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High court's 'first-sale' ruling threatens market segmentation

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Content Matters

This is a monthly column devoted to matters of interest to those who create content of all kinds (entertainment, news, software, advertising, etc.) and bring that content to market. Our hope is to shed light on key issues facing the creative content community. If you have questions, comments or topic ideas, let us know at ContentMatters@jenner.com. Because content matters.

Can a copyrighted work lawfully made and acquired overseas be imported into the U.S. without the copyright owner's consent? Yes, said the Supreme Court by a 6-to-3 vote in its highly anticipated March 19 decision in *Kirtsaeng v. John Wiley & Sons*, No. 11-697.

The court's ruling effectively eliminates copyright law as a tool to police parallel imports, or "gray-market" goods, and requires copyright owners to rethink current strategies for market segmentation — the practice of charging higher prices in the U.S. to recoup fixed investments while charging lower prices in foreign territories.

Kirtsaeng required the court to resolve an apparent conflict between two sections of the Copyright Act — specifically, how the first-sale doctrine, codified in Section 109(a), limits the importation ban of Section 602(a)(1). Part of U.S. copyright law for over a century, the first-sale doctrine provides generally that the owner of a lawfully made copy of a copyrighted work is free to re-sell that copy without restriction by the copyright holder. The importation ban, enacted in 1976, provides that importation, without approval of the copyright owner, of copyrighted works acquired abroad violates the act's exclusive distribution right.

The court's decision turned on the interpretation of five words: "lawfully made under this title." Section 109(a) protects "the owner of a particular copy ... *lawfully made under this title*." The court concluded that the language, context and history of these five words do not support a "geographical interpretation."

The case involved a graduate student, Supap Kirtsaeng, who imported and resold in the U.S. foreign-made editions of English-language textbooks that Wiley intended for exclusive sale abroad. Wiley sued Kirtsaeng in the Southern District of New York for violating the importation ban of Section 602(a)(1). The court held the first-sale doctrine did not apply to goods manufactured abroad, and a jury found Kirtsaeng liable for willful infringement. The 2nd U.S. Circuit Court of Appeals affirmed, concluding that the words "lawfully made under this title" indicated that the first-sale doctrine applies only to copies "made in territories in which the Copyright Act is law," i.e., those made domestically, not overseas.

The 2nd Circuit relied in part on the Supreme Court's 1998 decision in *Quality King Distributors v. L'anza Research*, 523 U.S. 135 (1998), which held that Section 602(a)(1)'s reference to Section 106's exclusive distribution right incorporates the first-sale doctrine and other limitations in the act. In that case, the court stated in dicta that if an author gave exclusive American distribution rights to an American publisher and exclusive British distribution rights to a British publisher, "presumably only those [copies] made by the publisher of the United States edition would be 'lawfully made under this title' within the meaning of [Section]109(a)," and "the first sale doctrine would not provide the publisher of the British edition who decided to sell in the American market with a defense" to a suit under Section 602(a) for illegal importation.

Other circuits also have considered the application of the first-sale doctrine to Section 602(a)(1) infringement claims. The 9th Circuit, for example, held in *Omega S.A. v. Costco Wholesale Corp.*, 541 F.3d 982 (2008), that the first-sale doctrine applies to copies lawfully made abroad but only if an authorized first sale occurs in the U.S., a decision that was affirmed without opinion by an equally divided Supreme Court in 2010.

As demonstrated by the wide range of amici that submitted briefs to the Supreme Court — from the U.S., the American Bar Association, and various copyright holders on behalf of Wiley to libraries, museum directors, and technology companies on behalf of Kirtsaeng — the decision has far-reaching implications for the global marketplace. It affects not only the sale and resale of traditional copyrighted works like books, CDs and DVDs, but also any product that incorporates a copyrighted element as an ornamental design or in images used on packaging.

In an opinion by Justice Stephen Breyer, the court found it "unlikely" that Congress would have intended the consequences of interpreting the phrase "lawfully made under this title" as a geographical restriction. Citing Kirtsaeng's amici, the court voiced concern that a geographical interpretation would force American libraries to determine where millions of books were printed and obtain authorization to circulate those made overseas, would prevent the resale of a foreign-made car containing copyrighted software, and would prevent anyone who bought a painting abroad from publicly displaying it without the copyright holder's permission.

The court also disavowed the *Quality King* dicta quoted above that pointed the opposite way, asking rhetorically if the court "having once written dicta calling a tomato a vegetable [is] bound to deny that it is a fruit forever after."

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The impact of the court's approach is to read the Section 602(a)(1) import ban out of the act almost entirely, since the only conduct still reached by that subsection is the unauthorized importation of nonpiratical copies *by a nonowner* of the copy (i.e., by a lessee or bailee) — applications that Justice Elena Kagan described in her concurrence as "fairly esoteric."

Justice Ruth Bader Ginsburg's dissent, which was joined by Justice Anthony Kennedy and Justice Antonin Scalia in part, focused instead on Congress's intent in enacting Section 602(a)(1) and criticized the majority for reducing that provision "to insignificance." She characterized the "parade of horribles" used to justify the court's decision as "largely imaginary" — noting that the undesirable consequences hypothesized by the majority could be largely avoided through application of fair use and implied license principles.

Justice Ginsburg argued that the phrase "lawfully made under this title" is "most sensibly read as referring to instances in which a copy's creation is governed by, and conducted in compliance with, Title 17 of the U.S. Code" — a statute that generally does not apply extraterritorially — and that this position is consistent with the legislative history of the act and the stance the U.S. has taken in trade negotiations.

In a concurrence, Justice Kagan noted that Congress may want to address the broader question whether — as the court held previously in *Quality King* — the first-sale doctrine limits the scope of the Copyright Act's importation ban at all. Accordingly, she suggested that if Congress wants to permit market segmentation, it should draft legislation that supersedes *Quality King*, not just *Kirtsaeng*.

Does the *Kirtsaeng* decision spell the end of market segmentation as we know it? The court acknowledged that its decision "will make it difficult, perhaps impossible, for publishers (and other copyright holders) to divide foreign and domestic markets." To protect their profit margins in the U.S., publishers may be forced to raise prices in less affluent countries or withdraw from those markets entirely.

Copyright owners may well choose to lobby Congress to reverse *Kirtsaeng* — or *Quality King*, as Justice Kagan suggests. One possibility is to amend the statute to resurrect the 9th Circuit's effort — articulated in *Omega v. Costco* and *Denbicare v. Toys "R" Us*, 84 F.3d 1143 (1996), but disapproved in *Kirtsaeng* — to harmonize Sections 109 and 602 by holding that the first-sale doctrine applies to works manufactured abroad, but only if they have been imported by or with the authority of the copyright owner. Another approach, suggested by Justice Kagan in a footnote, would revise the act to permit copyright owners to sue unauthorized *importers* as infringers, but provide first-sale doctrine immunity to subsequent U.S. purchasers of foreign-made copyrighted goods.

Content providers may also seek to limit the impact of *Kirtsaeng* through nonlegislative means. For example, publishers like Wiley may create market-specific versions of books that cannot effectively substitute for the American version. Similarly, they can release newer versions of works in the American market before releasing them in foreign markets.

The growing practice of distributing content digitally also may permit copyright holders to limit resale in various ways. For example, digital content is frequently licensed, rather than sold, with restrictions on future transfer. In *Vernor v. Autodesk*, 621 F.3d 1102 (2010), the 9th Circuit held that the first-sale doctrine did not apply where copyrighted software was licensed with restrictions on transfer.

The application of the first-sale doctrine to digital copies is likely also to be limited by the physics of digital distribution itself, since sending copies over the Internet typically results in the creation of new copies — an act that implicates the Section 106 reproduction right if the copying is not authorized.

In a timely illustration of this point, a New York federal district court held last week in *Capitol Records v. ReDigi Inc.,* No. 12Civ. 95 (RJS) (S.D.N.Y. March 30, 2013), that the first-sale doctrine did not allow consumers to "re-sell" digital copies of songs purchased on iTunes because the transfer of a digital file "necessarily" involves the creation of a new file on a new hard drive (even if the original file is deleted in the process) and therefore violates the reproduction right.

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