

Practical significance

In light of *Lenz*, copyright holders should consider fair use before sending a DMCA takedown notice. Copyright holders should reconsider policies or procedures that call for the issuance of takedown notices merely because unauthorized copyrighted material is found on a website. In other words, automatic takedown notice policies that do not allow for fair use consideration present some risk of liability under section 512(f)—at least in light of *Lenz*.

Lenz does not, however, imply that copyright owners must reach the correct decision about whether use of material constitutes fair use, or even that they must *carefully* consider the fair use issue. In fact, the *Lenz* court noted that ‘there are likely to be few [instances] in which a copyright owner’s determination that a particular use is not fair use will meet the requisite subjective bad faith required to prevail in an action for misrepresentation under 17 USC §512(f)’. Thus, copyright holders should make a determination that use of material is not fair use, but such a determination does not necessarily have to be correct.

So what is fair use? Fair use is a judicially created defence to copyright infringement based on public policy considerations that diminish the rationale for imposing the copyright monopoly. It is often invoked to protect certain uses of copyright material including criticism, comment, news reporting, teaching, scholarship, and research. But these uses are not necessarily a fair use of copyright material, nor are they the only uses that can constitute fair use. Instead, fair use is determined on a case-by-case basis after balancing several court-developed factors which are now codified in section 107 of the Copyright Act:

1. the purpose and character of the use, including whether such use is of a commercial nature or is for non-profit educational purposes;
2. the nature of the copyright work;
3. the amount and substantiality of the portion used in relation to the copyright work as a whole; and
4. the effect of the use upon the potential market for or value of the copyright work.

Although no single factor is determinative, the first is often particularly important. The US Supreme Court has noted that the non-commercial nature of a use and its private character are highly persuasive that the use is fair. Thus, the more commercial a use is, the less likely it will be considered fair. The second factor examines whether the copyright material’s nature indicates an implied consent to certain types of uses of that material. For example, a book of quotations is obviously made with the understanding that others will likely incorporate portions of the book, the quotations, for use in other works. Therefore, an understood or foreseeable use weighs in

favour of fair use. The third factor examines how much copyright material was taken and its proportion to the complete copyright work. The greater the proportion taken, the more likely that the use will not be considered fair. Finally, the US Supreme Court has stated that the fourth factor—the economic effect of the use—is the most important element of fair use. The greater the likely economic effect on the potential market or value of the copyright work, the less likely a use will be considered fair.

The fair use doctrine is an amorphous doctrine without bright lines, which is why a copyright holder need not necessarily make a correct determination as to whether a use of copyrighted material is a fair use. If a copyright owner can present evidence merely showing that it considered these factors and concluded that the use was not fair, this would appear to be enough, even for the *Lenz* court, to constitute ‘a good faith belief that use of the material in the manner complained of is not authorized by . . . law’.

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■ No first sale protection for reseller of unauthorized imports

Omega S. A. v Costco Wholesale Corp., Case No. 07-55368 (9th Cir., 3 September 2008)

The US Court of Appeals for the Ninth Circuit has ruled that a reseller, Costco, which sold genuine Swiss-made Omega watches that were imported into the USA without Omega’s permission, was not protected by the ‘first sale doctrine’ against Omega’s copyright infringement claim. The case turned on whether the protection of the first sale doctrine can apply to genuine copies that were not made in the USA and were not previously sold in the USA with permission of the copyright owner.

Legal context

Section 106(3) of the US Copyright Act grants copyright owners the exclusive right to distribute copies of their copyright works to the public by sale or other transfer of ownership, or by rental, lease, or lending. Section 602(a) of the Act further provides that it is an infringement of the copyright owner’s exclusive distribution right to import copies of a copyright work that have been

acquired outside the USA into the USA without the permission of the copyright owner.

An important limitation on a copyright owner's exclusive distribution right is the so-called 'first sale doctrine', which is codified in section 109(a) of the Act. That doctrine allows the owner of a copy 'lawfully made under this title' to sell or otherwise dispose of the possession of that copy without the authority of the copyright owner. There is an obvious tension when applying the first sale doctrine to 'grey market' goods. These are non-pirated (ie, genuine) goods imported from another country without permission of the copyright owner. 'Grey market' trade becomes attractive when copyright owners make their products available in different countries at different prices. Copyright owners want to restrict resale of 'grey market' goods, which tends to undercut sales of their authorized counterparts. 'Grey market' goods can also undermine a product's uniform image in the domestic market, especially if the foreign imported version differs from the domestic version in quality, features, warranty and support, etc.

In the landmark case of *Quality King Distributors, Inc. v Lanza Research International, Inc.*, 523 US 135 (1998), the US Supreme Court confirmed that the first sale doctrine can apply in cases involving unauthorized importation of copies lawfully made in the USA and first sold abroad. This case addresses the aftermath of *Quality King* and its impact on the Ninth Circuit's pre-existing case law.

Facts

Omega makes its watches in Switzerland and sells them globally through authorized distributors. The Omega watch design is the subject of a US copyright registration. The Omega watches at issue were sold by Omega to its authorized distributors overseas. Unidentified third parties eventually purchased the watches and sold them to ENE Ltd, a New York company which in turn sold the watches to Costco. Costco then resold the watches in California. Although Omega authorized the initial foreign sale of the watches, it did not authorize their importation into the USA or their resale by Costco.

Omega sued Costco for copyright infringement under sections 106(3) and 602(a) of the Act. The district court, citing *Quality King* as authority, granted summary judgment to Costco, denying Omega's infringement claim under the first sale doctrine. Omega appealed.

Analysis

The Ninth Circuit began its analysis by discussing the effect of the first sale doctrine on claims of infringing importation under section 602(a) of the Act. As explained by the Supreme Court in *Quality King*, infringing importation under section 602(a) is a subcategory of infringement

of the exclusive distribution right under section 106(3) of the Act. Because conduct covered by the first sale doctrine does not violate section 106(3), it also cannot be infringement under section 602(a). In short, the first sale doctrine is a defence to claims of infringement under both section 106(3) and section 602(a) of the Act.

Before *Quality King*, the Ninth Circuit had already established that the first sale doctrine can apply to foreign-made copies first sold abroad so long as there was an authorized prior sale of such copies in the USA. In *BMG Music v Perez*, 952 F.2d 318 (9th Cir. 1991), denying first sale protection for unauthorized importation of copyrighted goods made and sold abroad, the Ninth Circuit interpreted 'lawfully made under this title' to mean only copies legally made and sold in the USA. In a subsequent case, *Parfums Givenchy, Inc. v Drug Emporium, Inc.*, 38 F.3d 477 (9th Cir. 1994), the Ninth Circuit created an exception to *BMG Music* by holding that the first sale doctrine can apply to copies not made in the USA, so long as there was an authorized prior sale in the USA. This exception was later applied in *Denbicare USA, Inc. v Toys 'R' Us, Inc.*, 84 F.3d 1143 (9th Cir. 1996), which upheld first sale protection for unauthorized resale of copyright goods that were made in Hong Kong and voluntarily sold in the USA by the copyright owner.

Given that the Omega watches at issue were not made in the USA and were not the subject of a prior authorized sale in the USA, under pre-*Quality King* Ninth Circuit precedent, the first sale doctrine would provide no defence for Costco. However, Costco argued that *BMG Music*, *Drug Emporium*, and *Denbicare* were effectively overruled by *Quality King*. The Ninth Circuit disagreed, noting that:

- *Quality King* did not directly overrule *BMG Music*, *Drug Emporium*, and *Denbicare* because, unlike those cases, *Quality King* only involved copies made in the USA and did not address the effect of the first sale doctrine as it relates to claims involving foreign-made copies.
- There is a general presumption that the Act does not apply to conduct that occurs abroad even when the conduct produces harmful effect within the USA. In *BMG Music*, the Ninth Circuit limited the first sale doctrine to copies legally made in the USA, and its reason for doing so was the concern that applying the doctrine to foreign-made copies would violate the presumption against extraterritorial application of the Act. In *Quality King*, the first sale doctrine was applied based on foreign sales of domestically manufactured copies, but the Supreme Court clarified that merely recognizing the occurrence of foreign sales does not require the extraterritorial application of the Act any

more than would application of section 602(a) of the Act to copies acquired abroad. In contrast, granting the first sale defence to foreign-made copies would involve extraterritorial application, since it would give legality under the Act to manufacturing activities that occur entirely outside the USA.

- The phrase 'lawfully made under this title' means more than the making of the copies by the owner of a US copyright. In *Quality King*, the Supreme Court specifically recognized that section 602(a) of the Act covers 'copies that were "lawfully made" not under the US Copyright Act, but instead, under the law of some other country'. In other words, copies made by the copyright owner are not necessarily 'lawfully made under this title' since they can be lawfully made under the laws of a foreign country. The Ninth Circuit reasoned that 'lawfully made under this title' requires something more than just being lawfully made by the copyright owner— '[To] us, that "something" is the making of the copies *within the United States*'. As further support, the Ninth Circuit noted that in *Quality King*, the concurrence opinion by one of the justices cited a copyright treatise for the proposition that 'lawfully made under this title' means 'lawfully made in the United States', and the majority opinion did not dispute that interpretation.
- Although *BMG Music* has been criticized as providing substantially greater copyright protection to foreign-made copies (with the likely effect of driving US copyright owners to outsource the manufacturing of copies of their works overseas), *Drug Emporium* and *Denbicare*

resolved this problem by clarifying that the first sale doctrine can apply to foreign-made copies so long as a lawful (authorized) domestic sale of such copies has occurred.

Practical significance

Assuming that the Ninth Circuit's position is followed by other courts, *Omega v Costco* provides a useful roadmap for copyright owners and their legal counsel when assessing potential claims against importers and resellers of 'grey market' goods. If the genuine copies were either made in the USA or (when made in a foreign country) previously sold in the USA with permission of the copyright owner, the importer and the reseller would likely be in a position to assert the first sale defence against a claim that their importation and resale violate the copyright owner's exclusive distribution right under the Act. Such defence would probably be unavailable, however, if the genuine copies were neither made in the USA nor previously sold in the USA with permission of the copyright owner. On a related note, if copies are intended for foreign sale only, in order not to trigger the first sale doctrine copyright owners may want to have such copies made outside the USA.

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