**Supreme Court Will Analyze Reach of Copyright Owner's Importation Right**

**The Return Of the Native Product**

By Elliott Alderman (originally published in the Legal Times, Intellectual Property Supplement (1998)

At the moment of creation and fixation of its work, a domestic copyright owner has exclusive worldwide rights to its creation through Section 104 of the U.S. Copyright Act, 17 U.S.C. Section 104, and a network of multilateral treaties. One of these exclusive rights is that of distribution, and as the owner of this right, the copyright holder may divide the world into geographical markets or license others to distribute its work through "authorized" channels. See 17 U.S.C. Section 106(3). Significantly, however, the Copyright Act is not extraterritorial, and applies only to activities occurring within U.S. boundaries. Subafilms Ltd. v. MGM-Pathe Communications Co., 24 F.3d 1088 (9th Cir. 1994) (en banc). Activities occurring in other countries are governed by the laws of those countries. See DeBardossy v. Puski, 763 F. Supp. 1239 (S.D.N.Y 1991).

What happens when a copyrighted work is exported to be sold overseas and then, without the authorization of the U.S. copyright holder, imported back into the United States? These transborder transactions present a conflict between the rights of copyright owners to control the importation of their works and the rights of personal property owners to dispose of their purchases as they wish.

For example, a hair care manufacturer/distributor makes its products, containing copyrighted artwork and text, in the United States and sells them abroad through licensed distributors. It charges its foreign distributors a lower price than for domestic sales because it does not provide advertising and marketing support to foreign goods. If a foreign distributor sells the goods to a purchaser who, in violation of geographic distribution limitations and in order to exploit the price differential, then exports them back to the United States, the hair care company is forced to compete with its own lower-priced goods. If the products are also damaged in shipment and do not work, the company's reputation is tarnished, and it may lose sales of other goods.

Last year, the Supreme Court granted certiorari in the case of Quality King Distributors Inc. v. L'Anza Research International Inc., No. 96-1470, to determine the legitimacy of the unauthorized importation of such manufactured goods with copyrighted labels. But the impact of the Court's decision will extend far beyond such products to books, motion pictures, sculptures, and other works of intrinsic authorship.

USE ANTITRUST LAWS INSTEAD

Blurring of the distinction between goods with minimal copyrightable elements (such as bottled shampoo) and works of intrinsic creativity encourages linking of the copyright monopoly to unfounded allegations of trade restraint, resale price maintenance, and other economic misuse. If it is true that there are economic abuses in the sale of copyrighted goods, then that problem should be addressed under the antitrust laws, not by limiting the rights of copyright owners.

The semantics of referring to the end products of unauthorized importation as either parallel imports or gray market goods reflects the division between supporters and opponents of the practice. The neutral term "parallel import" connotes a legitimate, complementary distribution channel for genuine goods. Parallel importers view themselves as white knights, preventing what they perceive as discriminatory pricing regimes. There is a market for their goods, they explain, because U.S. manufacturers seek significantly higher domestic prices. They point to the billions of dollars in savings they have provided to U.S. consumers and the repeated failure of legislation to restrict their actions. If the Supreme Court forbids the parallel importation of copyrighted products, they fear, independent distributors will have difficulty selling these products and retailers will have trouble disposing of excess inventory.

Manufacturers, on the other hand, see a different reality. The term "gray market goods" brings to mind shady business dealings: In a world of white hats (authorized distributors) and black hats (infringers), gray market distributors are only somewhere in between. Gray market goods are seldom subject to the same warranties as domestic goods. They are often

damaged during storage and transit, and it is difficult to recall them if they do not go through authorized channels. Additionally, products intended for different markets may not meet U.S. content and safety standards. All these factors redound to the detriment of legitimate originators: If customers are not satisfied with products, manufacturers are blamed; if customers are satisfied, then unauthorized distributors "free ride" on the copyright owner's marketing and promotional activities. Finally, contrary to the assertions of many advocates, parallel imports often cost as much or more than legitimate imports.

COPYRIGHT LAW QUESTION

The case of Quality King v. L'Anza Research raises the specific issue of whether the Copyright Act's first-sale defense, 17 U.S.C. Section 109(a)--which grants the purchaser of a copyrighted work the right to dispose of it freely--applies to foreign sales so as to cut off the copyright owner's exclusive right to import works from other countries. See 17 U.S.C. Section 602(a). The Court, which heard oral argument on Dec. 8, 1997, granted certiorari to resolve a conflict between the 9th Circuit's holding in L'Anza Research International Inc. v. Quality King Distributors Inc., 98 F.3d 1109 (9th Cir. 1996), and the 3rd Circuit's earlier decision in Sebastian International Inc. v. Consumer Contacts (PTY) Ltd., 847 F.2d 1093 (3d Cir. 1988). The 3rd Circuit held in Sebastian that the place of sale is not determinative, and that the first-sale defense bars exercise of the importation right where the copyright owner manufactures goods in the United States andsells them anywhere. The 9th Circuit in L'Anza agreed that the place of sale is not controlling, but concluded that applying the first-sale defense to a foreign sale renders the importation right meaningless and deprives the copyright owner of the "full value" for the sale of its work.

Although the Supreme Court has previously permitted importation in the trademark context, K-Mart Corp. v. Cartier Inc., 486 U.S. 281 (1988), it has observed that the respective disciplines serve different purposes and has declined to interchange doctrines. See Sony Corp. v. Universal City Studios Inc., 464 U.S. 417 (1984) (noting differences between copyright and trademark law); Mazer v. Stein, 347 U.S. 201 (1954) (same).

Copyright primarily promotes the broad availability of works of authorship, Harper & Row, Publishers Inc. v. Nation Enterprises, 471 U.S. 539 (1985), through monetary reward to authors. See Sony Corp., 464 U.S. at 429. If authors lose control over the distribution of their creations and thus end up competing with lower-priced copies intended for different markets, they may also lose their incentive to create, depriving U.S. consumers of works of authorship.

Trademark, by contrast, serves the entirely different functions of preventing consumer confusion as to the source of goods and preserving goodwill toward the manufacturer of those goods. Societe Des Produits Nestle S.A. v. Casa Helvetia Inc., 982 F.2d 633 (1st Cir. 1992). Because genuine trademarked products are being imported, there is no consumer confusion unless the imports and the domestic goods are materially different--in which case, the importation is infringing.

Sebastian and L'Anza both involve the foreign sale of hair care products, and both courts considered variations of the "full value" concept, yet the 3rd and 9th Circuits came to opposite conclusions.

In Sebastian, the manufacturer licensed the defendant to distribute its products only in South Africa. Once the products were shipped there, the defendant rerouted the sealed containers to the United States and sold them here. The district court held that the rerouting violated Sebastian's importation right.

On appeal, the 3rd Circuit reversed, holding that a foreign sale triggers the Section 109 first-sale defense and bars an importation action, as long as the copyright owner manufactures the goods in the United States and sells them. The 3rd Circuit considered the adequacy of the payment that Sebastian received for the sale of its products, and concluded that the manufacturer would receive too large a reward if it got the purchase price and could also limit importations.

In L'Anza, the manufacturer restricted domestic sales to authorized vendors. Outside the United States, it distributed its goods to master distributors for sale within defined geographic areas. The foreign distributors were not permitted to export

the products, and paid 35 percent to 40 percent less than their U.S. counterparts, since they did not receive advertising and promotional support. The particular goods at issue were manufactured in the United States and sold in the United Kingdom. The district court held that Section 109 did not reach a foreign sale. On appeal, the 9th Circuit affirmed the decision on the alternative basis that Section 602 would be rendered meaningless if the first-sale defense were held to supersede the importation right. The crucial subtext, however, was that the court recognized that L'Anza would not get full value for its foreign sales because the overseas distributors paid 35 percent to 40 percent less than authorized U.S. distributors.

AMOUNT PAID IS IRRELEVANT

Although the 9th Circuit reached the correct result--that the first-sale defense does not reach foreign sales--the "full value" concept is problematic. The genesis of this notion is sound: The reward of financial benefits to authors encourages the availability of creative works. But the real issue in L'Anza is whether the copyright owner's importation right survives a foreign sale. The actual value of the sale should be determined by the scope of the right, not the other way around.

The Copyright Act does not condition either the first-sale defense or the importation right on the adequacy of the copyright owner's payment. A purchaser of a particular copy of a work owns that copy regardless of the adequacy of the consideration. See Denbicare USA Inc. v. Toys "R" Us Inc., 84 F.3d 1143 (9th Cir. 1996). Correspondingly, the copyright owner's importation right exists independently of how much it is paid for the sale of a particular copy.

Additionally, "full value" is a relative concept and invites unnecessary subjective analysis. For example, if a copyright owner is willing to sell its works in certain geographic areas for less than in others, has it received full value? Who determines full value, the owner or the market? What is the relevant market: that for particular copies, for the product generally, or for all products of the manufacturer?

Whether or not the copyright owner receives what is deemed "full value" for the sale of its work, the 9th Circuit's holding is, in fact, supported by a stronger foundation--the language of the Copyright Act.

The Copyright Act's provisions are densely interwoven, and resolution of the ostensible conflict between the first-sale doctrine and the copyright owner's exclusive importation right is aided by contextual reference to the other provisions of the statute.

Initially, the act grants the copyright owner the exclusive rights to reproduce, adapt, and publicly distribute, perform, and display its works of authorship. 17 U.S.C. Section 106(1)-(6). The owner may retain any or all of these rights or license others to use them, but the act accords no significance to the party who exercises a right, so long as the exercise is permissible.

One of these rights, that of domestic distribution, entitles the owner to "distribute copies . . . to the public by sale or other transfer of ownership, or by rental, lease or lending." 17 U.S.C. Section 106(3). Since the statute is limited to acts occurring in the United States, a foreign distribution is an exercise of rights conferred by foreign law, not of the Section 106(3) right.

The scope and exclusivity of the Section 106 rights are then qualified by the limitations in Section 107 through Section 121. One of these limitations, the first-sale defense, declares that, notwithstanding the otherwise exclusive distribution right in Section 106(3), "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." 17 U.S.C. Section 109(a) (emphasis added). Section 109 incorporates the fundamental copyright distinction between the ownership of an object and the ownership of the rights embodied in that object, see 17 U.S.C. Section 202, and it is triggered only by a sale. 17 U.S.C. Section 109(d). Also, Section 109 refers only to the distribution right. Red Baron-Franklin Park Inc. v. Taito Corp., 883 F.2d 275 (4th Cir. 1989).

There are additional restrictions in applying Section 109. Subclause (a) gives the owner of the copy the right to sell or otherwise dispose of it, but grants no importation right. Moreover, the section applies only to copies "lawfully made under

this title." This phrase has been interpreted to require that the acts of legally making copies and selling them occur in the United States, BMG Music v. Perez, 952 F.2d 318 (9th Cir. 1991), cert. denied, 505 U.S. 1206 (1992), which is consistent with the commonly understood view that the act does not apply to activities happening in a foreign country. Hence, a foreign sale would not trigger application of the first-sale defense.

This recognition that the statute has territorial restrictions is continued in the importation provision, which appears in a separate chapter of the act. Section 602(a) forbids the unauthorized importation into this country of copies of a work that have been acquired outside the United States, and makes the unauthorized importation an infringement of the Section 106(3) distribution right, actionable under Section 501. 17 U.S.C. Section 602(a). The phrase "acquired outside the United States" in Section 602 references a different market for goods, and separates foreign importation from the domestic distributions and sales contemplated in Section 106(3) and Section 109. Only the copyright owner has the right to import works into the United States, and to enforce this right the act reaches foreign acquisitions that might be exported here and would thus compete with the owner's exclusive U.S. distribution rights.

Section 602(b) also reflects the territorial limitations of the copyright statute. Acknowledging that U.S. law does not apply to the making of copies in a foreign country, Congress prohibited their importation where the copying would have been infringing if this title had been applicable. 17 U.S.C. Section 602(b).

Finally, Section 602 contains three narrow exceptions to the exclusivity of the importation right: importation for a governmental body, for private use, or for a scholarly, educational, or religious nonprofit. 17 U.S.C. Section 602(a)(1)-(3). All of these exceptions, which apply to products that would probably be acquired through foreign sale, clearly forbid further distribution. It is unclear why they would even be necessary if the first-sale defense indeed cut off the importation right.

In sum, it is evident that Section 109 and Section 602 can be read consistently, and that there is no real conflict between the two provisions. In L'Anza, the 9th Circuit framed the relationship--although it did not squarely resolve the issue--in terms of whether the importation right was different from, or merely an extension of, the Section 106(3) distribution right: If importation was not part of the bundle of Section 106 rights, it would not be subject to the limitations in Section 107 through Section 120; if it was merely an extension of the Section 106(3) right, it would be limited by Section 109(a). Because importation is a separate and distinct right, it is not subject to the first-sale defense.

Since copyrights are not extraterritorial, the domestic distribution right exists separately and apart from the foreign importation right. An importation may be followed by a subsequent distribution, but the rights are different and the Copyright Act treats the two acts differently. Section 602 makes infringing the act of unauthorized importation alone, even before any public distribution in the United States. S. Rep. No. 94-473, 94th Cong., 1st Sess. 152 (1975); H. Rep. No. 94-1476, 94th Cong., 2d Sess. 170 (1976). Similarly, provisions of the act reflect the distinction, and refer to the acts of importation and distribution disjunctively. 17 U.S.C. Section 501(a); 17 U.S.C. Section 1002(a); 17 U.S.C. Section 1008. Finally, even where Congress permitted exceptions to the importation right in Section 602(a), it clearly forbid further distribution following the importation.

In short, the 9th Circuit grounded its holding, that the importation right would be rendered meaningless if it were cut off by a foreign sale, on a finding that L'Anza did not receive full value for its products because of the disparity between U.S. and foreign pricing. As a copyright owner, L'Anza is surely entitled to the market value for its products. But the essential issue is the effect of a foreign sale on the existence of the right in the first instance, apart from the secondary question of whether L'Anza was adequately remunerated. By not clearly holding that the importation right is distinct from the Section 106 rights, and is thus not subject to the first-sale defense, the 9th Circuit's decision is too fact-specific and invites unwarranted inquiry into the adequacy of the copyright owner's payment.

The language and legislative history of the Copyright Act provide a sounder foundation for the conclusion that the first-sale defense is not extraterritorial. In Section 106, Congress provides exclusively domestic rights and, recognizing the territorial limitations of the statute, extends the law in Section 602 to foreign acquisitions only because their subsequent importation will have an effect in the United States. Consequently, the domestic distribution right co-exists with the foreign importation right, but the latter is separate and independent of the limitations to which the domestic right is subject. This distinction between the acts of distribution and importation is reflected throughout the act.

Additionally, Section 109 requires a sale to trigger application. Even if the first-sale defense were meant to apply extraterritorially, it is illogical to apply it to Section 602, since that provision has its own exceptions, which generally require a prior foreign sale. Clearly, if the exceptions are cut off by a foreign sale, there is no reason to have them in the first instance. And if the goods are acquired by means other than purchase, Section 109 is inapplicable in any event.

The Copyright Act was intended to protect the owner's importation right, and indirectly, its domestic distribution right, after a foreign sale. For if creators are forced to compete with a flood of cheaper imported copies of their works, the damage will be no different than if rampant reproduction were permitted, and allowing this result will destroy any incentive for further creation. Whether the imported objects are rudimentary product labels or intricate sculptures, they are entitled to protection.