First Sale Doctrine Changed: What It Means for Your Fashion Company

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In March 2013, the Supreme Court resolved a long-disputed conflict by issuing its opinion in *Kirtsaeng v. John Wiley & Sons, Inc.*, where it held the copyright first sale doctrine applies to copies of works manufactured outside the United States.

Under this ruling, the customer of a fashion company can import or sell lawful, foreign-made copies of copyrighted works or products that contain copyrighted works in the U.S. without having to obtain separate permission from the fashion company.

Doctrine

The long disputed conflict stemmed from discrepancies between the first sale doctrine and the importation restriction.

U.S. copyright law grants a copyright owner the exclusive right "to distribute copies of copyrighted works." This exclusive right is limited by the first sale doctrine, which states an owner of a lawfully made copy is entitled to sell or otherwise dispose of the possession of that copy without the authority or permission of the copyright owner.

The importation restriction, however, states importation of a copyrighted work acquired outside the U.S. infringes the copyright owner's exclusive right to distribute copies. The importation restriction seemingly contradicted the first sale doctrine by prohibiting the importation of a copy of a copyrighted work acquired outside the U.S.

Prior Supreme Court Rulings

The Supreme Court initially addressed this tension in *Quality King Distributors v. L'anza Research International*. In *Quality King*, a beauty products manufacturer made products in the U.S. and sold the products to distributors abroad for resale. The defendant purchased the items outside of the U.S. and imported the products back into the U.S. for sale. The plaintiff sued for copyright infringement, and the defendant asserted a defense based on the first sale doctrine. The Supreme Court held the first sale doctrine applies when the imported goods were originally made in the U.S. However, the Supreme Court did not address the issue of whether the first sale doctrine applies when a product is manufactured abroad.

The tension came up again in *Costco Wholesale Corp. v. Omega*. Omega, a foreign watch manufacturer, sued Costco for importing watches made outside of the U.S. The Supreme Court heard

the case, but deadlocked after one of the justices recused. Technically, the Supreme Court affirmed the lower court's decision, which held that the first sale doctrine did not apply to goods that were made and sold abroad.

Kirtsaeng

In *Kirtsaeng*, the Supreme Court finally addressed the issue of whether the first sale doctrine applies to goods manufactured and sold abroad. Wiley, a book publisher, printed foreign editions of its textbooks abroad, and the books contained language making clear the foreign copies were to be sold only in specific geographic regions outside of the U.S.

Kirtsaeng, a citizen of Thailand studying in the U.S., asked his friends and family in Thailand to buy copies of foreign edition English language textbooks, which he resold in the U.S. for a profit. Wiley sued Kirtsaeng for importing and reselling the publisher's foreign-made books.

In its opinion, the Supreme Court focused on whether the language "lawfully made under this title" in the statute restricted the scope of the first sale doctrine geographically. Wiley asserted, and the lower courts agreed, that the first sale doctrine had a geographical limitation, meaning that textbooks manufactured outside the U.S. were not made under the U.S. Copyright Act and were thus not subject to the first sale doctrine.

The Supreme Court disagreed, finding no geographical limitation. After reviewing the plain language of the statute, past versions of the same provision and the common law roots of the doctrine, the court found no support to restrict the first sale doctrine geographically.

Justice Breyer also highlighted that giving owners of works manufactured abroad the right to control the resale of works domestically would lead to "intolerable consequences" for the established practices of retailers in the U.S. If the first sale doctrine had a geographical limitation, there could be a threat of copyright infringement, for example, for the resale of foreign-made cars containing copyrighted automobile software. The court held these practical problems posed serious and extensive consequences.

Fashion Implications

In the fashion world, this case has the biggest implication on the control of grey market goods. Grey market goods are products manufactured overseas, sold legally by the manufacturer or distributor but outside of their authorized channel, and then imported into the U.S. for resale. Because of *Kirtsaeng*, the first sale doctrine makes it legal for grey market goods to be imported into the U.S. for resale.

This is problematic for the manufacturer or distributor of fashion goods who manufacture overseas, because it drastically limits the control a manufacturer or distributor would have over the sale of its goods in the U.S.

Further, the change in the first sale doctrine causes tension with the well-established fashion industry practice of granting exclusive distribution rights. This tension has already found its way to court in the second circuit in the recently filed case, *Michael Kors v. Costco* (Case 13 CV-4832). In addition to alleging bait and switch claims against Costco, Kors alleges that it has authorized dealers in the U.S., and Costco is not one of them. This means that either the Kors handbags sold at Costco were grey market goods, similar to the Omega watches, or Costco never had any Kors handbags for sale. Depending on what Kors learns in discovery, it might be able to add an interference claim against Costco.

Until more information comes to light, we are still left with the open question: would a company that imported grey market goods be liable for

inference with contractual relations if the manufacture of those grey market goods granted a different company the exclusive right to sell goods in that territory? We think the answer will depend on the extent of knowledge the importing company has about the manufacturer's business practices and policies.

Conclusion

In sum, fashion companies that make and sell goods outside the U.S. will have to reevaluate their pricing and marketing strategies in response to what will be an influx of importers and resellers. We also advise companies to evaluate contract terms with overseas suppliers, vendors and distributors because that is the best way fashion companies can protect their geographic markets, at least for now.

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