



## Copyright Alert

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# U.S. Supreme Court Reaches a Split Decision in *Costco Wholesale Corporation v. Omega S.A.*

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On December 13th, the U.S. Supreme Court handed down a non-decision in *Costco Wholesale Corp. v. Omega S.A.*, a closely watched copyright case that could have potentially resolved an important international copyright issue that sometimes affects gray market goods; that is, whether gray market goods bearing the manufacturer's copyright qualify under the First Sale doctrine. <sup>1</sup> Unfortunately, because of the nature of the decision, the *status quo* among the Circuits remains. <sup>2</sup> Specifically, since the court was equally split in the recent *Costco* decision, it carries no precedential weight, leaving each Court of Appeals where it previously stood. In the 9th Circuit, the decision in *Costco* that gray market goods may not qualify for First Sale protection under copyright law stands as binding on those courts under its jurisdiction. <sup>3</sup>

In our client advisory on so-called "gray market" goods and how trademark and copyright laws apply in that context, [available here](#), we discussed the *Costco* case and the "gray market" and First Sale doctrine concepts generally. To briefly reiterate, gray market goods are those manufactured and purchased outside of the United States, then imported into the United States for resale. The attraction of gray market goods lies in the concept of discriminatory pricing, namely, obtaining genuine versions of goods available at lower prices outside the United States and importing them into the U.S. for resale at a higher price, enjoying a profit from that spread. In *Costco*, genuine Omega watches were purchased that were manufactured overseas and then subsequently imported into the United States by Costco where they were resold. Omega sued Costco for copyright infringement based on a copyrighted element on the back of the watch, claiming that the resale in the United States infringed Omega's exclusive distribution right. Costco argued that because of the copyright First Sale defense, the claims should be dismissed. The First Sale defense essentially operates as a limitation to the exclusive distribution right of copyright owners and mandates that a copyright owner can only control the distribution of a good incorporating a copyright *until the first qualifying sale of that good occurs*. After that first sale, the copyright owner can no longer restrain the free alienability of those goods absent a private agreement between the parties. In *Costco*, Omega claimed that because the watches contained a copyrighted element and were manufactured outside of the United States, those non-U.S. sales were not qualifying "first sales" under the Copyright Act and, thus, when the watches were subsequently resold in the United States by Costco, they constituted an infringement of Omega's exclusive distribution right. Costco argued the converse, that the prior foreign sales to Costco were in fact "first sales" under U.S. copyright law even though they took place outside of the United States and, thus, Omega could not regulate the subsequent resale of the goods thereafter in the United States.

The issue presented to the Supreme Court was whether the First Sale defense (codified in 17 U.S.C. §109) applies to goods manufactured and purchased *outside* the United States for the first time *in addition to* those manufactured and purchased *within* the United States for the first time. The territorial nature of the U.S. Copyright law is at the heart of the matter. At trial, the Central District of California sided with Costco and held that the sale

of the foreign-manufactured watches outside of the United States was indeed a first sale, and thus Omega's copyright infringement claim was improper since the First Sale defense applied (and the claim was thus dismissed). On appeal, however, the 9th Circuit reversed that decision and remanded the case back to the trial court on the theory that the First Sale defense may not in fact apply to goods first manufactured and purchased outside of the United States and then imported and resold in the United States (i.e., gray market goods). The First Sale then must take place within the ambit of the territory to which the U.S. Copyright Act is applicable.

Since the Supreme Court did not issue a decision changing the law of the individual Circuits, the law in each Circuit remains as is until the issue is finally resolved by the Supreme Court or the statutory ambiguity is clarified by Congress. The 9th Circuit decision in *Costco* reviewed a dismissal of the case prior to a full trial on the merits and before all the facts and arguments were presented. The Central District of California will now proceed with a trial on Omega's copyright infringement claim (absent Costco's First Sale defense, of course) unless settlement occurs. What this means is that within the 9th Circuit, copyrighted gray market goods may *not* be entitled to the protections of the First Sale doctrine. Thus, including U.S. copyrighted material on or in goods manufactured and sold outside of the United States remains a viable protection strategy. While there are several other courts that have thus far agreed with the 9th Circuit's interpretation, we are only aware of the Central District of California in the *Costco* case taking the opposite position, namely that gray market goods are definitively entitled to the protections of the First Sale Doctrine. This *status quo* means qualifying goods in the United States may continue to benefit from true differential pricing in different countries.

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#### Endnotes

- <sup>1</sup> *Costco Wholesale Corporation v. Omega, S.A.*, 562 U.S. \_\_\_\_ (2010).
- <sup>2</sup> Justice Elena Kagan was forced to recuse herself because she filed a friend of the court brief in this case during her time with the Justice Department. As a result, only eight justices were able to participate in the decision allowing for the four to four split.
- <sup>3</sup> The United States Court of Appeals for the Ninth Circuit has appellate jurisdiction over all Federal District Courts in the states of Alaska, Arizona, California, Hawaii, Idaho, Montana, Nevada, Oregon, and Washington. It also has jurisdiction over the territorial courts in the U.S. territories of Guam and the Northern Mariana Islands.

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