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## Copyright Law - Gray Marketing - The First Sale Doctrine of Copyright Law Closes Another Avenue of Redress

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1989]

COPYRIGHT LAW—GRAY MARKETING—THE FIRST SALE  
DOCTRINE OF COPYRIGHT LAW CLOSES ANOTHER  
AVENUE OF REDRESS\*

*Sebastian International, Inc. v. Consumer Contacts (PTY) Ltd.* (1988)

“Gray marketing” (or “parallel importation”) occurs when a company, other than the manufacturer’s authorized distributor, purchases that manufacturer’s products outside the United States and imports them into this country. The importer then directly competes with the authorized distributor.<sup>1</sup> Generally, because the manufacturers set lower selling prices for their export goods, independent, unauthorized distributors are able to sell the goods in the United States at rates substantially below the authorized distributor’s prices.<sup>2</sup> Products sold on the gray market include those manufactured abroad under authorized licensing agreements and then purchased and imported by unauthorized distributors. They also include those manufactured domestically, exported overseas and then purchased and reimported into the United States by unauthorized distributors.<sup>3</sup> Gray marketing poses a serious problem to both domestic manufacturers and authorized distributors.<sup>4</sup>

Copyright laws provide one possible source of relief against gray marketing of copyrighted goods. The general purpose of copyright law is to give the public maximum access to an author’s work while, at the same time, granting the author a limited monopoly in order to en-

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1. Gorelick & Little, *The Case for Parallel Importation*, 11 N.C.J. INT’L L. & COM. REG. 205, 206 (1986). It should be noted that there is nothing inherently illegal about this practice, although the term “gray market” might suggest otherwise. The goods purchased are authentic and are purchased for whatever price the manufacturer is asking in the foreign market. *Id.* at 207.

2. See Donohue, *The Use of Copyright Laws to Prevent the Importation of “Genuine Goods,”* 11 N.C.J. INT’L L. & COM. REG. 183, 183-84 (1986). Aside from the currency considerations, products offered for sale to markets outside the country are generally sold at much lower prices than the same goods for sale in the domestic market. *Id.* Thus, almost any product which has bypassed the domestic distribution chain will be available at lower pricing regardless of the value of the dollar to the foreign currency.

3. See Brief for The Coalition for Competitive Imports as Amicus Curiae at 2, *Sebastian Int’l, Inc. v. Consumer Contacts (PTY) Ltd.*, 847 F.2d 1093 (3d Cir. 1988) (No. 87-5439).

4. It has been estimated that “[t]he retailers of parallel imports are responsible for total consumer sales of \$100 billion a year.” *Id.* at 4. See also Kersner & Stein, *Judicial Construction of Section 526 and the Importation of Grey Market Goods: From Total Exclusion to Unimpeded Entry*, 11 N.C.J. INT’L L. & COM. REG. 251, 251 (1986) (noting dramatic increase in number of imports of gray market goods).

(597)

courage and reward creative work.<sup>5</sup> Three sections of the Copyright Act<sup>6</sup> combine to provide potential relief from gray marketing. Section 106 of the Act grants exclusive rights to the owner of the copyright, including the right to distribute copies of the copyrighted work.<sup>7</sup> However, this distribution right is limited by section 109 of the Act, which restricts the right to control the copyrighted work once an authorized transfer of that copy has occurred.<sup>8</sup> This restriction, known as the "first sale doctrine," limits the conferred distribution right once the original owner has consented to the sale of a particular copy.<sup>9</sup> Finally, section 602 of the Act protects an original copyright holder against unauthorized importation of copies.<sup>10</sup> Thus, a copyright holder is limited in his exclusive distribution rights by making a first sale and is protected against unauthorized importation of copies.

In the gray marketing situation, two of these three provisions conflict and must be reconciled.<sup>11</sup> Section 109(a) limits the exclusive distri-

5. *Sony Corp. of Am. v. Universal City Studios*, 464 U.S. 417, 429 (1984) (referring to important public purpose achieved by limited grant of monopoly privileges); see also *Mazer v. Stein*, 347 U.S. 201, 219 (1954) (noting that "encouragement of individual effort by personal gain is the best way to advance public welfare").

6. Copyright Act of 1976, 17 U.S.C. §§ 101-810 (1982 & Supp. V 1987) (repealing Copyright Act of 1909, ch. 320, § 41, 35 Stat. 1075).

7. *Id.* § 106. Section 106 provides in pertinent part: "Subject to sections 107 through 118, the owner of copyright . . . has the exclusive rights . . . (1) to reproduce the copyrighted work in copies or phonorecords; . . . [and] (3) to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership . . ." *Id.*

8. *Id.* § 109(a). Section 109(a) provides in pertinent part: "Notwithstanding the provisions of section 106(3), the owner of a particular copy . . . lawfully made under this title . . . is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy . . ." *Id.* The legislative intent in enacting this section was to limit the monopoly given to the author through his exclusive right to distribute as granted in § 106. H.R. REP. NO. 1476, 94th Cong., 2d Sess. 79, reprinted in 1976 U.S. CODE CONG. & ADMIN. NEWS 5659, 5693-95. It foreclosed the continuing control over disposition of copies once ownership has been transferred. *Id.*

9. See 2 M. NIMMER, NIMMER ON COPYRIGHT § 8.12[B][1], at 8-120.10 (1988) ("It is clear that once the copyright owner consents to the sale of particular copies . . . of his work, he may not thereafter exercise the distribution right with respect to such copies . . .").

10. 17 U.S.C. § 602(a). Section 602(a) provides in pertinent part: "Importation into the United States, without the authority of the owner of copyright under this title, of copies . . . of a work that have been acquired outside the United States is an infringement of the exclusive right to distribute copies . . . under section 106 . . ." *Id.* There was no counterpart to § 602(a) prior to the Copyright Act of 1976, so the legislative history of this provision is sparse. For a complete discussion of the background surrounding this legislation, see Tyson & Parker, *Parallel Importation of Copyrighted Phonorecords*, 10 N.C.J. INT'L L. & COM. REG. 397, 402-06 (1985).

11. See Tyson & Parker, *supra* note 10, at 398 ("[T]he application of section 109(a) produces a result diametrically opposite from that mandated by the literal terms of section 602(a).").

bution rights granted under section 106, and section 602(a) extends these rights. The ambiguous language of section 602(a) gives rise to this conflict by stating that the unauthorized importer infringes upon "the exclusive right to distribute copies . . . under section 106 . . ." <sup>12</sup> This may be read as incorporating section 602(a) into section 106, thus creating an *additional* exclusive right—the right to control imports.<sup>13</sup> Under this interpretation, the first sale doctrine does not apply when goods are acquired outside the United States, and thus the importation prohibition is not restricted. Alternatively, section 602(a) may be read as limiting the right to control imports to those situations where an independent section 106 right *already* exists and has not been extinguished by a first sale.<sup>14</sup> Under this interpretation, the first sale doctrine applies to all copyrights, and thus upon the first sale, the importation prohibition is extinguished along with the other exclusive rights. In *Sebastian International, Inc. v. Consumer Contacts (PTY) Ltd.*,<sup>15</sup> the United States Court of Appeals for the Third Circuit was presented with the opportunity to reconcile these provisions of the Copyright Act against the backdrop of gray market importation.

Sebastian International (Sebastian), a California corporation, entered into an oral contract with Consumer Contacts (d/b/a 3-D Marketing Services) (3-D), a South African company, to have 3-D distribute Sebastian's hair care products only to beauty salons in South Africa.<sup>16</sup> Pursuant to this agreement, Sebastian shipped four containers of its hair care products to 3-D in South Africa in January, 1987.<sup>17</sup> 3-D did not open these containers, but sold them to defendant Fabric Ltd. (Fabric), who reshipped them to the United States.<sup>18</sup> Sebastian then sought a restraining order based on breach of contract to stop Fabric and several other distributors from distributing the products in the United States.<sup>19</sup> The district court granted the temporary restraining order and scheduled a hearing.<sup>20</sup> The plaintiff subsequently amended its complaint to allege a copyright violation against Fabric under section 602 of the Copyright Act.<sup>21</sup> After it became apparent that the plaintiff could not show that defendant Fabric had the requisite knowledge of the contractual limitations placed upon 3-D, the breach of contract claim was dismissed against Fabric.<sup>22</sup> The district court then lifted the restraining

12. 17 U.S.C. § 602(a).

13. Tyson & Parker, *supra* note 10, at 403.

14. *Id.*

15. 847 F.2d 1093 (3d Cir. 1988).

16. *Id.* at 1094.

17. *Id.*

18. *Id.*

19. *Id.* at 1094-95.

20. *Id.* at 1095.

21. *Id.*

22. *Sebastian Int'l, Inc. v. Consumer Contacts (PTY) Ltd.*, 664 F. Supp. 909, 911 (D.N.J. 1987), *rev'd*, 847 F.2d 1093 (3d Cir. 1988). The knowledge

order, but simultaneously imposed a preliminary injunction based on the copyright infringement claim, finding that two labels of the products in question had been properly registered and, therefore, fell within the copyright protections.<sup>23</sup>

In imposing the injunction on the defendants, the district court held that the importation provision of section 602(a) was not restricted by the first sale doctrine, adopting the interpretation that section 602(a) created a distribution right in addition to those granted by section 106.<sup>24</sup> The defendants then appealed to the Third Circuit claiming that the district court had incorrectly interpreted section 602(a) and that the first sale doctrine precluded any copyright infringement claim.<sup>25</sup>

The United States Court of Appeals for the Third Circuit, with Judge Weis writing for a unanimous panel,<sup>26</sup> vacated the district court's order granting a preliminary injunction.<sup>27</sup> The Third Circuit held that once a copyright holder transfers ownership of any copies, the first sale doctrine extinguishes any distribution rights, including importation rights, over those copies.<sup>28</sup>

The Third Circuit began its analysis by looking at the purposes of the copyright laws.<sup>29</sup> The court noted the monopoly privileges of the Copyright Act "promote an important public purpose by encouraging

requirement of a contract claim against gray marketers was defined by the Third Circuit in *Johnson & Johnson Prod. v. DAL Int'l Trading Co.*, 798 F.2d 100 (3d Cir. 1986). Under a contract theory, the plaintiff must establish that the holder of the gray market goods had actual knowledge of the contractual limitations imposed on the original buyer. *Id.* at 106.

23. *Sebastian*, 664 F. Supp. at 912-13. The exact text on the label read: Hair stays wet-looking as long as you like. Brushes out to full-bodied dry look. WET 4 as one step-four choice (finishing) in Sebastian's four step program for a healthy scalp and head of hair. WET is not oily, won't flake and keeps hair wet-looking for hours, allowing you to sculpture, contour, wave or curl. It stays looking wet until it's brushed out. When brushed, hair looks and feels thicker, extra full. Try brushing partly, leaving some parts wet for a different look.

*Id.* at 913. The district court addressed the question of whether this text was copyrightable and stated: "While this text tries the limits of the modicum of creativity necessary for a work to be copyrightable, . . . as a whole it comes within the purview of the Copyright Act." *Id.*

24. *Id.* at 920.

25. *Sebastian*, 847 F.2d at 1095. The defendant also claimed that the plaintiff had not shown irreparable harm in its request for the restraining order. *Id.* The Third Circuit did not discuss this issue.

26. *Id.* at 1094. Judge Weis was joined in his opinion by Chief Judge Gibbons and Judge Greenberg.

27. *Id.* at 1099. The court remanded the case for disposition of the remaining issues. *Id.*

28. *Id.* The court stated: "We differ . . . with the district court's finding of infringement because, in our view, a first sale by the copyright owner extinguishes any right later to control importation of those copies." *Id.*

29. *Id.* at 1095. The court noted that the Copyright Act is based on the United States Constitution, article I, § 8, which authorizes Congress to grant authors and inventors monopoly privileges for limited time periods. *Id.*

the creative activity of authors and by allowing public access to 'the products of their genius after the limited period of exclusive control has expired.'"<sup>30</sup> The court noted, however, that the copyright laws have attempted to achieve a proper balance between the interest in the free flow of creative products and the authors' interests in controlling the exploitation of their writings.<sup>31</sup> Section 109(a), the first sale doctrine, lies on one side of the balancing scale and section 602(a), the importation prohibition, lies on the other.

In analyzing the purposes of section 109(a), the court looked to the report of the Senate Judiciary Committee.<sup>32</sup> The report, describing the scope of section 109(a), stated that once the transfer of a copy occurs, the owner's exclusive right of distribution no longer runs to that copy.<sup>33</sup> The court then briefly discussed two considerations underlying the first sale doctrine.<sup>34</sup> First, the court identified section 109(a) as a codification of the common law principles against restraints on alienation of personal property.<sup>35</sup> Second, the court noted the financial considerations behind the doctrine, reasoning that once a transfer or sale has occurred, the original copyright owner has received his reward for the use of the copyrighted article.<sup>36</sup>

The Third Circuit next discussed the purposes and intent behind section 602(a), the importation clause, noting that it was intended to

30. *Id.* (quoting *Sony Corp. of Am. v. Universal City Studios*, 464 U.S. 417, 429 (1984)).

31. *Id.*

32. *Id.* at 1096 (citing S. REP. NO. 983, 93d Cong., 2d Sess. 131 (1974), reprinted in 13 OMNIBUS COPYRIGHT REVISION LEGISLATIVE HISTORY (1977)). See also *supra* note 8 and accompanying text. Prior to its examination of this report, the court traced the lineage of the first sale doctrine back to *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339 (1908). *Sebastian*, 847 F.2d at 1096. In *Bobbs-Merrill*, the Supreme Court established that a copyright holder's right of exclusive sale did not enable the holder to restrict future resales of the item. *Id.* (citing *Bobbs-Merrill*, 210 U.S. at 350).

33. *Sebastian*, 847 F.2d at 1096 (citing S. REP. NO. 983, 93d Cong., 2d Sess. 131 (1974), reprinted in 13 OMNIBUS COPYRIGHT REVISION LEGISLATIVE HISTORY (1977)).

34. *Id.*

35. *Id.* See also 2 M. NIMMER, *supra* note 9, § 8.12, at 8-120.9 ("[T]he policy favoring a copyright monopoly for authors gives way to the policy opposing restraints of trade and restraints on alienation.").

36. *Sebastian*, 847 F.2d at 1096-97 (citing *Burke & Van Heusen, Inc. v. Arrow Drug, Inc.*, 233 F. Supp. 881, 884 (E.D. Pa. 1964)); see also *Cosmair, Inc. v. Dynamite Enter.*, 226 U.S.P.Q. (BNA) 344 (S.D. Fla. 1985). The *Cosmair* court, denying plaintiffs' motion for a preliminary injunction, noted that the plaintiffs had not established that they would suffer irreparable harm by such denial, stating: "The Plaintiffs have already received their profits on the products from the sale to the original purchase [sic]." *Id.* at 348. Accord *Tyson & Parker*, *supra* note 10, at 401 ("Once the copyright owner reaps a profit from the disposition of copies of a work, the distribution privilege lapses as to those copies."). Although the *Sebastian* court noted that financial reward is generally considered of secondary importance in copyright law, it is a factor that must be considered in analyzing the first sale doctrine. *Sebastian*, 847 F.2d at 1095.

cover two paradigmatic situations.<sup>37</sup> These situations are: 1) the importation of piratical copies (those made without the authority of the copy-right owner); and 2) the importation of lawfully made copies without authorization.<sup>38</sup>

The court then addressed the two possible interpretations of section 602(a).<sup>39</sup> As discussed above, one interpretation is that section 602(a) grants an additional right to copyright owners, the right of importation control, which is not subject to the limitations of the first sale doctrine.<sup>40</sup> The second interpretation is that section 602(a) is not a separate and distinct right, "but serves only as a specific example of those rights subject still to the first sale limitation."<sup>41</sup> Under this view, the importation right falls under the distribution rights granted by section 106(3) and is subject to the limitations of section 109(a).<sup>42</sup> The court noted that the legislative record gives no guidance in deciding which interpretation should prevail.<sup>43</sup>

To aid in the resolution of this conflict, the Third Circuit focused on three decisions of the district courts and the problems presented by each.<sup>44</sup> In *Columbia Broadcasting System v. Scorpio Music Distributors*,<sup>45</sup> the United States District Court for the Eastern District of Pennsylvania held that there was a copyright infringement under section 602(a) when copies of phonorecords produced in the Philippines were imported into the United States without the consent of the original copyright owner.<sup>46</sup>

37. *Sebastian*, 847 F.2d at 1097 (citing H.R. REP. NO. 1476, 94th Cong., 2d Sess. 169, reprinted in 1976 U.S. CODE CONG. & ADMIN. NEWS 5659, 5785).

38. *Id.* The piratical copy situation was not presented by this case and was not discussed by the court. *Id.*

39. *Id.* For further discussion of these two interpretations, see *supra* notes 13-14 and accompanying text.

40. *Sebastian*, 847 F.2d at 1097 (explaining that district court adopted this view).

41. *Id.*

42. *Id.*

43. *Id.* The court noted that neither interpretation is "conclusively supported by the statutory language or legislative history." *Id.*; see also Tyson & Parker, *supra* note 10, at 403 ("The history of section 602(a) provides little guidance for solving this problem."); Note, *Parallel Importing Under the Copyright Act of 1976*, 17 N.Y.U.J. INT'L L. & POL. 113, 138 (1984) ("It is difficult to determine Congressional intent with respect to [§ 602].").

44. *Sebastian*, 847 F.2d at 1098.

45. 569 F. Supp. 47 (E.D. Pa. 1983), *aff'd without opinion*, 738 F.2d 424 (3d Cir. 1984). In *Scorpio*, CBS-Sony, a Japanese corporation, entered into an agreement with a Philippine manufacturer to produce and distribute records in the Philippines only. *Id.* at 47. Columbia Broadcasting System (CBS), the U.S. copyright holder, authorized the agreement and retained the copyrights in the United States. *Id.* Just prior to the termination of the agreement between CBS-Sony and the Philippine distributor, defendant Scorpio placed an order to purchase records from International Traders, a U.S. corporation. CBS sued Scorpio because the records in question were purchased from the Philippine corporation. *Id.*

46. *Id.* at 50.

The *Scorpio* court focused on the "lawfully made under this title" language of section 109(a) and held that the first sale doctrine did not limit the importation right.<sup>47</sup> The court interpreted those words as providing copyright protection only to buyers of copies which have been manufactured and sold within the United States, and noted that the protection of the copyright laws does not "extend beyond the borders of this country unless the Code expressly states."<sup>48</sup> Thus, the *Scorpio* court adopted the first interpretation of the copyright laws and held that where goods were manufactured and sold outside the United States, the first sale doctrine did not extinguish exclusive distribution rights.<sup>49</sup>

The Third Circuit next referred to *T.B. Harms Co. v. Jem Records, Inc.*,<sup>50</sup> a case in which the United States District Court for the District of New Jersey held that a compulsory licensing requirement under section 115 of the Copyright Act did not extinguish or limit any exclusive distribution rights.<sup>51</sup> The compulsory licensing regulation allows an artist to use a copyrighted musical work in exchange for a payment of royalty, and is a limitation on the copyright owner's monopoly.<sup>52</sup> The *Harms* court analogized the compulsory licensing regulation to the first sale doctrine, and held that section 602(a) was not limited by the compulsory licensing provision.<sup>53</sup> The *Harms* court pointed to the similarities between this case and the *Scorpio* case and agreed with the reasoning and reconciliation of the provisions adopted by the *Scorpio* court.<sup>54</sup>

47. *Id.* at 49.

48. *Id.* The district court interpreted the language of § 109(a) as granting first sale protection to third party buyers "of copies which have been legally manufactured and sold within the United States and not to purchasers of imports such as are involved here." *Id.* The court also thought that construing § 109(a) as limiting the importation right under "the more recently enacted § 602(a) would render § 602 virtually meaningless." *Id.*

49. *Id.* For a complete discussion of *Scorpio*, see Note, *supra* note 43.

50. 655 F. Supp. 1575 (D.N.J. 1987). In *Harms*, defendant Jem, a U.S. distributor of records, imported, sold and distributed copies of a recording lawfully produced in New Zealand without the consent of Harms, the valid copyright owner in the United States. *Id.* at 1577.

51. *Id.* at 1583. The *Harms* court agreed that allowing the defendant to limit the copyright holder's exclusive rights would render § 602 "virtually meaningless." *Id.* (quoting *Scorpio*, 569 F. Supp. at 49-50).

52. Tyson & Parker, *supra* note 10, at 406 n.40 (referring to use of "Happy Birthday to You" in television and films as example); see also 2 M. NIMMER, *supra* note 9, § 8.04[A], at 8-53 (noting that exclusive right of reproduction granted to copyright owner is modified by § 115 compulsory license regulation).

53. *Harms*, 655 F. Supp. at 1582-83. The court stated that "[t]he present case is clearly analogous to [*Scorpio*]" and found the only difference between the two cases was the fact that the "parties relied on different limitations on the owners' exclusive right of distribution." *Id.*

54. *Id.* The court stated that "[h]ere, as in [*Scorpio*], to allow the defendant to rely on a limitation of the owner's exclusive rights to circumvent the prohibition on importation would tie the hands of the copyright holder who seeks to exercise his rights to control copies of the work which enter the American market." *Id.* at 1583.



The third case that the *Sebastian* court analyzed was *Hearst Corp. v. Stark*.<sup>55</sup> In *Hearst*, the United States District Court for the Northern District of California followed the reasoning of the *Scorpio* court and held that the first sale doctrine did not limit the application of section 602(a) where goods manufactured outside the United States were imported without authorization.<sup>56</sup> However, in *Hearst*, the court based much of its decision on the precise wording of section 109(a), which refers to the resale of "a particular copy," and held that the first sale doctrine did not protect the wholesale distribution of multiple copies.<sup>57</sup> The court stated: "Even if section 109 did permit [the sale of] a particular copy of a copyrighted work, that section would not authorize the wholesale importation and redistribution of multiple copyrighted works in conflict with section 602. The singular language of section 109 contrasts with the pluralistic language of section 602, which refers to importation, copies, and distribution."<sup>58</sup>

The *Sebastian* court acknowledged that the district court cases are not binding upon the Third Circuit, but it chose to distinguish them from the instant case.<sup>59</sup> The court noted that all of these cases involved the protection that section 109(a) affords (or does not afford) an importer when the goods are manufactured outside the United States.<sup>60</sup> In *Sebastian*, the goods were manufactured in the United States, distinguishing it from the previous decisions in that there was no question in this case that the goods were "lawfully made under this title."<sup>61</sup>

The Third Circuit then reasoned that section 602(a) does not create a separate right in addition to those conferred by section 106(3). The

55. 639 F. Supp. 970 (N.D. Cal. 1986). In *Hearst*, the defendant imported eighteen titles of books into the United States which were manufactured in England by the owner of the copyright in England. *Id.* at 972. This importation was done without the consent of the plaintiff, the owner of the copyright in the United States. *Id.*

56. *Id.* at 977.

57. *Id.* at 976. This reasoning has been questioned by commentators. See 2 M. NIMMER, *supra* note 9, § 8.12[B], at 8-130.2 (criticizing *Hearst* decision because it "would allow importation of a single copy . . . but would bar large-scale importations").

58. *Hearst*, 639 F. Supp. at 976.

59. *Sebastian*, 847 F.2d at 1098 (noting that cases discussed "demonstrate a significant difference from the factual situation presented here").

60. *Id.*

61. *Id.* (noting simplicity of this case because it "centers on actual copies of labels printed in this country by the copyright owner"). Under any interpretation, products manufactured in the United States are "lawfully made" within the meaning of § 109(a) and subject to all of the copyright laws, including the first sale doctrine. See Tyson & Parker, *supra* note 10, at 402 ("Thus, the only limits to the first sale doctrine within the express terms of the provision are that the person in possession of the [copy] must be an owner, and the [copy] may not be piratical *i.e.*, that it must have been acquired in a lawful manner.").

The Third Circuit opted not to comment on the interpretation of § 109(a) when applied to goods manufactured overseas. *Sebastian*, 847 F.2d at 1098.

court therefore concluded that because section 106(3) is limited by the first sale doctrine, the importation right created by section 602(a) is necessarily limited by the first sale doctrine as well.<sup>62</sup>

In reconciling the two apparently conflicting provisions of copyright law, the Third Circuit avoided many of the problems that have plagued courts that have adopted contrary interpretations. One such problem has been the interpretation of the language “lawfully made under this title” in section 109(a). The issue presented by this language is whether the first sale defense is available to protect unauthorized importers of products manufactured outside the United States. The court in *Scorpio* determined that this language only granted first sale protection to third party buyers of products “which have been legally manufactured and sold within the United States.”<sup>63</sup> That court, however, did not decide the precise issue of how section 109(a) reconciles with section 602(a) when the goods are manufactured in the United States and reimported by an unauthorized distributor.<sup>64</sup>

The *Hearst* court adopted *Scorpio*'s analysis that “lawfully made under this title” applies only to goods manufactured in the United States, and, therefore, concluded that “[w]hile the ‘first sale’ defense remains in certain factual circumstances, it provides no defense to defendants for their importations here.”<sup>65</sup> Based on the *Scorpio* rationale, the *Hearst* court held that the first sale doctrine did not apply to the defendants. In addition, the court provided alternative grounds for its holding. The alternative rationale involved further interpretation of section 109(a).<sup>66</sup> By looking at the precise language of that section, the court determined that even if section 109(a) did limit section 602, the limitation would only be applicable to a “particular copy” of a work, and not to wholesale importation as was involved in *Hearst*.<sup>67</sup> The Third Circuit in *Sebastian* avoided this problem by confining its decision to the facts involved—where products are manufactured in the United States.<sup>68</sup>

Another problem posed by the *Scorpio* court's interpretation of the language “lawfully made under this title” is that courts would have to determine not only the place of manufacture, but also where title

62. *Sebastian*, 847 F.2d at 1099 (stating simply that “a first sale by the copyright owner extinguishes any right later to control importation of those copies”).

63. *Scorpio*, 569 F. Supp. at 49.

64. *Id.* The court noted that the defendant's contentions that the first sale doctrine protected *any* unauthorized importation would have been far more persuasive without the limiting language of § 109(a). *Id.*

65. *Hearst*, 639 F. Supp. at 977.

66. *Id.* at 976.

67. *Id.* The court stated: “Section 109 only applies to the resale of ‘a particular copy’ of a work. Here, defendants are importing large quantities of titles . . . .” *Id.*

68. *Sebastian*, 847 F.2d at 1098 (court specifically refused to pass upon district courts' interpretations of “lawfully made under this title” language of § 109(a)).

passed, in order to establish that the goods had been *sold* in the United States. The United States District Court for the Southern District of Florida addressed this issue in *Cosmair, Inc. v. Dynamite Enterprises, Inc.*,<sup>69</sup> stating that it was impossible to determine whether the first sale doctrine applied because the place of sale could not be established.<sup>70</sup> By not focusing on the place of manufacture or sale, the Third Circuit avoided this problem.<sup>71</sup>

A more fundamental problem, however, is whether the issue of gray marketing should be addressed through narrow application of the copyright laws.<sup>72</sup> There are various theories under which an aggrieved manufacturer could seek redress for the unauthorized importation of its products.<sup>73</sup> Because the real harm to the manufacturer flows from the distribution of the goods into the United States market, the remedy most often sought under any theory of recovery is an injunction.<sup>74</sup> Therefore, the desirability of a particular theory will depend in part on whether it allows for injunctive relief.

One theory for restraining the unauthorized importation of goods is breach of contract. This arises where the manufacturer sells its products based on representations by the buyer that the goods are for sale in a particular territory outside the United States. Once the buyer resells those products outside of that exclusive territory, he has breached his contract with the manufacturer.<sup>75</sup> The Third Circuit rejected this theory in *Johnson & Johnson Products, Inc. v. DAL International Trading Co.*,<sup>76</sup> refusing to grant injunctive relief where the holder of the goods did not have actual knowledge of the contractual limitations. In *Johnson & Johnson*, the court held that the manufacturer was not entitled to injunctive relief because a purchaser in good faith does not have a duty to inquire into the

69. 226 U.S.P.Q. (BNA) 344 (S.D. Fla. 1985).

70. *Id.* at 346-47. In this case it was not easily discernable where title had passed. The court was uncertain as to whether a provision of the Uniform Commercial Code or the parties' intent should control. *Id.*

71. *Sebastian*, 847 F.2d at 1099. The *Sebastian* court concluded: "Consequently, we agree with the district court that the place of sale is not the critical factor in determining whether section 602(a) governs." *Id.*

72. *Id.* The *Sebastian* court specifically noted that while its decision was predicated on copyright law, the underlying dispute of gray marketing was dominant. *Id.* Because the court felt that this issue was important enough to mention, gray marketing concerns were undoubtedly a strong factor motivating the Third Circuit to reach its outcome.

73. See generally Turner, *Grey Market Litigation in the United States District Courts*, 11 N.C.J. INT'L L. & COM. REC. 349 (1986). In addition to trademark and copyright actions, there are also possible fraud and RICO remedies available. *Id.*

74. See *id.* at 361 ("[T]he most effective device to halt the flow of grey goods is a preliminary injunction.").

75. See *Johnson & Johnson Prod. v. DAL Int'l Trading Co.*, 798 F.2d 100, 103 & n.2 (3d Cir. 1986).

76. 798 F.2d 100 (3d Cir. 1986).

validity of the title absent any knowledge of fraud.<sup>77</sup> Thus, there is no contractual remedy to stop a third party purchaser from importing and distributing gray market goods.<sup>78</sup>

Another theory which manufacturers have attempted to use is trademark violation.<sup>79</sup> Trademark law prohibits the importation into the United States of goods manufactured abroad that bear the properly registered trademark of a citizen or corporation of the United States.<sup>80</sup> Because this prohibition is limited to goods produced overseas, trademark law will not be an available avenue for relief where the goods sold on the gray market were manufactured in the United States, exported and then re-imported, as in the *Sebastian* case.

Additionally, the viability of a trademark violation claim was severely limited by the Supreme Court's recent decision in *K Mart Corp. v. Cartier*.<sup>81</sup> In *K Mart*, the Court upheld customs regulations which allowed the parallel importation of products by persons other than the owner of the registered trademark.<sup>82</sup> Because *K Mart* held that trademark law does not prohibit gray marketing of foreign-made products, one commentator has suggested that, in the right situation, copyright law "may provide the most effective relief against unwanted imports."<sup>83</sup>

Thus, a principal avenue that remains open to copyright holders seeking protection from gray marketing is the Copyright Act. The question that must be resolved is whether the Act is the proper hook upon which to hang the perceived injustices of gray marketing. The Third Circuit in *Sebastian* held that copyright law is not the solution to gray marketing, and it is submitted that the decision in *Sebastian* was correct.

If copyright law is used in this expansive manner, several problems will ensue. Under copyright law, it is not necessary to register a copyright in order to own the rights to that copy; however, registration is a prerequisite to bringing a copyright infringement action against a viola-

77. *Id.* at 106.

78. *See Sebastian*, 847 F.2d at 1099. The court explained that domestic manufacturers attempt to gain protection of their economic interests through copyright laws because contractual remedies have proved inadequate. *Id.*

79. *See generally* Turner, *supra* note 73, at 350-60.

80. 19 U.S.C. § 1526(a) (1982).

81. 108 S. Ct. 1811 (1988).

82. *Id.* at 1819. The Court described three situations in which parallel importation can arise under trademark law: 1) a domestic firm purchases a trademark for use in the United States from a foreign firm, which then sells the trademarked products in the United States itself or through a third party; 2) a parent, subsidiary or the foreign firm itself registers the trademark and then the foreign firm imports identical products; and 3) a domestic holder of a trademark authorizes its use by a foreign firm for a particular overseas market, and that foreign firm then imports the trademarked goods into the United States. *Id.* at 1814-15. The Court allowed the regulation to stand as it applied to the first two categories but not the third. *Id.* at 1819.

83. Palladino, *High Court Duo on Discounters: Legal Fog Still Shrouds 'Gray-Market' Goods*, vii *Legal Times*, June 20, 1988, at 19, col. 1.

tor.<sup>84</sup> Thus, the ability to invoke the Copyright Act in a case of gray marketing may hinge on registration as it did in *Sebastian*. The lower court in *Sebastian* allowed an action to be brought only as it applied to two products that were being imported because the other products had not been registered.<sup>85</sup> Additionally, there will be questions as to whether the products or parts of the products are even copyrightable in the first place.<sup>86</sup> This question arose in *Sebastian*, where the copyright claimed was the text on the back of hair care products.<sup>87</sup> The Third Circuit referred to this as superficial targeting of a dispute over a product's label when in reality the dispute raged over the product itself.<sup>88</sup> If copyright laws continue to be used to prevent gray marketing, manufacturers will find themselves stretching to find any work in their products which is copyrightable, and will make sure that such work is registered in order to bring potential future infringement claims. As the Third Circuit pointed out, this is not a proper use of the copyright laws.<sup>89</sup>

The Third Circuit suggested in *Sebastian* that the problems of gray marketing should be handled by Congress, and not by judicial extension of a limited area of law.<sup>90</sup> It is submitted that this approach is the proper one. It is also suggested that some of the problems of gray market importation may be tackled by the manufacturers themselves. Most domestic manufacturers offer their products at substantially reduced rates for sale abroad.<sup>91</sup> This is evidenced by the mere existence of gray market goods. In situations such as *Sebastian*, where products are manufactured in the United States, sold overseas, and then imported back into the United States, manufacturers could raise their overseas prices to make gray marketing economically unfeasible. If the economic harm to the manufacturers arising from the gray marketing of their goods were

84. Turner, *supra* note 73, at 361.

85. *Sebastian Int'l, Inc. v. Consumer Contacts (PTY) Ltd.*, 664 F. Supp. 909, 912 (D.N.J. 1987), *rev'd*, 847 F.2d 1093 (3d Cir. 1988).

86. *See Cosmair, Inc. v. Dynamite Enter.*, 226 U.S.P.Q. (BNA) 344 (S.D. Fla. 1985). In deciding whether to issue a preliminary injunction, the court expressed concern about the validity of the copyright of a design on a bottle of perfume. *Id.* at 347-48.

87. *Sebastian*, 664 F. Supp. at 913. For the exact text of the labels in question, see *supra* note 23.

88. *Sebastian*, 847 F.2d at 1099 (noting that closure of contractual remedies in gray market disputes has caused manufacturers to turn to copyright law, creating anomalous situation).

89. *Id.*

90. *Id.*; see also Kelly, *An Overview of the Influx of Grey Market Goods Into the United States*, 11 N.C.J. INT'L L. & COM. REG. 231, 250 (1986) ("Congress [needs] to reaffirm the statutory framework that permits parallel imports under all the laws of the United States."); Palladino, *supra* note 83, at 20.

91. *See* Brief for The Coalition for Competitive Imports as Amicus Curiae at 2-3, *Sebastian Int'l, Inc. v. Consumer Contacts (PTY) Ltd.*, 847 F.2d 1093 (3d Cir. 1988) (No. 87-5439); see also Donohue, *supra* note 2, at 183-84 (listing reasons for price differential between goods intended for domestic market and goods intended for sale overseas).

substantial, then they would be forced to take the risk of losing some legitimate overseas sales in order to combat gray marketing.

In the absence of congressional action, the copyright laws should not be construed as a mechanism to prevent gray marketing. The purpose of the copyright laws is to protect the exploitation of creative ideas and works.<sup>92</sup> Once a copyright owner has received his reward for that work he should not be allowed to control its further distribution.<sup>93</sup> In order to use the copyright laws to prevent gray marketing, the courts must give a stilted construction to the laws and read out the intent of an entire provision (section 109). Courts cannot be required to give a reading to the laws that circumvents the purpose and intent of the overall legislative scheme.

The Third Circuit in deciding *Sebastian* did not pass judgment on gray marketing—it did not decide whether the public's right to lower-priced products outweighed the harm to the copyright owners. But the court did reconcile the two conflicting interpretations of the copyright laws in a manner consistent with the underlying policy against stretching the Copyright Act's "limited monopoly" to cover a broad problem.<sup>94</sup> Gray marketing should be addressed through fraud, contract or trademark claims. It is far too tenuous to hold importers liable for an infringement of a copyright predicated on the wording of a label.

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92. See *Sony Corp. of Am. v. Universal City Studios*, 464 U.S. 417, 429 (1984); see also *Sebastian*, 847 F.2d at 1095.

93. See *Tyson & Parker*, *supra* note 10, at 410.

94. *Sebastian*, 847 F.2d at 1099.

