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## Gray-Market Goods and Copyright's Gray Area

James Gibson

*University of Richmond - School of Law*, [jgibson@richmond.edu](mailto:jgibson@richmond.edu)

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## Gray-Market Goods and Copyright's Gray Area

**Prof. Jim Gibson, University of Richmond School of Law**

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Copyright law generally gives authors no control over the aftermarket for their goods. Suppose I write a book, and I sell you a copy of it. You are free to resell the book, or lend it to a friend, or give it away. That's because as long as your copy is "lawfully made under this title" (that is, made with my authorization under U.S. law), then copyright has nothing to say about its further distribution – who owns it, who sells it to whom, etc.

This notion is known as the first sale doctrine. It is so named because at one time it was the copyright owner's first sale of a particular copy that exhausted his or her right to control its further distribution. That name has stuck, even though the law has recognized for decades that it's now the copyright owner's *making* of the copy, not its sale, that exhausts his or her rights.

That distinction made little difference until a curious 1998 case called *Quality King v. L'anza Research*. L'anza sold shampoo in bottles that featured a copyrighted design on the label. It made its labels and shampoo in the United States, but it exported some units abroad. In doing so, it engaged in price discrimination: In the United States, it sold its shampoo exclusively through pricey salons, but in foreign markets it was not so exclusive and its prices were considerably lower.

Quality King acquired some of L'anza's products from a distributor abroad, at the lower price. Then it shipped them back into the United States for resale at a higher price – a classic arbitrage. One can immediately see why L'anza was upset; Quality King's scheme threatened to upend L'anza's price discrimination, undercutting L'anza domestic sales. And it did so using L'anza's own products – what are known as "gray market" goods, because they are perfectly genuine, yet are sold in a market that the manufacturer did not have in mind.

Whatever you think of L'anza's position on the matter, the Supreme Court held that copyright law didn't provide it with a remedy. After all, L'anza had authorized the making of the copyrighted labels, so its right to control their further distribution was exhausted under the first sale doctrine. Quality King's actions therefore did not implicate L'anza's copyright at all.

In the course of reaching this conclusion, however, the Court noted that if L'anza had made the labels *outside* the United States, the outcome would have been different. You see, the first sale doctrine applies only to copyrighted goods "lawfully made *under this title*" – i.e., made with the copyright owner's permission *under U.S. law*. If the goods were lawfully made under *another* "title," then the first sale doctrine would not provide Quality King with a defense. So if L'anza had printed its labels in, say, France, they would have been made under some other country's "title" – i.e., French copyright law – and would not be subject to the first sale doctrine, despite having been authorized by the copyright owner.

Fast forward a dozen years. Swiss watchmaker Omega discovers that Costco is selling Omega watches in the United States at a deep discount, having purchased them from third-party distributors. Engraved on the underside of each watch is Omega's copyrighted logo. Omega sues Costco, claiming a violation of Omega's right to control the distribution of its copyrighted gray-market goods.

Costco cites the first sale doctrine, because the watches were clearly made with Omega's permission. But Omega cites *Quality King*. Because Omega engraved the watches with its logo *in Switzerland*, they were not "lawfully made under *this* title." Instead, they were lawfully made under Swiss copyright law. The first sale doctrine therefore does not apply, and Omega maintains the right to control the downstream sale and distribution of the watches in the United States. Or so the U.S. Court of Appeals for the Ninth Circuit held, in a victory for Omega. (The Supreme Court reviewed the case, but the justices split four-to-four and so issued no ruling on the matter.)

This issue may seem arcane and technical. That's because it *is* arcane and technical. But it has hugely important implications for domestic commerce. When sales of used goods were restricted to pawn shops and the occasional used bookstore, this was no big deal. But in an age of Craigslist and eBay, the used-goods market is more widely available to consumers – and is therefore more threatening to manufacturers. Many copyright owners would therefore love to control the aftermarket for their goods, either to extract licensing fees from resellers or to force consumers to buy expensive new copies rather than cheap used copies.

So if the *Omega* case is correct, all second-hand sellers of copyrighted goods are in trouble. Lenders too – libraries have no right to lend books for free without a first-sale defense. How are these institutions to determine whether a given book or DVD was manufactured here or abroad? There's no way to tell simply by looking at a product whether its resale would be infringing.

Moreover, in both *Quality King* and *Omega*, the plaintiffs were attempting to use their copyright entitlements to control a market that had nothing to do with the sorts of expressive goods that copyright law usually cares about. L'anza was selling shampoo, not shampoo labels, and Omega was selling watches, not engraved logos. The copyrighted part of the good was simply the tail wagging the dog. In other words, all a seller has to do to gain control of the aftermarket for its goods is print its copyrighted *labels* in a foreign country. So it's not just classic copyrighted goods like books and movies and music that are affected. Any unauthorized domestic sale of a product bearing a copyrighted label could infringe copyright.

Finally, the "lawfully made under this title" language also appears elsewhere in U.S. copyright law. For example, if you purchase a copy of a copyrighted photograph or poster or other graphical work, you are allowed to display it in a public place – e.g., hang it in your coffee shop – as long as it was (you guessed it) "lawfully made under this title." But under the *Quality King* and *Omega* precedent, if that poster were printed abroad, you would be liable merely for hanging it on your coffee shop wall, even if the copyright owner had authorized the foreign printing. You could not hang a Picasso in a gallery without his heirs' permission.

The solution to this dilemma remains to be seen. The holding in the *Quality King* case might be interpreted differently from how I have described it here; only Justice Ginsburg's concurring opinion was clear on the issue. And the *Omega* ruling might fail to find adherents in other courts, where a battle over exhaustion doctrines in patent and trademark has been raging for years (e.g., see [Randy Picker's recent essay](#) on how contract law affects first sale). But if not, the future looks black for gray-market goods.