

## INTELLECTUAL PROPERTY & *Life Sciences*

### How Copyright Law Governs Sales of Watches

By Noel D. Humphreys

Lawyers look from at least three different angles at Congress' choosing to permit copyright owners to restrict sales of imported products such as shampoo and watches in the US.

First, the Constitution grants Congress authority to "promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries." Congress has used this power to restrict unauthorized importation and distribution of authentic (as well as counterfeit) goods.

As the Supreme Court explained, the economic philosophy behind the Constitution's Copyright Clause "is the conviction that encouragement of individual effort by personal gain is the best way to advance public welfare through the talents of authors and inventors." *Mazer v. Stein*, 347 U.S. 201, 219 (1954).

The legal system has extended that underlying philosophy to bottles full of

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shampoo and watches bearing copyrighted logos.

Second, purveyors enhance revenue by selling at higher prices to those who will buy at higher prices and selling at lower prices to those who will buy only at lower prices. Copyright law facilitates this price differentiation strategy. Worldwide companies attempt to keep prices high in the U.S. while selling the same goods in other markets at lower prices.

Third, looked at differently, differential pricing for comparable goods based on market segmentation means that purchasers who buy at higher prices pay more than was really necessary. In other words, it could be said that copyright law facilitates a market where American consumers pay artificially inflated prices.

The Supreme Court is apparently considering a recent Ninth Circuit decision that has spotlighted this dilemma. Omega, the watchmaker, makes world-renowned, high-quality Swiss watches. Omega sells those watches in the U.S. for prices that are higher than the prices charged for the same watches in Latin America. A Latin American distributor sold some authentic watches to Costco outside the U.S. Costco offered the watches for sale in California at prices that Omega thought were too low. Costco was not an authorized Omega

distributor.

A small logo appears on the back side of the watch. That logo is registered with the U.S. Copyright Office. Therefore, when Costco offered these watches for sale, Costco was distributing copies of the copyrighted work (the registered logo) in the U.S. *Omega S.A. v. Costco Wholesale Corp.*, 541 F.3d 982 (9th Cir. 2008).

Copyright law gives the copyright owner the exclusive right to distribute copies of a copyrighted work. This part of the law usually is thought to limit the exclusive right to control distribution to only the first sale of the copy, which is why eBay auctions second-hand books and second-hand video games. The copyright law embodies the "first sale" doctrine at 17 U.S.C. Section 109(a). That section provides that the "owner of a particular copy ... lawfully made under this title ... is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy."

The *Omega-Costco* case arises against the background of a similar case decided by the Supreme Court in *Quality King Distributors, Inc. v. L'Anza Research International, Inc.* 523 U.S. 135 (1998).

In that case, L'Anza Research manufactured hair care products and sold its products to U.S. wholesalers who were

authorized to sell in the U.S. only to authorized retailers, primarily beauty salons. L'Anza Research justified higher U.S. prices by pointing to its U.S. advertising and promotional efforts. L'Anza Research also sold to a British distributor who resold to a distributor in Malta. The Maltese reseller sold several tons of product to a U.S. retailer, who sold the products in the U.S. outside the authorized network at prices that L'Anza Research considered too low. The goods were made in the U.S. and the first sale of those good occurred in the U.S.

L'Anza Research's bottles bore copyrighted labels. L'Anza Research won summary judgment in federal district court to stop unauthorized sales of bottles bearing L'Anza's labels. Section 106(3) of the copyright law grants the right to control distribution of copies (including the copies on the shampoo bottles). The Ninth Circuit upheld the summary judgment. Defendant had argued that the "first sale" doctrine protected Quality King from liability.

The "first sale" doctrine states, the Supreme Court said in *Quality King*: "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, Section 109(a) unambiguously states that such an owner 'is entitled, without the authority of the copyright owner, to sell' that item."

The *Quality King* decision interpreted the "first sale" doctrine to protect Quality King. The portion of the statute that forbids importation of infringing copies did not restrict importation of the goods in this particular case, because the goods had been lawfully made in the U.S. The words "lawfully made under this title" in Section 109 were critical, because products made outside the U.S. bearing U.S.-copyrighted labels are made under another country's copyright law, not under U.S. copyright law.

Costco's Omega watches were made in Switzerland, not the U.S. Therefore, in accordance with the *Quality King* decision, the "first sale" doctrine did not protect

Costco's ownership and ability to resell Swiss-made watches bearing the half-centimeter globe on the back, in the Ninth Circuit's decision.

Congress constructed the statute this way in part to protect publishers and authors who wish to split foreign publishing rights from U.S. publishing rights. Congress wanted an author to have the power to exclude from the U.S. British editions of a U.S.-copyrighted book, when the author has granted U.K. rights to one publisher and U.S. rights to a different publisher. Only books made in the U.S. under the U.S. rights are "lawfully made under" U.S. copyright law.

Recent Southern District of New York decisions illustrate the impact. Under this interpretation, courts stopped importation into the U.S. of textbooks made in Asia and licensed for distribution in Asia. The importers were arbitrating the price differential between cheaper-priced Asian editions and more expensive U.S. editions.

Unauthorized importation of genuine, authentic, nonpirated goods that are not counterfeits or knockoffs is sometimes referred to as "parallel importation," and the goods are called "gray market" goods. This nomenclature distinguishes such goods from phony goods that carry a real trademark but are not authorized anywhere by the trademark owner. Counterfeit goods are a serious problem in such industries as pharmaceuticals and spare parts for airplanes and cars because of safety or health issues. Counterfeit goods are common in entertainment (such as unauthorized copies of recorded music or films) and in apparel, perfume and accessories (such as handbags).

Sometimes, dealers in the U.S. sell goods with disclosures or safety instructions or warranties that gray-market goods lack. Such considerations could potentially justify higher prices to U.S. customers. In the *Quality King* decision, the Supreme Court appeared to accept that U.S. customers should pay more because L'Anza Research did more advertising and promotion in the U.S.

The *Omega-Costco* appeal to the

Supreme Court has attracted amicus briefs. Critics of the decision take a few different approaches. For example, in an era when many items are produced abroad (say, China), the words "lawfully made under this title" would mean that the law would not permit consumers to dispose of books or videogames, even when purchased from authorized dealers. Where a copyright holder had the goods made would complicate all resales. Another approach would be that copyright law should not apply to sales of watches. To apply copyright law to products that consumers typically buy for the shampoo or for the watch rather than for copyrighted packaging subverts the law.

In these cases, copyright law has protected copyright holders who divided up the world ("segmented the market") to sell their copyrighted works — bottles of shampoo, logos on watches, textbooks — at a higher price in the U.S. and at a cheaper price elsewhere.

Congress grants monopoly rights to authors to control distributions of their works based on the idea that this method is most likely to provide incentives to authors to produce more. Looked at another way, these monopoly rights granted by copyright laws interfere with a free market to force U.S. consumers to pay higher prices for goods that consumers elsewhere buy for less. Free markets and free trade make this interference an anachronism. Is the balance in the *Omega-Costco* decision the copyright tradeoff that Congress intended to promote the progress of science and the useful arts?

The Supreme Court may reconsider what Congress intended. The Supreme Court asked the Solicitor General for advice on whether to hear Costco's appeal from the Ninth Circuit's *Omega-Costco* decision. In March, the Solicitor General advised the Court not to hear the case, declaring that the Ninth Circuit decision was consistent with well-settled law. At the time of this writing the Court has not yet granted or denied certiorari in the matter. ■