OUTSIDE PERSPECTIVES

Can Authorized Foreign Sales Exhaust Intellectual Property Rights In The United States?

THE DIFFERENCE IN PRICING IN DIFFERENT countries creates an incentive for gray market goods. "Gray market" goods, or "parallel imports," are genuine products possessing a brand name protected by a patent, trademark, or copyright. They are typically manufactured abroad, and purchased and imported into the United States by third parties, thereby bypassing the authorized U.S. distribution channels. Retailers can exploit the price differences in the gray market to sell these genuine products at a discount.

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Can a third party who lawfully buys a product in Thailand, for example, sell this product in the United States without violating the owner's intellectual property rights? In patent and copyright law, generally the answer is no – the resale of a foreign-made or sold product would infringe IP rights in the United States. In trademark law, the resale would infringe if the resold good materially differs from the authentic good. Later this fall, the U.S. Supreme Court will hear a case that may- or may not- alter this landscape.

Costco Wholesale Corp. v. Omega, S.A.

In October, 2010, the U.S. Supreme Court will hear the case of *Costco Wholesale Corp. v. Omega, S.A.* The *Costco* case involves international "exhaustion" in a copyright case, but the Court's decision may impact patent and trademark cases as well. "Exhaustion," or the first sale doctrine, states that once a product is sold by an authorized seller, then all IP rights in that product are exhausted. The buyer is free to resell the product without fear of infringing the original owner's IP rights. For example, the Supreme Court recently held that LG Electronics' sales of chips exhausted its patent rights in those chips. *Quanta Computer, Inc. v. LG Electronics*, *Inc.*, 128 S. Ct. 2109, 2115 (2008) ("the longstanding doctrine of patent exhaustion provides that the initial authorized sale of a patented item terminates all patent rights to that item."). Thus, LG could not accuse downstream re-sellers of patent infringement of its chips.

One important limitation on exhaustion common to both patent and copyright law is the requirement of an authorized sale in the United States. Typically, exhaustion does not kick in unless there has been an initial, authorized sale in the United States. The requirement of a domestic copy or sale prevents the extraterritorial application of United States law. "United States patent rights are not exhausted by products of foreign provenance. To invoke the protection of the first sale doctrine, the authorized first sale must have occurred under the United States patent." *Jazz Photo Corp. v. ITC*, 264 F.3d 1094, 1105 (Fed. Cir. 2001). In copyright law, § 109 provides that the first sale doctrine applies to the "particular copy…lawfully made under this title." 17 U.S.C. § 109(a). A product made overseas is not "lawfully made" under the United States Copyright Act. Consequently, exhaustion under patent and copyright law does not apply to foreign made or sold products.

In the *Costco* case, Costco acquired genuine Omega watches that were manufactured in Switzerland from authorized distributors overseas. By purchasing these watches overseas, Costco paid substantially less than

the U.S. market value. Costco then offered these gray market watches at a deep discount in the United States. Engraved on the underside of the watches is a U.S.-copyrighted "Omega Globe Design." When Omega sued for copyright infringement, Costco argued that its actions were protected by the first sale doctrine. That is, Costco argued that since the initial purchase overseas was an authorized one, Costco was now free to sell these watches without liability for copyright infringement.

The Ninth Circuit held that the first sale doctrine could not be used as a defense against Omega's copyright claims. The Court held that the Supreme Court's opinion in *Quality King Distribs., Inc. v. L'anza Research Int'l, Inc.*, 523 U.S. 135 (1998), did not overrule the Ninth Circuit's earlier interpretation of the first sale doctrine. *Quality King* involved "round trip" importation: a product with a U.S.-copyrighted label was manufactured inside the United States, exported to an authorized foreign distributor, sold to unidentified third parties overseas, shipped back into the United States without the copyright owner's permission, and then sold in California by unauthorized retailers. 523 U.S. at 138-39. The first sale doctrine applied because the product was made in the United States. However, because the facts involved only domestically manufactured copies, the *Quality King* Court did not address the effect of § 109(a) on claims involving unauthorized importation of copies made abroad. *See id*. at 154 (Ginsburg, J., concurring) ("[W]e do not today resolve cases in which the allegedly infringing imports were manufactured abroad."). Moreover, the *Quality King* Court never discussed the scope of § 109(a) or defined what "lawfully made under this title" means.

The question presented for the Supreme Court in *Costco* is therefore whether the Ninth Circuit correctly held that the first sale doctrine does not apply to imported goods manufactured abroad. The Court may simply agree that exhaustion does apply to round trip importation (*Quality King*) but not to "one way trip" importation of foreign-made goods (*Costco*). Such a rule would create an incentive to move manufacturing overseas and for the purchase of products overseas to limit exhaustion. To address these policy concerns, the Court may further opine on the need for express Congressional approval of any extraterritorial application of U.S. law. Such a discussion in a copyright case would provide guidance on the application of exhaustion in patent and trademark cases.

Conclusion

If the Supreme Court affirms the Ninth Circuit's decision in *Costco* that a foreign sale does not exhaust domestic copyright rights, the holding would signal that the Court is reluctant to extend U.S. law absent express language from Congress. Such a holding may also affect exhaustion in patent and trademark law, which are judge-made doctrines rather than statutory as in copyright law. Courts would likely limit the extraterritorial application of U.S. exhaustion law. Accordingly, United States IP rights would increase if foreign sales did not trigger exhaustion. In either case, corporate counsel for companies whose products are sold abroad should watch the *Costco v. Omega* case carefully.

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