in § 109(a). When members of Congress propose legislation, they must represent the views of all of their constituents; consequently, a law that is solely geared towards copyright owners is rather one sided. In fact, these restrictions are likely to have a detrimental effect on consumers, the constituents that Congress is elected to represent. Even the Copyright Office has voiced concerns about imposing territorial restrictions on the first sale doctrine. An excerpt from the Report of the Register of Copyrights provides that applying limitations imposes “territorial restriction[s] in a private contract upon third persons with no

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49 *Kirtsaeng*, 2009 WL 3364037 at *8.
knowledge of the agreement.” In other words, a narrow interpretation of § 109(a) puts consumers at the mercy of the copyright owners. Unless every copyrighted product sold downstream comes with a shrink-wrap contract to notify consumers that they are liable for selling the product outside of the geographical area sanctioned by the copyright owner, the downstream consumer has no way of knowing where she can sell the item. These public policy concerns, discussed in greater detail infra, would, undoubtedly, have swayed Congress members’ attitudes when they drafted § 109(a).

C. Judicial History

The judicial history of the first sale doctrine provides little help in determining whether expanding the doctrine to U.S. sales of internationally manufactured products is, strictly speaking, legal. A variety of courts have established the existence of the doctrine and touched on tangential issues, but have not adjudicated cases with facts akin to Costco v. Omega. It appears that courts have been awaiting a Supreme Court decision to bring closure to the issue. However, the Costco v. Omega Court’s per curiam decision provides no guidance. If nothing else, the Court’s holding will further perplex the judiciary and demonstrates the need for a revision of the precedent established by this case.

This first sale doctrine originally came into force after the Court’s holding in Bobbs-Merrill Co. v. Straus, where the Court found that the exclusive right to vend only applied to the initial sale of a copyrighted product. Later, the 1909 Act allowed copyright owners to exercise

50 Copyright Law Revision, supra note 31, at 126.
51 See infra Part V.
55 Id. at 350.
their “right to vend . . . with respect to the initial sale of copies of the work, but not to prevent or restrict the resale, or other subsequent transfer even if not through resale, of such copies.” The phrase “lawfully made under this title” was later added to § 109 when the Copyright Act was redrafted in 1976. It was not until the early 1990s that courts finally began investigating the meaning behind the phrase.

The first of these cases was *BMG Music v. Perez*, in which the Ninth Circuit limited the application of first sale doctrine protection to “copies legally made and sold in the United States.” The court largely based its analysis on the reasoning of the district court in *CBS v. Scorpio Music Distributors*, which found that application of the first sale doctrine to copyrighted phonorecords manufactured abroad and resold in the U.S. “would render § 602 virtually meaningless.” The BMG court determined that a decision favoring a broadened first sale doctrine would be detrimental to the monopoly interests accorded to copyright owners, in violation of § 602. Yet, this rationale lacks substance, as discussed infra, the purpose of copyright law is the dissemination of knowledge, not withholding information in order to cater to monopolistic interests.

As an indication of how unsound the *BMG Music* explanation was, the Supreme Court rejected the Ninth Circuit’s § 602 argument in *Quality King Distributors v. L’Anza Research*.

“The major doctrinal development from *Quality King* was its conclusive rejection of the idea that

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56 NIMMER, supra note 26, at § 8.12[B][1].
57 See generally Quality King, 523 U.S. 135; BMG Music, 952 F.2d 318; Columbia Broadcasting, 569 F. Supp. 47.
58 BMG Music, 952 F.2d at 319.
59 See generally BMG Music, 952 F.2d 318.
60 Columbia Broadcasting, 569 F.Supp. at 49. See also Parfums Givenchy v. Drug Emporium, 38 F.3d 477, 482 n.8 (9th Cir. 1994) (agreeing with the BMG Music court “in holding that sales abroad of foreign manufactured United States copyrighted materials do not terminate the United States copyright holder’s exclusive distribution rights in the United States under §§ 106 and 602(a)”).
61 Columbia Broadcasting, 569 F. Supp. at 49.
62 See infra Part IV.
application of § 109(a) to any unauthorized importation of lawfully made copies would render § 602 meaningless."\textsuperscript{65} The Court held that language used in § 602 was much more encompassing than the phrase “lawfully made under this title” as it was used in § 109(a); consequently, § 602 included copies made both under the U.S. Copyright Act and those products lawfully manufactured in another country.\textsuperscript{66} However, while the Court disagreed with the Ninth Circuit’s reasoning, it came to a parallel conclusion. The Court held the language in § 109 to mean that, if a good is manufactured in the U.S. and sold overseas, a business that resells the product in U.S. markets cannot be held liable for copyright infringement pursuant to the first sale doctrine.\textsuperscript{67} In other words, the Court reflected on a situation where the product is manufactured domestically, but it did not address whether copies produced abroad would also attain first sale protection.

Following \textit{Quality King}, few cases have challenged the application of the first sale doctrine. Omega’s suit against Costco presented the first opportunity in many years for the Court to clarify how the doctrine should be applied, particularly in the case of products manufactured overseas and imported into the U.S. Yet, the \textit{Costco v. Omega} Court did nothing to resolve the quandaries surrounding § 109. By affirming the Ninth Circuit’s ruling\textsuperscript{68} and effectively sustaining the holding in \textit{BMG Music}, while avoiding any discussion of the issue, the Court has engaged in a legal fiction.

Perhaps the problem is that the judiciary continues to attempt to reconcile the language Congress used in drafting the 1976 Act. The language is ambiguous and arguments can be made for both sides of the issue. Moreover, few courts have taken into account the fact that a broader application of the first sale doctrine would be consistent with the aims of U.S. copyright law. The

\textsuperscript{65} Brooks, \textit{supra} note 63, at 25.
\textsuperscript{66} \textit{Id.} (citing \textit{Quality King}, 523 U.S. at 146-147).
\textsuperscript{67} \textit{Quality King}, 523 U.S. at 148.
Third Circuit provided what seems to be the wisest advice yet in *Sebastian International, Inc. v. Consumer Contacts*, when it proposed “that the controversy . . . should be resolved directly on its merits by Congress, not by judicial extension of the Copyright Act’s limited monopoly.”

Since the courts have been unwilling to acknowledge the philosophical justifications undergirding copyright law, legislators are likely to be more suitable candidates to give meaning to (and perhaps redraft) § 109. After all, “[u]nder our constitutional framework, federal courts do not sit as councils of revision, empowered to rewrite legislation in accord with their own conceptions of prudent public policy,” the onus falls on Congress.

IV. Philosophical Justifications

The philosophical framework of American copyright law, largely based on England’s Statute of Anne, is “pro-consumer” in nature and an about-face from copyright law’s traditionally monopolistic roots. The framers of the U.S. Constitution envisioned a utilitarian framework when they endowed Congress with the power to grant copyrights to “promote the progress of science and useful arts.” In other words, the drafters offered copyright owners a temporary monopoly on their works in exchange for encouraging creation as a means of advancing learning and knowledge. There are two components involved in this process: in order for the public to learn, (1) knowledge must be created, and (2) the public must have access to content. Of course, authors must be incentivized to create and economic encouragement is the

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71 ROBERT P. MERGES, PETER S. MENELL & MARK A. LEMLEY, INTELLECTUAL PROPERTY IN THE NEW TECHNOLOGICAL AGE 385 (rev. 4th ed. 2007) [hereinafter MERGES ET AL.].
72 U.S. CONST. art. I, § 8, cl. 8.
best form of inspiration.\textsuperscript{74} Even so, this economic reward to authors should be a secondary consideration.\textsuperscript{75}

Copyright law is perceived to be a balancing act “between fostering incentives for the creation of literary and artistic works and the optimal use and dissemination of such works.”\textsuperscript{76} The tension between these underlying principles becomes apparent when assessed in the context of whether copyright law should limit the first sale doctrine based on geographical origin of a product. Inherent in the “creation” prong is the rationale that “lawfully made under this title” should support the copyright owner’s economic incentive. Essentially, extending the first sale doctrine to products manufactured internationally opens up a loophole for downstream distributors to resell copyrighted goods on the gray market. By virtue of their ability to sell unauthorized goods in the United States and their immunity from copyright infringement suits under the first sale doctrine, downstream sellers will cut into copyright owner’s profits.

Naturally, copyright owners have a right to be angry about lost profits; yet, their irritation is unwarranted. “The immediate effect of our copyright law is to secure a fair return for an ‘author’s’ creative labor. But the ultimate aim is, by this incentive, to stimulate artistic creativity for the general public good.”\textsuperscript{77} Consequently, limiting the first sale doctrine is antithetical to the goals of U.S. copyright law. Instead of concentrating on maximizing profits, the primary purposes of the utilitarian theory, “distribution” and the dissemination of knowledge, should be emphasized. By extension, the first sale doctrine should be expanded to include products manufactured internationally and first sold in the United States.

\textsuperscript{74} See Merges et al., supra note 71, at 13.
\textsuperscript{75} United States v. Paramount Pictures, 334 U.S. 131, 158 (1948).
\textsuperscript{76} Merges et al., supra note 71, at 391.
\textsuperscript{77} Twentieth Century Music Corp. v. Aiken, 422 U.S. 151, 156 (1975).
A. Creation

One of the functions behind the Copyright Act is to motivate individuals to create. Among the incentives sufficient to encourage creative labor, monetary rewards tend to yield the best results. “The profit motive is the engine that ensures the progress of science.” This is arguably a byproduct of commercialization and industrialization; copyrights have become commoditized. As copyright owners discovered that their monopoly rights over their copyright was a means to make money, protection of those rights has become more expansive, longer in duration, and the means of enforcement have become stronger. “[T]he dominant metaphor for copyright has changed . . . from a quid pro quo exchange between authors and the public to an ‘economic analysis’ model that seeks to maximize incentives for creation and exploitation of new works by maximizing copyright protection.”

As a result of this increasingly profit driven mindset, copyright owners perceive an expansion of the first sale doctrine as a major threat to their revenues. For example, a book author or publisher who produces two versions of a manuscript, a domestic version and a foreign edition, may be less inclined to continue generating these works (at least the foreign edition) if he or she can no longer use copyright law to prevent downstream sellers from importing and reselling these unauthorized copies in the U.S. Gray market products inevitably compete with authorized goods, causing copyright owners to lower their prices in an effort to remain competitive and costing them a percentage of their earnings. But there is more, detractors of the

[80] Id.
[82] See Richelieu, supra note 30, at 832.
first sale doctrine employ a slippery slope argument. They argue that, as a result of lost profits, copyright owners may choose to invest less money in research and development and will have fewer resources available to expend in the process of creating new products.\footnote{See Merges et al., supra note 71, at 15-16. Some might also argue that applying the doctrine to products manufactured abroad has “the potential to disrupt the availability of U.S. copyrighted educational and other literary materials in foreign nations.” Kirtsaeng, 2009 WL 3364037, at *8. In other words, copyright owners might be discouraged from producing lower cost and lower quality alternative products, such as textbooks, for the international community. This would fly in the face of the utilitarian theory because “[t]he intent of copyright protection seems to be, fundamentally, to encourage, rather than discourage, the broad publication of U.S.-copyrighted works.” Id. But this state of affairs assumes an unlikely, worst case scenario.} Society will bear the consequences of this inability to produce new work because of the resulting decline in the proliferation of knowledge.

Despite the potential harms that could result from a broader application of the first sale doctrine, the risks are improbable. After all, copyright owners will not lose all their profits, if any at all, and even a dip in revenue would not be sufficient to stymie the incentive to create. “[T]he market itself often provides means by which inventors can realize sufficient rewards to pursue innovation without formal intellectual property rights beyond contract law.”\footnote{Merges et al., supra note 71, at 16.} Of greater concern is the gradually changing landscape of copyright production. Rather than fulfilling the original goals for which the doctrine was created, copyright law has become a tool for generating profits. This is a problem, because an inventor who intends to use his copyright “indefinitely and exclusively for his own profit, [and] withholds his invention from the public, comes not within the policy or objects of the Constitution or acts of Congress.”\footnote{Kendall v. Winsor, 62 U.S. 322, 328 (1858).} The U.S. does not abide by the Lockean theory that copyright owners are justified in retaining ownership of their work because of the “sweat of the brow” employed in creating the work.\footnote{See John Locke, The Second Treatise of Government 17 (Thomas P. Peardon ed., Liberal Arts Press 1952) (1690).} Instead, the utilitarian theory holds that an author’s profits should be a secondary consideration; “[a]ny private benefit an author
gains through copyright protection is merely the vehicle by which a broader public interest is promoted.”

The “creation” rationale underlying copyright law is warranted only to the extent that it is balanced against the distribution of copyrighted works and the diffusion of knowledge. “Granting authors and inventors the right to exclude others from using their ideas necessarily limits the diffusion of those ideas and so prevents many people from benefitting from them.”

By relying on the “creation” justification to limit the application of the first sale doctrine, market competition is suppressed and the owner of the intellectual property is given the opportunity to “raise the price of that work above the marginal cost of reproducing it . . . This means that in many cases fewer people will buy the work than if it were distributed on a competitive basis, and they will pay more for the privilege.” Limiting access to a copyrighted work in this manner is bound to have a stifling effect on the dissemination of knowledge and clearly offsets the balance required by copyright law. Thus, a more liberal application of the first sale doctrine, applying it to products manufactured exterritorialy, would avoid imposing unnecessarily harsh limitations and would serve to proliferate knowledge.

B. Distribution

Despite having become a for profit vehicle for copyright owners, the principal function of copyright is not limited to that purpose. “There is a quid pro quo at the heart of the copyright system: if an author seeks benefits by commercializing a work, then the public should be able to

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87 Thomas Plotkin & Tarae Howell, “Fair is Foul and Foul is Fair:” Have Insurers Loosened the Chokepoint of Copyright and Permitted Fair Use’s Breathing Space in Documentary Films?, 15 CONN. INS. L.J. 407, 411 (2009).
88 See MERGES ET AL., supra note 71, at 13.
89 Id.
benefit by having access to the work.”91 When the general public is denied access to a copyrighted work while the copyright owner profits from his or her monopoly on a work, an inequitable transaction results and the goals of copyright law are not served.92

Distribution of copyrighted works is important because it propagates knowledge and promotes learning.93 The dissemination of knowledge “requires access to the work in which the ideas to be learned are embodied. Because there can be no access without distribution, encouraging distribution is vitally important.”94 In order to ensure the most expansive possible dissemination of copyrighted works, an unrestrained application of the first sale doctrine would be appropriate. To hold differently would limit downstream owners of copyrighted works. Successive “owners” of a copyrighted work would be relegated to negotiating with the original owner to secure the rights to sell or transfer the copy to another person.95 Bargaining for access to a work would render copyrighted works unobtainable or too difficult to get to, meaning that the public would be deprived of these works.96

Consumers would be affected, not only due to their inadequate access to a product (the result of monopoly pricing), but also because limited distribution impedes further progress. Creators of copyrighted works would not receive the benefit of their competitors’ copyrights; yet their access to these copyrights is “important because the authors produce competing works that allow the public a choice of views and expressions of each kind of work, thus leading to further advances in public learning and knowledge.”97 The purpose of U.S. copyright law is to “promote

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92 See id.
93 See Ginsburg et al., supra note 73, at 306.
94 Id.
95 See Paul Goldstein, Goldstein on Copyright § 7.6.1, at 7:131 (3d ed. 2011).
96 See Kreiss, supra note 91, at 5.
97 Id. at 4.
the progress of science and useful arts” and hampering the spread of knowledge is adverse to that principle.98 Piggy-backing on existing intellectual property traditionally yields advances and developments that would not have been possible if the original owner of the work kept it to himself or herself. In fact, Congress built mechanisms into the Act to help prevent monopolistic tendencies: “[t]he law limits the duration and scope of copyrights because it wants to make sure that copyright protection does not unduly burden other creators or free expression.”99

Copyright owners would not necessarily lose any rights if the first sale doctrine were expanded to include internationally produced items. Section 106(3) “accords the copyright owner the ‘right to control the first public distribution’ of his [or her] work.”100 In other words, the privilege to distribute a copyrighted work is terminated as soon as the copy initially enters the market. Thus, application of the first sale doctrine would not constrain a copyright owner from choosing the means by which he or she chooses to sell the product. “The decision where and when to ‘exhaust’ the distribution right” is still the copyright owner's prerogative.101 Assuming the copies have been lawfully produced “at this point, the policy favoring a copyright monopoly for authors gives way to the policy opposing restraints of trade and restraints on alienation.”102

The utilitarian theory is not unique to copyright law; it is “the dominant paradigm for analyzing and justifying the various forms of intellectual property protection.”103 While the primary purpose of patent and copyright law is the development of new works and the

98 U.S. CONST. art. I, § 8, cl. 8.
99 MERGES ET AL., supra note 71, at 391.
101 Brief for the Petitioner, supra note 10, at 24.
102 NIMMER, supra note 26, at § 8.12[A].
103 MERGES ET AL., supra note 71, at 10.
dissemination of knowledge,"^{104} "it is trademark law that emphasizes the source of origin . . . The Supreme Court has cautioned against applying doctrine formulated in one area to the other."^{105} Consequently, in order to harmonize the objectives of U.S. copyright law with the application of the first sale doctrine, a broad interpretation of § 109 would be appropriate. Expanding the first sale doctrine to include products manufactured and sold abroad would yield new discoveries and would be elemental in the diffusion of novel ideas.

V. Effects on the Economy

If the Court leaves the Costco v. Omega holding in place and Congress does not amend § 109, a copyright owner’s right to distribute copyrighted goods would last indefinitely for any products manufactured and sold internationally and resold in the U.S. market. This outcome leads to a dizzying list of public policy concerns, many of which could have a profoundly devastating effect on the U.S. economy. Unlike the slippery slope arguments made by detractors of a broader first sale doctrine, these concerns have even been voiced (albeit dismissed) by the Ninth Circuit. The Parfums Givenchy court stated that the holding in BMG Music “would mean that foreign manufactured goods would receive greater copyright protection than goods manufactured in the United States because the copyright holder would retain control over the distribution of the foreign manufactured copies even after the copies have been lawfully sold in the United States.”^{106} This, in turn, provides enormous incentives for businesses to outsource work to countries where the work can be done for substantially cheaper.^{107}

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^{104}See id. at 13.
^{106}Parfums Givenchy, Inc. v. Drug Emporium Inc., 38 F.3d 477, 482 n.8 (9th Cir. 1994). “A U.S. copyright owner, for example, would be unable to exercise distribution rights after one lawful, domestic sale of a watch lawfully made in South Dakota, but, without the limits imposed by § 109(a), the same owner could seemingly exercise distribution
Supposedly, the Ninth Circuit resolved this issue in Parfums Givenchy; however, the court’s explanation is perplexing and unsatisfying. According to current precedent, the first sale doctrine is applicable as long as a copyrighted item was first sold domestically. On the other hand, if the first sale takes place outside of the U.S., the BMG Music court’s reasoning (the same rationale that was effectively rejected by the Supreme Court in Quality King) would apply. In other words, tough luck for the downstream seller, because applying the first sale doctrine “would render § 602 virtually meaningless.” This conclusion simply repeats the same unreasonable holdings that the courts have toyed with for the last twenty years. The status quo provides no recourse for anyone interested in selling internationally manufactured items on the U.S. gray market if the item was first sold abroad.

Instead of reviving bad precedent, the Court should have looked to the disastrous policy consequences of such a narrow holding. Aside from the substantial loss of jobs, as copyright owners and manufacturers shift their production facilities offshore in an effort to circumvent copyright laws (not to mention the accompanying deficiency in tax revenues), the Ninth Circuit’s decision puts retailers and consumers at great risk. The Costco v. Omega ruling “creates potential liability even for many goods purchased domestically . . . individual consumers would be liable for copyright infringement whenever they sell, give away, or donate a product that was originally sold abroad . . . and [might be subject] to $150,000 in statutory damages per infringing work” as

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108 See id.
109 See id. (citing Parfums Givenchy, 38 F.3d at 481).
110 See id. at 989-90.
well as potential criminal prosecution.\textsuperscript{112} This will deprive successive owners of the flexibility of freedom to trade as they will be required to get authorization from the copyrighted product’s owner each time they want to sell a good. In effect, the Court’s position relegates consumers to purchasing only new products directly from the copyright owner, alternatively forcing them to risk violating copyright law. Even copyrighted items purchased at garage sales will not be immune. For those consumers who purchase an item from a third party, the excessive costs of the due diligence required to ferret out the history of the good will be impossibly high, thus deterring consumers from purchasing any goods from the secondary market.\textsuperscript{113}

Consumers will not be the only ones affected; small businesses and rental stores are subject to the same rules. The holding is a major blow to every entity “directly or indirectly involved in the cross-border trade of traditional copyrightable material, such as books, magazines, photographs, phonorecords (CDs), and moving images in all their formats” as well as those businesses trading goods “which may have copyrightable elements affixed to them.”\textsuperscript{114} Of particular concern, is the damage done to the e-commerce sector. The Court’s ruling may put companies like eBay and Netflix out of business, and subject all of their users to liability for copyright infringement.\textsuperscript{115} Figures from a recent U.S. Department of Commerce Statistical Abstract indicate that projected Internet retail sales will “reach more than $334.7 billion” in the near future.\textsuperscript{116} However, the price discrimination resulting from this decision will act as a “drain

\textsuperscript{112} Brief of Amicus Curiae Public Citizen in Support of Petitioner at 8, Costco Wholesale Corp. v. Omega, S.A., No. 08-1423, slip op. (U.S. Dec. 13, 2010) (per curiam) (No. 08-1423). “Even an unwitting purchaser who buys a copy in the secondary market can be held liable for infringement if the copy was not the subject of a first sale by the copyright holder.” American Int’l Pictures, Inc. v. Foreman, 576 F.2d 661, 664 (5th Cir. 1978).
\textsuperscript{113} See COPYRIGHT LAW REVISION, at 126.
on consumers and the American economy [and cost] billions of dollars in higher prices for goods that could have been purchased more cheaply through parallel importation.”

These scenarios are just the tip of the iceberg. Amici in the Costco v. Omega case have described countless potential outcomes of a Supreme Court holding limiting the first sale doctrine. Admittedly, amici describe the most severe possible consequences of the Costco v. Omega holding and their predictions are probably far more dire than the actual tangible impact of the case. However, these considerations cannot be disregarded. If even a fraction of their concerns come to fruition, the U.S. economy will suffer a great deal. Consequently, it is in the Court’s best interests to review its decision and produce a result that corresponds to the aforementioned potentially catastrophic outcomes. In the alternative, Congress should redraft § 109 in favor of a broader application of the first sale doctrine.

VI. Potential Solutions for Copyright Owners

The truth is that a narrow reading of the first sale doctrine is unnecessary; a variety of solutions can be implemented to thwart the behavior that concerns copyright owners and limit the effectiveness of gray markets. These solutions align with the justifications behind copyright law and provide a more efficient means of resolving the issue.

117 Id.
A. Contractual Agreements

Copyright owners can retain control over domestic sales of internationally manufactured products via license agreements and contractual limitations. Admittedly, this solution suffers from some shortcomings. Contract law will have a limited reach in some cases. For instance, if a U.S. manufacturer agreed to limit its sales to certain markets in return for exclusivity in U.S. markets, and the foreign manufacturer violated this agreement, it would be financially burdensome for the U.S. manufacturer to litigate such a case and enforce a judgment. Moreover it would be “extremely difficult and sometimes impossible to find out who is the person that should be sued.” Yet these weaknesses could be remedied with a variety of modifications to the contractual language. Copyright owners might consider incorporating a liquidated damages clause into their contracts. Such a provision might require that distributors who neglect to keep a copyrighted good within a limited “geographic distribution region pay the manufacturer a pre-set amount of damages . . . shift[ing] the burden of preventing gray markets from the manufacturer to the distributor of goods, who is required to ensure that its goods do not end up in the gray market.”

A more substantial problem with the contract law approach is that a copyright holder could withhold licenses from distributors, thus circumventing the dissemination rationale inherent in copyright law. However, this is an unlikely, worst case scenario. Picking and choosing who may reap the benefits of a distribution contract is bad for business and likely to cut

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121 Id.
122 Stanley, supra note 29, at 879.
123 Id.
124 See supra Part IV.
into the copyright owner’s profits. Moreover, after weighing the harms potentially resulting from the Costco v. Omega Court’s holding against the injury U.S. consumers would suffer as a result of a copyright owner choosing who to contract with, the balance clearly falls in favor of license agreements and contractual limitations. The net damage done to the dissemination of knowledge would be minimal in comparison to the many harms that are likely to result from the Costco v. Omega Court’s ruling.

B. Manipulating Prices and Quality

Copyright owners could also consider varying the prices of their products. By raising the prices of goods produced for foreign markets and making them equal to the prices they charge for domestic products, manufacturers could effectively wipe out gray markets for their goods. Of course, this would require that copyright owners also improve the quality of their foreign made products to keep them on the same playing field as their domestically sold products. Alternatively, copyrighted products could be priced “in dollar terms. Such pricing will eliminate price differentials with U.S. products . . . A third strategy is to set a range for price fluctuations in particular markets and let local conditions dictate where the price falls within the range.” This solution is, admittedly, not foolproof. There is nothing to indicate that price increases or selling products in dollars rather than local currencies would go over well with cash-strapped consumers in developing markets. It is probable that some consumers may simply stop buying products and this would be antithetical to the objectives of copyright law. Nevertheless, it is a reasonable alternative to the status quo.

125 Stanley, supra note 29, at 880.
126 Richelieu, supra note 30, at 856.
C. Rewriting § 109

Congress is responsible for rewriting legislation and manufacturers should consider lobbying their legislators to modify the first sale doctrine and clarify their intentions with regard to the meaning of § 109. Additionally, unanswered questions pertaining to first sale doctrine remain in the text of the Copyright Act. An issue that does not appear to have been addressed by the judiciary or the legislature is the meaning of the language preceding “lawfully made under this title.” The Act refers to “the owner of a particular copy... lawfully made under this title.” This is noteworthy because “the economic impact on the copyright owner (and, consequently, the potential impact on his [or her] incentive to create)” is significantly smaller if the resale in question pertains to only a “few particular copies purchased abroad at a discounted price,” rather than a large number of copies (for example, Costco’s entire inventory of a certain product). Perhaps Congress will consider employing separate standards under § 109(a), depending on the quantity of copies purchased abroad and resold in the U.S. market. A revision to this effect would be beneficial to consumers and copyright owners, reducing confusion as to what kinds of products will qualify for first sale immunity and potentially thwarting the aforementioned harms that will result from a narrow interpretation of § 109(a).

VII. Conclusion

The ambiguity surrounding the application of the first sale doctrine and the statutory language used in § 109(a) of the U.S. Copyright Act with respect to products manufactured and sold internationally has caused excessive litigation and confusion. Section 109(a) needs to be

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128 Richelieu, supra note 30, at 856.
130 E-mail from Stefania Fusco, Professor, Santa Clara University School of Law, to author (Dec. 11, 2010, 04:59:08 PST) (on file with author).
amended to reflect its true purpose and the aims of copyright law: to promote knowledge via creation and distribution. The Court’s narrow holding in *Costco v. Omega* is antithetical to those objectives. To make matters worse, the Court’s decision may conceivably cause significant harm to the U.S. economy and eliminate the rights of consumers and small business. Despite the disappointing outcome of *Costco v. Omega*, the opportunity to reverse the Court’s holding, or better yet, to incentivize legislators to revise § 109(a), is still a realistic goal. Congress should redraft this portion of the Act broadly to accommodate the domestic sale of copyrighted goods lawfully manufactured and sold abroad. Expanding the first sale doctrine in this manner will yield new discoveries and stimulate learning, in accordance with the aims of copyright law.