George Mason
Journal of International
Commercial Law

Vol. 3, Issue 2

<u>**Articles**</u>

The Four Stages in the Electrification of Letters of Credit
Professor James E. Byrne

Can the "Formidable Shield" Last: A Re-examination of Copyright Law as a Means to Control Uncopyrighted Gray Market Goods
Ya Xia

<u>**Student Notes**</u>

Reducing Ambiguity or Increasing Contracting Costs? Interpreting UCP 600 Article 16 Obligations and *Fortis Bank v. Indian Overseas*.
Caitlin E. Huggins

From Your Land to Mine: The Benefits of Applying the First Sale Doctrine to Goods Manufactured Abroad
Kaitlyn E. Amundsen

George Mason
Journal of International Commercial Law
2011-2012 Candidate Members

Kaitlyn Amundsen

Al Bender

Lauren Brice

Jenna Coons

Sabrina Cotter

Justin Du Mouchel

Kayla Florio

Mark Henderson

Alex Lange

Michael Lew

Matt Porter

Mark Probasco

Kate Purdom

Jason Saylor

Kate Schiewetz

Dustin Sifford

Peter Traisak

Kaitlin Wojnar

Lin Yang

Table of Contents

Articles

Student Notes

The Journal Staff would like to express our profound appreciation for the George Mason University School of Law faculty and administration, without whom this publication would not have been possible.

We would like to thank our Board of Advisors, and in particular our Faculty Advisor Professor James E. Byrne. Words cannot express the value of your guidance, insight and assistance.

The Four Stages in the Electrification of Letters of Credit

Professor James E. Byrne*

Introduction

In the euphoria accompanying the dot-com revolution of the 1990s, it was first thought by some that electrification[1] of commerce could be readily accomplished by legislation directed at removing benighted obstacles to the use of electronic communications. In this process, which usually was statutory and occasionally mandatory, it came to be grudgingly conceded that there were certain exceptions that had to be recognized in favor of solely paper based undertakings, the most notorious of which was the obligation to pay embodied in a negotiable instrument.[2] It was, however, thought by many that these exceptions would erode as the

---

* Professor Byrne is a member of the faculty of George Mason University School of Law and Director of the Institute of International Banking Law & Practice (IIBLP). He chaired the U.S. Delegation to the Working Group that drafted the UN Convention on Standby Letters of Credit and Independent Guarantees, was Reporter and Chair of the International Standby Practices (ISP98) Drafting Group, was advisor in the revision of U.S. UCC Article 5 (Letters of Credit), and advised the Drafting Group for UCP600. He served on the ICC drafting groups for the eUCP and ISBP. He acknowledges the invaluable assistance of Joshua D. Chamberlain (GMUSL 2012); Dr. Alan Davidson, University of Queensland College of Law; James E. Duggan (IIBLP Intern); Andrey Kuznetsov, Assistant Counsel, IIBLP; Ramsey R. Saleeby, Assistant Counsel, IIBLP; and Courtney A. Stevens, J.D. (GMUSL 2011). The assistance of George Mason University School of Law and its Law & Economics Center is acknowledged. This paper is based on a presentation at the UNCITRAL Colloquium Electronic Commerce in Spring 2011.

[1] In this paper, the term "electrification" is used somewhat cavalierly to signify the de-materialization of data without reference to a particular format or technology and without any expectation of exclusivity.

[2] In addition to negotiable instruments, bills of lading, warehouse receipts, and other documents of title, exceptions are sometimes made for documents that are thought to require greater solemnity such as trusts, wills, deeds, and mortgages. Useful general studies of electronic commerce are Alan Davidson, The Law of Electronic Commerce (2009); Report 50 of the New Zealand Law Commission, electronic Commerce Part One (1998); and the UCITRAL Secretariat's Commentary to the UN Model Law available at www.uncitral .org.

particular area accommodated itself to electrification or was bypassed and became an antiquated relic in the museum of commercial devices.[3]

One of the most common tactics was to accord by statutory fiat the same status as paper to electronic data.[4] The insight behind this approach was that if paper was the equivalent of electronic data, commercial interests would opt for electronic data. This approach did not take into account the heavy hand of tradition and the disinclination to incur the expenditures necessary to switch to electronic data, particularly when both a paper and electronic systems must be maintained.[5]

In retrospect, however, the legislative approach was far too optimistic and perhaps too simplistic, revealing that the electrification of commerce cannot be accomplished or perhaps even hastened merely by legalization. Nor is a desire to electrify on the part of some parties or by those who engineer the systems of commerce enough, even when accompanied by financial incentives. In addition, electrification may not be an "all or nothing" proposition, in the sense that electrification must be exclusive. It is possible that some documentation can be in electronic and other documentation in a paper format in the same transaction, an approach which has particular merit as a transitional stage towards full

[3] To an extent the process of irrelevancy has already happened with the quintessential negotiable instrument, the promissory note. *See* JAMES ROGERS, THE END OF NEGOTIABLE INSTRUMENTS (2012). The ability to confer super-charged rights on good faith purchasers already exists in the US for alternative commercial undertakings that do not require unique paper containing a highly formulaic recital in connection with letters of credit, personal property lease, and security instrument in personal property. *See, e.g.*, U.C.C. §§ 2A-407 (Irrevocable Promises: Finance Leases) (so-called "Hell or High Water" clause extended to non-consumer finance lease of personality); 8-303 (Protected Purchaser); and 9-403 (Agreement Not to Assert Defenses Against Assignee) (2002).

[4] In their more prescient moments, advocates of ecommerce recognized that the best route was legal equivalency of ecommerce with paper was optimal and that businesses should be given a choice. For example, see ¶ 15 of the Guide to Enactment of the UNCITRAL Model Law on Electronic Commerce.

[5] While not, strictly speaking, a legislative solution, some resistance has been overcome by private mandate. For example, private and public procurement systems have mandated exclusive use of electronic bids and billing. Many of the procurement and billing systems of the US Government and state governments are exclusively electronic. See, e.g., the SAP software system, such as that outlined at http://www.sap.com/solutions/business-suite/erp/financials/billingconsolidation.epx, and *E-procurement*, Wikipedia, http://en.wikipedia.org/E-procurement.

electrification.[6] Finally, a given area or undertaking may not be uniform with regard to being electrified with some aspects more amenable than others.

For purposes of this paper, the process of the electrification is divided into four stages.[7] The four stages are: 1) the legalization of the utilization of electronic commerce; 2) the systemization of electronic commerce in that field; 3) the acceptance of electronic commerce as the norm for transactions; and 4) the transformation or evolution of the product as a result of the utilization of electronic commerce. The stages suggested here overlap one another to a certain extent and evince a certain arbitrary character regarding their application. Electrification also can proceed at different paces with respect to each stage. It is submitted, however, that these stages offer a useful analytical tool, not only for the understanding of electronic commerce in general, but also for understanding how to obtain its increased utilization in a given field. Because of the limitations inherent in any system of categorization, the character of these stages will be explored more fully subsequently.

The field of letters of credit is used in this paper as an empirical laboratory in which the ongoing progress of electrification is considered, and obstacles, problems, and issues weighed. This paper draws on the insights from this process and formulates proposals towards better understanding it from the perspective of an important instrument of commerce and finance, the letter of credit.[8] There are considerable

---

[6] An example is eUCP Article e1(a) (Scope of UCP), discussed later, which permits presentation of electronic documents ("records") "alone or in combination with paper documents."

[7] It is not apparent to the author that there has been any definitive treatment of the process of implementation of electrification, a study that would require drawing upon various disciplines including business, sociology, law, and electronics. The categories suggested here derive chiefly from the author's experience and studies of electronic commerce over the last 25 years, from when he taught a law school course in EFT in 1985 entitled "electronic funds transfer" (EFT) to the evolution of a new world of initials and concepts. In speaking of "stages", it is important to qualify the term. It is not used to suggest chronological or sequential steps that must be completed before "moving on" to another "stage". Perhaps the terms "field" or "area" better capture the notion that there are dimensions of the process of electrification which must be taken into account but these terms have their own limitations as well. Consequently, the author has settled for the term "stages".

[8] For the purpose of this paper, the term "letter of credit" and related terms are, unless otherwise apparent from the context, intended to connote the entire family or genus of letter-of-credit related undertakings, namely definite promises to pay on the presentation of required documents. *See, e.g.*, JOHN DOLAN, THE LAW OF LETTERS OF CREDIT:

advantages to considering electrification from the perspective of letters of credit. Historically, letters of credit have been more amenable to electrification than many types of commercial undertakings. From the mid-nineteenth century, letters of credit were issued telegraphically,[9] and methods of authentication were quickly devised so that there were no objections based on either the lack of a writing or handwritten signature to the enforceability of a letter of credit so issued.

In addition the letter of credit undertaking, unlike the promise contained in a negotiable undertaking, is not merged with the obligation that it contains so that there is no reification of the obligation in a unique piece of paper. While there are formal requirements for an enforceable letter of credit,[10] namely a signed writing,[11] they are minimal and not locked into a

COMMERCIAL AND STANDBY CREDITS 2-3 (1984). This family includes include so-called commercial letters of credit (misnamed "documentary" in some circles), standby letters of credit, independent guarantees (also known as demand guarantee, first demand guarantees, and bank guarantees), confirmations, pre-advices, and reimbursement undertakings. This typology of letters of credit is merely descriptive, there being no fundamental difference at the abstract level of law between the various members of the genus "letter of credit".

[9] *See, e.g.*, Wilbert Ward, American Commercial Credits 51-54 (1922) (referring to cabling credits between beneficiaries and banks). *See also* Brown, Shipley & Co., Tourists' Telegraphic Code for Use Between Brown, Shipley & Co. And Users of their Travelling Credits (E.B. Gilburt ed. 1906) (providing shorthand codes for bank customers to use to telegraph requests for funds and letters of credit to the bank), for a typical booklet that provided for travelers who commonly resorted to travelers letter of credit addressed to anyone, a precursor to the modern credit card.

[10] Negotiable instruments are laden with numerous restrictions and requirements, making them cumbersome. *See, e.g.*, U.S. U.C.C. § 3-104 (Negotiable Instrument) (2010) (specifying the following elements of a "negotiable instrument": (i) unconditional promise or order to pay, (ii) fixed amount of money, (iii) payable to bearer or order at the time it is issued, (iv) on demand or at a definite time, and (v) does not contain any instruction or undertaking other than to pay) and the United Nations Convention on Bills of Exchange and International Promissory Notes art. 3, Dec. 9, 1988, U.N. Doc. A/RES/43/165 (specifying that a valid "bill of exchange" must be (i) in writing, (ii) contain an unconditional order to pay, (iii) an order to pay a definite sum of money, (iii) payable on demand or at a definite time, (iv) dated, and (v) signed by the drawer). These technicalities render negotiable instruments largely irrelevant for many modern commercial uses which has caused them to be by-passed in the real world in many respects. *See* STEPHEN C. VELTRI, THE ABCS OF THE UCC: ARTICLE 3: NEGOTIABLE INSTRUMENTS AND ARTICLE 4: BANK DEPOSITS AND COLLECTIONS 10-22 (2d ed. 2004). Moreover, what statutes say about negotiability has little to do with what bankers focus on, namely the "magic terms" of order or bearer. In commenting on drafts drawn under commercial letters of credit, the International Chamber of Commerce has had to emphasize that their maturity cannot be linked to the date contained on a bill of lading, a rule that many bankers ignore. *See* International Standard Banking Practice (ISBP) (2007) ¶ 43(a) [ICC Publication No. 681] which provides that if a draft presented under an LC is drawn other than at sight "it must be

unique "operative letter of credit instrument" from the perspective of law or practice. However by way of useful contrast, some types of letters of credit, particularly those providing payment for transactions in goods,[12] require presentation of unique documents such as bills of lading or warehouse receipts that are consigned to order and thereby have elements of negotiability, in that the undertaking of the carrier or warehouseman is to deliver the goods to the person entitled under the document and who presents it. As will be discussed later, the paper-intense character of presentations under commercial LCs, with its accompanying expenses, has caused corporate users and banks to move towards alternative paperless undertakings such as open account.

For purposes of this paper, the process involving electrification of a letter of credit is loosely divided into three phases, namely: (1) issuance of a

---

possible to establish the maturity date from the data in the draft itself." Thus, draft presented under a letter of credit requiring presentation of a "draft" would not comply if its tenor was "30 days from bill of lading date" even if the bill of lading were one of the presented documents. This rule is silly for paper presentations. It would be even sillier, were there electronic presentations of data.

[11] *See, e.g.*, U.N. Comm'n on Int'l Trade Law [UNCITRAL], *United Nations Convention on Independent Guarantees and Standby Letters of Credit*, art. 7, *adopted* Dec. 11, 1995, 2169 U.N.T.S. 163 (entered into force Jan. 1, 2000) [hereinafter UN LC Convention], *available at* http://www.uncitral.org/pdf/english/texts/payments/guarantees/guarantees.pdf (Issuance, form, and irrevocability of undertaking) (operative in "any form which preserves a complete record of the text of the undertaking and provides authentication of its source by generally accepted means or by a procedure agreed upon by the guarantor/issuer and the beneficiary."); U.C.C. § 5-104 (1995) ("any form that is a record and is authenticated (i) by a signature or (ii) in accordance with the agreement of the parties or the standard practice referred to in Section 5-108(e)").

[12] These credits are properly understood as "commercial" letters of credit, although in some parts of the world misnamed "documentary" letters of credit (because by their very nature all letters of credit are "documentary"). *See, e.g.,* RICHARD KING, GUTTERIDGE & MEGRAH'S LAW OF BANKERS' COMMERCIAL CREDITS (8th Ed. 2001).(recognizing the common usage of "documentary" but uses "commercial" in the text in order to distinguish a commercial letter of credit from a standby). The first versions of the Uniform Customs and Practice (UCP1933 and UCP1951) were entitled the "Uniform Customs and Practice for Commercial Documentary Credits". *See* DAN TAYLOR, THE COMPLETE UCP 49, 65 (ICC 2008). *See generally,* BORIS KOZOLCHYK, COMMERCIAL LETTERS OF CREDIT IN THE AMERICAS 84-86 (1966) (detailing the history of the rules, making it apparent that the term "commercial" was deleted, leaving "documentary" as the only term in the 1962 revision to accommodate eccentric British banking practice). Indeed, in these two widely recognized treatises, the significance of the term "commercial" in the titles is self evident. BORIS KOZOLUCHYK, IX INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW, Ch. 5 at ¶ 44 (1979) (Kozolchyk takes exception to the use of the label 'documentary').

letter of credit, (2) presentation and examination, and (3) payment.[13] Issuance involves the process of release of the operative undertaking and its transmission to the beneficiary in a manner that enables it to comfortably act on it. Presentation and examination involves the process of the creation of documents on which the letter of credit obligation is conditioned, the submission of the documents to a bank named in the credit as eligible to receive the documents, the forwarding of these documents to persons who have made an undertaking under the LC, the examination of the documents, and any notification of refusal or subsequent cures if warranted. Payment involves the honor of their obligation by those persons making an undertaking on the letter of credit.

Each of these three phases can be and has been electrified to some extent although the pace and depth of electrification varies by stage and phase. As indicated, the issuance of a letter of credit or its amendments has been electrified since the invention of the telegraph. Payments have been accomplished through electronic means at least since the beginning of the twentieth century and, although there is little evidence, probably earlier.[14] Payment systems, such as those effecting electronic payments, depend to some extent on settlement or the ability to settle and may involve complexity in an international context. At the very least, electronic messages authorizing charges against correspondent accounts or reimbursement from correspondent accounts are readily electrifiable and have been so treated for decades. As will be described, the principal difficulty in the electrification of letter of credit practice has involved the second phase of the process, namely the preparation and presentation of

[13] This division is the author's, although its components are evident to anyone familiar with letters of credit. While it is possible to add other dimensions to this classification such as the transfer of transferable letters of credit, amendments, or other miscellaneous matters, these three general movements describe with considerable utility the basic operational flow of a letter of credit or letter of credit type instrument and coincidentally provides a useful platform for viewing the evolution of LC electrification.

[14] Fedwire which began in 1918 was initially effected by means of telegraphic communications between Federal Reserve banks. Board of Governors of the Federal Reserve System, Fedwire Funds Transfer System: Assessment of Compliance with the Core Principles for Systemically Important Payment Systems (2009), *available at* http://www.federalreserve.gov/paymentsystems/fedfunds_coreprinciples.htm#history.
SWIFT also provides for electronic payment through its MT 100 series of messages and settlement through MT 752 (Authorization to Pay, Accept or Negotiate), 754 (Advice of Payment/Acceptance/Negotiate), and 756 (Advice of Reimbursement or Payment). Unlike Fedwire, there is no clearance through SWIFT which is only a messaging system.

documents.[15] It is at the stage that many of the insights and lessons that are available from this field can be observed and considered.

STAGE 1: Legalization of Electronic LCs

The first stage of electrification involves a process described here as "legalization". By legalization, what is meant is an attempt to provide a legal infrastructure which is conducive to utilization of electronic commerce. To a certain extent, that effort was represented by many of the statutory or model law attempts of the 1990s which attempted to provide recognition and acceptance of electronic data as the functional equivalent of paper-based data.[16] While this state affects all three of the phases of letter of credit processing, namely issuance, performance, and payment, it affects the process of issuance the most pronouncedly. In the field of letters of credit, to a considerable extent, that process involved the legalization of issues of formation, formality, and payment systems.

As indicated, letters of credit have long been issued via telegraph and, as the methodology for telecommunication evolved to cable, telex and increasingly technologically-sophisticated means of electric data interchange. In the more than 150 years of electronic issuance, the defense by an issuer that its letter of credit was not binding due to failure to meet formal requirements, that is, not in the form of a signed writing, has rarely if ever been raised and, as appears to the author from diligent study, never successfully so.

The legalization of electronic issuance of a letter of credit in positive law first appeared in the process of the drafting of the first version of Article 5 (Letters of Credit) of the U.S. Uniform Commercial Code. It was present in two distinct aspects, the general definitions provided in UCC

---

[15] Even at this stage, there has been electrification to a considerable extent. Major international banks currently scan documents presented and examine them at regional processing centers, moving them around the globe on a 24-hour basis.

[16] In one of its most notable achievements, the United Nations Commission on International Trade Law (UNCITRAL) has taken the lead in laying the basis for the extensive legislation that provides that where a writing is required that requirement is taken to have been met with electronic writing where certain conditions are fulfilled. This work culminated in UNCITRAL, UNITED NATIONS CONVENTION ON THE USE OF ELECTRONIC COMMUNICATIONS IN INTERNATIONAL CONTRACTS, adopted Nov. 23, 2005, *available at* http://www.uncitral.org/pdf/english/texts/electcom/06-57452_Ebook.pdf. *See also* UNIFORM ELECTRONIC TRANSACTIONS ACT (1999), *available at* http://www.law.upenn.edu/bll/archives/ulc/fnact99/1990s/ueta99.htm (completed by the Uniform Law Commissioners in 1999, enacted by all U.S. states except Washington).

Article 1 (General Provisions) and in the formality provisions of UCC Article 5 (Letters of Credit).

The 1957 version of UCC Section 1-201(46) defined "written" or "writing" as including "printing, typewriting or any other intentional reduction to tangible form. Section 1-201(39) defined "signed" as including "any symbol executed or adopted by a party with present intention to authenticate a writing.[17] The 1957 version of UCC Section 5-104(2) (Formal Requirements; Signing) represents a significant breakthrough in the codification of the electrification process. It states that "a telegram may be sufficient signed writing if it identifies its sender by an authorized authentication." This provision is one of the first express statutory recognitions of electronic writings and signatures.

As a result, when the dot-com revolution occurred, the question of allowing for the electronic issuance of a letter of credit was a "non-event". Not only were the definitions of "signed" and "writing" in Article 1 of the UCC sufficiently broad to encompass an electronic letter of credit,[18] but then current UCC Section 5-104 expressly embraced the notion of electrification by its reference to a telegraph message.[19] Under the common

[17] The 1957 version is used because it was the first version that was widely adopted. While the 1952 version was adopted by Pennsylvania, all further legislative action was suspended pending completion of the Report of the New York Law Revision Commission. *See* James E. Byrne, *The Revision of UCC Article 5: A Strategy for Success*, 56 Brooklyn L. Rev. 13 (1990). The first draft of what became U.C.C. Article 5 (Letters of Credit), then U.C.C. Article IV (Bank Collections: Bank Operations and Foreign Banking) issued in 1947, contained a definition of "telegram" as "a telegram includes a message transmitted by radio, teletype, or the like." Section 2(8) reprinted in III Uniform Commercial Code Drafts 235, 242 (Kelly, ed. 1984). Section 1-201(37) (General Definitions) of the of Article 1 General Provisions (1949) defines "written" or "writing" as including "printing, typewriting or other intentional reduction to permanent form." This definition is sufficient to include electronic transmissions by telegram as noted in its Official Comment which notes that that it is a broadening of the definition from the Negotiable Instruments Law. *See* VI Kelly, *supra*, at 35, 39.

[18] U.C.C. § 1-201 defined "written" or "writing" as including "printing, typewriting or any other intentional reduction to tangible form." U.C.C. § 1-201(46) (2002). Section 1-201(39) defined "signed" as including "any symbol executed or adopted by a party with present intention to authenticate a writing." U.C.C. § 1-201(39) (2002). *See also* U.C.C. § 5-104, cmt. 2 (2002) ("the definition of 'document' contemplates and facilitates the growing recognition of electronic and other nonpaper media as 'documents.'") Citations to the U.C.C. are to the Model Code unless otherwise indicated.

[19] U.C.C. § 5-104(2) (1994).

law approach to codification in the UCC,[20] extrapolation from express reference to telegraph to similar electronic methodology was not an issue and presented no problem.

Although the electrification of issuance and payment was taken for granted without the need for permission, it was not mandated. However, this liberalized approach should be compared to the more restrained approach taken with respect to performance in which electronic presentation must be expressly allowed. In this difference, there is a lesson which perhaps may have implications beyond the field of letters of credit, namely that electrification is not homogenous even in the same transaction. There were suggestions made in the discussions of the UNCITRAL Working Group that the LC beneficiary should have a right to make electronic presentation. This approach was not embraced and, a more conservative approach was adopted whereby terminology was utilized which would support electronic presentations expressly provided for in the undertaking. The default rule retained paper. The determination of whether or not documents could be presented electronically was not undertaken by a positive law but left to the evolution of the practice. This approach is one of great wisdom because it respects the idiosyncrasies of the field and concerns related to it, which are discussed subsequently.

STAGE 2: Systemization of LCs

The process of systemization involves the creation of an infrastructure which includes law but goes beyond it in order to facilitate utilization of electronic commerce. Systemization has practical dimensions, such as electronics, computers, and similar systems which this author is not qualified to discuss, but it also involves creating rules or protocols which facilitate electronic commerce. In the field of letters of credit, these efforts would involve both rules of practice and systems. Since the end of World War I, there has been an international movement to formulate rules of practice governing letters of credit.[21] Practice rules emerged after World

---

[20] This approach is embodied in UCC Section 1-103 (1957 version) (Supplementary Principles of Law Applicable), Section 1-103(b) (Construction of [Uniform Commercial Code] to Promote its Purposes and Policies; Applicability of Supplementary Principles of Law) in Revised UCC Article 1 (2001). It provides "Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppels, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions."

[21] The dimensions of this movement are traced in the various editions of what was for many years the leading US treatise on letters of credit, *American Commercial Credits* by

War I when the center of gravity in international trade finance shifted from London.[22] Through a process of unification led by the US letter of credit community, these rules were harmonized and emerged as the Uniform Customs and Practice for Commercial Documentary Credits (1933 version) (ICC Brochure No. 82).[23] Rules for demand guarantees, the Uniform Rules for Demand Guarantees (UDDG 458),[24] were drafted in 1992 and revised in 2010 as URDG 758.[25] Rules for standbys are contained in the International Standby Practices (ISP98). These rules provide a comprehensive system for these products that is complemented by law, whether statutory or judge-made.[26]

The importance of this standardization was magnified by the absence of any normative positive international law, and indeed (with the sole exception of the United States since the mid-1950s) of any systematic domestic positive law for letters of credit.[27] While there are statutory

Wilbert Ward (1922). Subsequent editions were Ward, *Bank Credits and Acceptances* (1931); Wilbert Ward & Henry Harfield, *Bank Credits and Acceptances* (3d ed. 1948); Ward & Harfield, *Bank Credits and Acceptances* (4th ed. 1958); and Harfield, *Bank Credits and Acceptances* (5th ed. 1974). After Ward's death, he was bumped by Harfield. It and its subsequent editions reveal the emergence of rules and organizations that shaped practice by formulating standards of practice and standardization of forms. It was Ward himself who proposed adoption of the practice rules that became the UCP by the nascent International Chamber of Commerce and who served as the first Chair of its Banking Commission.

[22] Boris Kozolchyk, Commercial Letters of Credit in the Americas 83 (1966).

[23] The texts and documents of this process are usefully collected in DAN TAYLOR, THE COMPLETE UCP (2008) (ICC PUB. NO. 683). Subsequent revisions were UCP151 (1951), UCP290 (1974), UCP400 (1983), UCP500 (1993), and UCP600 (2007).

[24] For an exhaustive analysis of UCP600, tracing the evolution of each article, *see* JAMES E. BYRNE ET AL., UCP600: AN ANALYTICAL COMMENTARY (2010).

[25] Commentary on these rules may be found in Roy Goode, Guide to the ICC Uniform Rules for Demand Guarantees (1992) and Georges Affaki & Roy Goode, Guide to ICC Uniform Rules for Demand Guarantees URDG 758 (2011).

[26] Indeed, the three instances of positive law expressly defer to practice rules. *See* United Nations Convention on Independent Guarantees and Stand-by Letters of Credit, art. 5 (Principles of interpretation) U.N. Doc. A/RES/50/48 (Dec. 11, 1995); Rev. U.C.C. § 5-103(Scope) & cmt. 2 (1995); PRC Letter of Credit Rules, art. 2 (Application of International Rules or Practices) (2005).

[27] Drafting work on a statute for letters of credit began in the 1930s, was suspended as was all work on the UCC during World War II, and began in earnest after the war. The first version of Model UCC Article 5 (Letters of Credit) was adopted by the sponsors of the UCC in 1952 and enacted by Pennsylvania. As a result of the Report of the New York Law

provisions regarding letters of credit in other countries, they are not systematic.[28] As a result, most letter of credit "law" is the result of judicial decisions. In 1995, the UN General Assembly adopted the United Nations Convention on Independent Guarantees and Standby Letters of Credit which has been ratified by eight countries.[29] Since the revision of UCC Article 5 and the UN LC Convention were drafted at the same time, considerable efforts were made to align them. In 2005, the Peoples' Supreme Court of the Peoples' Republic of China promulgated progressive rules for letters of credit that are binding on all Chinese courts.[30]

Three examples of legalization aptly illustrate the systemization of electrification. They involve different phases of the letter of credit process.

1. Default rules regarding issuance

It was not uncommon for banks that sent letters of credit by electronic transmission (described in letter of credit practice as "teletransmission") also to send a paper document containing the teletransmitted text. This dual (and redundant) practice arose from concern about the conservative nature of bankers. It may also have reflected some doubts regarding so-called "advanced" methods of telecommunications and their reliability, security and the completeness of the communication received. Under the practice rules prior to UCP400 (effective 1983),[31] the default rule for such a dual transmission was that the paper version was treated as the operative instrument and the electronic telecommunication

---

Revision Commission, extensive revisions were made to the UCC including UCC Article 5 in the 1957 Model Code, and enactments by many states followed. The Model Revised UCC Article 5 (Letters of Credit) was adopted by the National Association of Uniform Law Commissioners and the American Law Institute in 1995 and has subsequently been adopted by all US jurisdictions with relatively few non conforming amendments. For a study of the process of adoption of the original UCC Article 5 and the clash between the letter of credit practice community and the drafters. *See* James E. Byrne, *The Revision of UCC Article 5: A Strategy for Success*, 56 Brooklyn L. Rev. 13 (1990).

[28] *E.g.*, Tunisia has a model statute. *See* Documentary Credit World, July-Aug. 2012, at 41, 43.

[29] The countries having adopted it as of 1 April 2012 are Belarus, Ecuador, El Salvador, Gabon, Kuwait, Liberia, Panama, and Tunisia. The US has signed but not yet adopted it.

[30] *See* LC Rules & Laws (5th ed. 2012) for an English translation of the rules. These rules reflect the influence of the UN LC Convention and Revised UCC Article 5.

[31] Int'l Chamber of Commerce, Pub. No. 400,Uniform Customs and Practice for Documentary Credits art. 12, (1983) [hereinafter UCP400].

simply as a courtesy unless the undertaking expressly provided that the electronic communication was the operative instrument, in which case the paper copy was a courtesy.[32] In UCP400 (1983) Article 12, this default rule was reversed, signaling an increase in the comfort level of the international banking operations community regarding electronic telecommunication.[33]

This switch of the default rules was a significant moment in the electrification of letters of credit in that it indicated the willingness of banks to accept that electronic transmission of their undertakings as the norm.

---

[32] When a bank gave an electronic notification of the issuance of a credit to a correspondent bank, UCP82 (1933) Article 9 para.2 provided that the "original" must be sent to the correspondent. INT'L CHAMBER OF COMMERCE, PUB. 82, UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS art. 9, para. 2 (1933). Article 4 recognized that the issuer might rely solely on the electronic message without sending a mail confirmation. INT'L CHAMBER OF COMMERCE, PUB. NO. 222, UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS art. 4 (1962). Depending on the intent of the issuer, either the paper version created by the issuer or the version printed or created by the correspondent or even beneficiary from the issuer's electronic communication might be the operative credit on which the beneficiary could rely. Where the credit or amendment is communicated by telecommunication or pre-advised, via telefax, the operative credit would be the printout of the telefax. *See also* BYRNE, *supra* note 24, at 1403-11.(providing a comparison chart of prior versions from UCP82 to UCP600); DAN TAYLOR, THE COMPLETE UCP: TEXTS, RULES AND HISTORY 1920-2007 (2008) (containing the texts of prior versions of the UCP).

[33] UCP400 Article 12(a) provided:

> When an issuing bank instructs a bank (advising bank) by any teletransmission to advise a credit or an amendment to a credit, and intends the mail confirmation to be the operative credit instrument, or the operative amendment, the teletransmission must state "full details to follow" (or words of similar effect), or that the mail confirmation will be the operative credit instrument or the operative amendment. The issuing bank must forward the operative credit instrument or the operative amendment to such advising bank without delay.
>
> Article 12(b) provided:
>
> The teletransmission will be deemed to be the operative credit instrument or the operative amendment, and no mail confirmation should be sent, unless the teletransmission states "full details to follow" (or words of similar effect), or states that the mail confirmation is to be the operative credit instrument or the operative amendment.

UCP400, *supra* note 31 art. 12(a)-(b).

2. Provision regarding originality and authentication of documents

Additional provisions were included in UCP400 in an attempt to facilitate electronic data interchange (EDI) as eCommerce was known at the time.[34]

These provisions appear in UCP400 Article 22(c) (1983) which provided that:

> unless otherwise stipulated in the credit, banks will accept as originals documents produced or appearing to have been produced: by reprographic systems; by, or as the result of, automated or computerized systems; as carbon copies, if marked as originals, always provided that, where necessary, such documents appear to have been authenticated.[35]

This provision addressed performance and the presentation of documents. It attempted to accommodate the movement towards what were called "automated or computerized systems" and required that banks accept as "originals" documents which produced, were produced, or appeared to have been produced by either "reprographic systems" or as a result of automated or computerized systems. This provision was taken forward into the next provision of the UCP, UCP500 Article 20 (1994).[36] This provision

---

[34] These changes were due to the foresight and leadership of Mr. Bernard S. Wheble, the then-Chair of the ICC Commission on Banking Techniques and Practice, who was at the time the leading figure in the field of letters of credit. In his Introduction to UCP 1974/1983 Revisions Compared and Explained (1984), Wheble stated that one of its goals was to reflect "a look to the future" by making changes in the rules to allow for "the communications revolution replacing paper as a means of transmitting information (data) relating to a trading transaction by means of automated or electronic data processing (ADP/EDP)…." [page 5]. His contribution was acknowledged in the dedication to him of Byrne and Taylor, The ICC Guide to the eUCP (2009), the definitive commentary on the rules for electronic presentation under UCP letters of credit.

[35] UCP 400, *supra* note 31, art. 22(c).

[36] UCP 500 Article 20 (b) provided that:

> Unless otherwise stipulated in the Credit, banks will also accept as an original document(s), a document(s) produced or appearing to have been produced: (i) by reprographic, automated or computerized systems; as carbon copies; provided that it is marked as original and, where necessary, appears to be signed. A document may be signed by handwriting, by facsimile signature, by perforated signature, by stamp, by symbol, or by any other mechanical or electronic method of authentication.

addressed several questions including what could also be accepted as an original document, how a document could be signed and what constituted a "copy".

While the motive was well intended, the drafting left much to be desired. The text as drafted raised the question of whether or not a document that was produced, or appeared to have been produced by a computer, had to be "marked" as an original, how a banker examining documents was to determine whether or not the document was produced by reprographic, automated or computerized systems, and the impact of such a rule on a practice which is founded on the examination of documents "on their face".

In a series of cases, the courts at first concluded that the lack of originality was a basis for refusal, even regarding documents which appeared on their face of the originals and the journey towards the acceptance of such documents.[37] This controversy led to, in effect, an "opinion" of the ICC which in effect rewrote or reinterpreted the provisions in UCP500 which were, in turn, incorporated into UCP600 Article 16.[38]

Subsection (c) continues:

> (i) Unless otherwise stipulated in the Credit, banks will accept as a copy(ies), a document(s) either labelled copy or not marked as an original - a copy(ies) need not be signed. (ii) Credits that require multiple document(s) such as "duplicate", "two fold", "two copies" and the like, will be satisfied by the presentation of one original and the remaining number in copies except where the document itself indicates otherwise.

Int'l Chamber of Commerce, Pub. No. 500,Uniform Customs and Practice for Documentary Credits, art. 20 (1993) [hereinafter UPC 500].

[37] This journey is detailed in JAMES E. BYRNE, THE "ORIGINAL" DOCUMENTS CONTROVERSY: FROM GLENCORE TO THE ICC DECISION (Christopher S. Byrnes & William R. Deiss eds., 1999), and marked by decisions such as Glencore Int'l AG v. Bank of China, [1996] EWHC (Comm) 95, and Kredietbank Antwerp v. Midland Bank PLC, [1997], All E.R. (D) 431.

[38] The ICC Decision on Originals (12 July 1999) reprinted in LC Rules & Laws (4th ed.) at 129. INT'L CHAMBER OF COMMERCE, PUB. NO. 600, UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS, art. 16 (2007) [hereinafter UCP600]. ISP98 Rule 4.15 places the UCP article in the context of standard letter of credit practice but does not provide for such a mechanism to originalize a document by stamping a document "original," although it does not reject this usage. *See* JAMES E. BYRNE, ISP98 AND UCP500 COMPARED 270 (2000). Instead, the ISP rule indicates when an original is required and establishes a presumption that documents are original unless they are apparently copes. Even when they are apparently copies, the rule provides that the presence of what appears to be an original

These legal decisions caused considerable controversy throughout the world and lead to enormous disruptions of trade and commerce as well as considerable litigation and it took considerable measures on the part of many to sort or the resulting mess.

A lesson to be learned from this is that overly-ambitious drafting, however well intentioned, can cause more harm than good.

3. SWIFT and Standardization

The banks involved in letter of credit transactions have taken the lead in facilitating the electrification of letters of credit, most recently collectively, through the agency of SWIFT, apart from and in a certain sense in parallel to the evolution of letter of credit practice rules and law.[39] SWIFT has pursued an agenda encouraging electronic messaging so as to reduce paper and to increase the dependability and authenticity of such communications and has successfully created a set of message types regarding letter of credit related communications. The protocols and even the terminology surrounding these communications have, to a certain extent, influenced the practice related to letters of credit, notwithstanding many disclaimers on the part of SWIFT to do so.[40] To a considerable extent,

---

signature renders them acceptable as originals. A more detailed analysis and further insights are provided in JAMES E. BYRNE, ISP98 AND UCP500 COMPARED 270 (2000).

[39] The Society for World-Wide Inter-bank Financial Telecommunications (SWIFT) is a private international cooperative society of over 10,000 banks and is headquartered in Belgium. It transmits financial messages. *See* SWIFT Website, www.swift.com (last visited Mar. 25, 2012). Because of political reasons, SWIFT has not emphasized the effect of its formatting on the substance of letters of credit, deliberately attempting to cast itself in a secondary role, it is not fully appreciated to what extent the medium has shaped the message. This aspect of letter of credit standardization, however, is a field ripe for academic study. One clear example is the utilization of the terminology related to the "availability" of a letter of credit. This terminology, which quickly became embedded in SWIFT formats, has shaped the thinking of bankers to the extent that, although incomprehensible to most people, bankers continue to think in a credit being available by payment, negotiation, deferred payment undertaking, or site, as is reflected in the latest revision of the Uniform Customs and Practice for Documentary Credits, ICC Publication No. 600, effective 1 July, 2007. INT'L CHAMBER OF COMMERCE, PUB. NO. 600, UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS (2007) [hereinafter UCP600]. *See also* JAMES E. BYRNE ET AL., UCP600: AN ANALYTICAL COMMENTARY 25 (2010).

[40] While SWIFT and the ICC maintain the fiction that SWIFT's systems do not make rules but follow them, there have been numerous instances of the reverse. For example, the term "available" (a credit being "available" in a certain manner as in UCP600 Article 6) came from SWIFT and makes no sense absent the context of the fields so named. UCP600 Article 16(c) (Discrepant Documents, Waiver and Notice) was so structured around the

SWIFT's influence on LC practice has supplanted the role of forms as a means of standardization, although with regard to certain rules of practice, particularly related to standbys and independent guarantees, the role of forms retains significance because SWIFT formatting is essentially a blank slate.[41]

STAGE 3: Acceptance

While it is relatively easy to create a legal framework, rules, and systems, it is much more difficult to obtain market acceptance of them. Acceptance cannot be mandated,[42] yet acceptance of the electrification of a field is essential for its widespread use.

In the attempts made to accommodate commercial letter of credit practice to electrification, considerable time and energy was spent seeking alternatives to order bills of lading which tended to present the most serious obstacles to the electrification of performance or presentation of documents under a letter of credit. Although attempts were made to provide for electrification of documents by contract,[43] absent an international legal

notice of refusal in MT 734 (Advice of Refusal) that its drafters forgot to indicate that the bank giving the notice must do what it indicated that it would do. *See* China New Era Int'l Ltd. v. Bank of China (Hong Kong) Ltd., [2010] 5 H.K.C. 82 (C.A.) (H.K.), where the court interpreted the rule to say what it had omitted from the prior version. *See generally*, James E. Byrne, UCP600: An Analytical Commentary 12-13 (2010).

[41] Its format for letters of credit, the MT 700 series is widely used for commercial letters of credit. MT760 for standbys and independent guarantees is less widely used. Whereas MT 700 and 701 permit mass processing, MT 760 is essentially a blank letter. SWIFT's new project to create formatting for standbys and independent guarantees in an XML format attempts to facilitate the mass processing of these undertakings. The ISP98 Model Forms are an example of a bridge between rules and formats. *See* Documentary Credit World, May 2012, at 10. For more information, email: info@doccreditworld.com.

[42] As noted above, procurement and billing by and for large purchasers, public and private are a notable exception. In order to deal with these large entities, vendors must switch to and use the mandated systems.

[43] The experiments began with the efforts of Chase Manhattan Bank to provide for electronic bills of lading in CBOL, a project that foundered on the unwillingness of other banks to support a system operated by a competitor and the unwillingness of Lloyds of London to insure the process due to the absence of any basis on which to determine potential risk. They continued to SWIFT's Bolero, a project that was based on a contract to deliver the goods rather than a statutory scheme embracing electronic bills of lading. As should have been obvious to a first year law student, private contracting would not answer the problems of priority in the case of insolvency.

regime giving effect to such undertakings, the possibility of electronic bills of lading that would be widely accepted by banks is nonexistent.[44]

Leading figures in the UCP world attempted to circumvent these limitations by pressing for documentation which did not require unique originality, particularly in the form of a so-called "sea waybill." While it was not entirely clear what was the character of this undertaking, it was largely understood to be a receipt for the goods and a contract for carriage but not a document representing title to or control of the goods. As a result, the sea waybill could not be said to be "negotiable." Nor was there any obligation on the part of the carrier to deliver the goods to the person entitled under the document such that that person could itself issue a delivery order requiring such delivery to the holder of the order. Under a sea waybill, the contractual obligation of the carrier was to deliver the goods to the named consignee without more. Possession of the document was irrelevant with respect to this obligation. While UCP500 contained Article 24 (carried forward in UCP600 Article 21) regarding sea waybills, this provision is not widely used and has been largely bypassed.

An end-run to what might be perceived to be a log jam regarding commercial interests and bills of lading is being orchestrated by banks and SWIFT through the mechanism of a "TSU" or trade services utility by means of an electronic invoice labeled a "BPO" (for "Bank Payment Obligation").[45] Despite the name, it is a promise by the bank to pay if its customer's order is satisfied; that is, a letter of credit. This approach is in part a reaction to the fairly dramatic decrease in the number of commercial letters of credit, in use and the abandonment of this instrument in favor of either commercial standby letters of credit or open account undertakings.[46]

---

[44] An interesting, albeit local, exception exists with respect to the United States market for cotton warehouse receipts in which there is a federal statute supporting electronic warehouse receipts. United States Warehouse Act, 7 U.S.C. §§ 241-56 (2006). The limited nature of the market makes such a device possible.

[45] See Summary of the March 2012 ICC Banking Commission Meeting "Reframing the Future of Trade Finance", Documentary Credit World, Apr. 2012, at 34.

[46] This movement, parenthetically, is likely to be accelerated in the event that the risk weighting capitalization proposals inherent in Basel III are implemented assigning a risk weighting of 100 percent to commercial letters of credit as well as standbys and independent guarantees. In that case, it is unlikely that sophisticated customers would be prepared to tolerate the increasing complexity of the commercial letter of credit practice and would abandon it wholesale either in favor of open account or commercial standbys. While, as may well be expected, traditional practitioners and the letter of credit community

As indicated, the evolution of the UCP towards accommodation of electrification began with UCP400, and gradually increased to the point where the drafters of the UCP squarely faced the question of what to do about the possibility of electronic performance, that is, the presentation of electronic documents. Rather than revising or altering the UCP regime, they decided to create a supplemental set of rules to be used with ePresentations which were labeled the eUCP.[47] Originally released in 2002 as a supplement to the-then current version (UCP500), the eUCP was further revised in 2007 to supplement UCP600.[48] These rules contain a fairly sophisticated scheme by which both paper and electronic documents can be presented, by which issues regarding authenticity can be determined, allocating risk of non-receipt of an electronic communication, address questions related to notice of refusal, originality and copies, date of issuance, transport, and the corruption of an electronic record after it has been presented.[49] Despite the careful formulation of the eUCP, and the lack of any serious substantive criticism of it in the literature, the rules have not been used. To date, to the knowledge of the author based on global informal surveys, there has been one instance in which these rules were utilized and that one instance was a mistake in which the bank utilizing the rules did not permit presentation of an electronic document.[50] In the field of letters of credit, this process of acceptance is to a considerable extent a matter of comfort both with respect to the banks issuing letters of credit, their customers, the applicants, and beneficiaries as well as various correspondent banks who play a role in the letter of credit process. The eUCP is only one of a long line of failures in the efforts of market leaders to entice LC users into using electronic data in lieu of paper documents.

---

bemoan this development, the reality is that due to the increasing layers of complexity letters of credit are often an excuse for nonpayment rather than a mode of payment.

[47] TAYLOR, *supra* note 32, at 238-43 (reproducing a copy of the 2007 eUCP Version 1.1 Supplement to UCP600 for Electronic Presentation).

[48] TAYLOR, *supra* note 32, at 198-203 (reproducing a copy of the 2007 eUCP Version 1.1 Supplement to UCP600 for Electronic Presentation).

[49] *See generally*, Byrne & Taylor, *ICC Guide to the eUCP*, (Int'l Chamber of Commerce Pub. No. 639 2002).

[50] This was made by the Korean Exchange Bank in December 2010. ePresentation documents surrounding the LC, which included certificate of weight, certificate of analysis as well as the bill of lading and insurance certificate were handled through Bolero's trade platform. *See KEB Issues First Paperless LC Under eUCP*, TRADE FIN., Dec. 14, 2010.

As intimated, there is a significant difference between commercial letters of credit and standby letters of credit or independent guarantees with respect to issues of performance. There are regular presentations of documents whose operative original is significant under commercial letters of credit. Under standby letters of credit and independent guarantees, it is unlikely that there would be a unique original document presented. As a result, standbys and independent guarantees are more amenable to electrification than are commercial LCs. Being more amenable, however, does not mean that electrification is inevitable or even the norm.

A classical illustration of this point arose in the context of drafting the UN LC Convention. Since this document is related to independent guarantees and standby letters of credit, undertakings not requiring unique documents, it was taken for granted by attorneys and legal scholars unfamiliar with letter of credit practice that it would be possible and, indeed, desirable to provide as a default rule that unless the undertaking provided otherwise presentation of an electronic document complied. The difficulty was that their ideas did not correspond with either practice or the expectation of issuers or users of standbys or independent guarantees. Their expectation was that a paper, rather than an electronic, document must be presented, even though there was no particular desirability of a piece of paper or any particular advantage in terms of authenticity to paper. As a result, any rule that so provided would either be continually varied, a clear sign that the rule is wrong, or would afford a reason for refusing to invoke the statute at all. Happily, the UN LC Convention and corresponding provisions in revised UCC Article 5 avoided (wisely) taking a position with regard to this and left it simply to questions of practice.[51]

ISP98 Rule 3.06 provides an important insight into the frontiers of acceptance of electrification.[52] Rule 3.06 provided that the norm was that

---

[51] "An undertaking may be issued in any form which preserves a complete record of the text of the undertaking and provides authentication of its source by generally accepted means or by a procedure agreed upon by the guarantor/issuer and the beneficiary." UN LC Convention, *supra* note 11, art. 7, § 2.The UN LC Convention may have been overambitious in providing for an electronic substitute of a writing in other situations such as acceptance of an amendment and cancellation, but presumably these matters can be sorted out through judicial interpretation and application of rules and practice.

[52] INT'L CHAMBER OF COMMERCE, PUB. NO. 590, INTERNATIONAL STANDBY PRACTICES ISP98 R. 3.06(a) (1998) [hereinafter ISP98]. ISP98 Rule 3.06 (Complying Medium of Presentation) provides that

(a) to comply, a document must be presented in the medium indicated in the standby; (b) where no medium is indicated, to comply a document must be presented as a paper document, unless only a demand is required, in which case: (i) a demand that is presented there would be presentation of a paper document.[53] It was, of course, recognized that the undertaking could provide for presentation of electronic documents. Indeed, a number of standby letters of credit allow for electronic presentation and even for presentation by means of telefax.[54]

The notable exception to this flexible rule is a situation where a standby letter of credit issued in favor of a bank required presentation only of a demand. In that case, the practice was to permit presentation of a demand by an authenticated electronic means even if the standby did not expressly so provide. In such a situation ISP98 Rule 3.06(b)(i) provided that "a demand presented via SWIFT, tested telex, or other similar authenticated means by a beneficiary that is a SWIFT participant or a bank" would comply, notwithstanding the fact that there was no provision in the independent guarantee permitting presentation by an electronic media. In addition, the rule would apply where the beneficiary was an institution with access to authenticable communications.[55] Interestingly, although in many respects the URDG 758 copies provisions of the ISP, it did not recognize the standard practice with respect to standbys that permitted electronic presentation of documents under clean standbys. In addition, ISP98 provided extensive definitional rules in ISP98 Rule 1.09(c) to accommodate any provision in an ISP undertaking that would allow for electronic presentation.[56]

---

via SWIFT, tested telex, or other similar authenticated means by a beneficiary that is a SWIFT participant or a bank complies; otherwise (ii) a demand that is not presented as a paper document does not comply unless the issuer permits, in its sole discretion, the use of that medium; (c) a document is not presented as a paper document if it is communicated by electronic means even if the issuer or nominated person receiving it generates a paper document from it; (d) Where presentation in an electronic medium is indicated, to comply a document must be presented as an electronic record capable of being authenticated by the issuer or nominated person to whom it is presented.

[53] *Id.*

[54] Landlord/tenant standbys are a good example, as are undertakings for the Chicago Commodity Exchange.

[55] In the ICC's latest exercise in rulemaking for independent guarantees, the URDG 758 (effective 1 July 2010) there is no parallel provision. INT'L CHAMBER OF COMMERCE, PUB. NO. 758, UNIFORM RULES FOR DEMAND GUARANTEES art. 15, (2010) [hereinafter URDG 758].

[56] ISP98 Rule 1.09(c) (1998) provides that in a standby providing for or permitting electronic presentation, "Electronic Record" means (i) a record (information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form); (ii) communicated by electronic means to a system for

The lesson to be learned from this stage of electronic acceptability is that attempts to mandate by legislative fiat or enticement are bound to fail absent market acceptance.[57]

The requisite degree of comfort with electrification must be achieved not only by those who make independent undertakings, which include banks and financial institutions, the beneficiaries of those undertakings one would expect would favor the ability to make electronic presentations, but also those who are obligated to reimburse the financial institutions and those in the background who make the transaction work. It is no great surprise that the normal conservative character of commerce and finance would slow down the acceptance of electronic telecommunication in this field. Moreover, the touted savings inherent in electrification are not necessarily apparent to the budget maker who must allow for an enormous outlay to set up systems to accommodate electrification.

STAGE 4: The Transformation and Evolution of the Product

It should not be assumed that the result of electrification is the same product as the paper version. While appearances may be the same as the paper version and the processing speedier, eProducts have a way of evolving themselves and of changing the business environment in which they operate. The result of this evolution can be the transformation of the product itself. The current world of eLCs as it deals with oil fluctuation clauses and marine bills of lading offers a glimpse of what the future may have in store for the product.

---

receiving, storing, re-transmitting, or otherwise processing information (data, text, images, sounds, codes, computer programs, software, databases, and the like); and (iii) capable of being authenticated and then examined for compliance with the terms and conditions of the standby; "Authenticate" means to verify an electronic record by generally accepted procedure or methodology in commercial practice: (ii) the identity of a sender or source, and (ii) the integrity of or errors in the transmission of information consent; "Electronic signature" means letters, characters, numbers, or other symbols in electronic form, attached to or logically associated with an electronic record that are executed or adopted by a party with present intent to authenticate an electronic record; and "Receipt" occurs when: (i) an electronic record enters in a form capable of being processed by the information system designated in the standby, or (ii) an issuer retrieves an electronic record sent to an information system other than that designated by the issuer." ISP98, *supra* note 52, R. 1.09(c) (1998).

[57] This evokes the lesson gleaned from *King Canute and the Waves*, a legend familiar to English schoolchildren of King Canute and the Waves in which King Canute (of Denmark) sat on a throne on the shore of the ocean and commanded the waves to recede, which of course they did not. Helene Adeline Guerber, *King Canute and the Waves, in* THE STORY OF THE ENGLISH, 63-67 (Amer. Book Co. ed. 1898).

Letters of credit are commonly used to pay for purchase of oil on the spot market either in the form of standbys or commercial letters of credit. Oil is a highly volatile commodity within a fairly wild range of extremes from the time of issuance of the LC to the time of delivery of the oil. While traditional letters of credit state a maximum amount, such a maximum defeats the purpose of the oil fluctuation credit. What the beneficiary/seller wants is the issuer's undertaking that it will pay the price of the oil however it may fluctuate. Accordingly, such letters of credit state a price which is linked to some objective source by which the price can be measured. Commonly, the linkage is to well-known market surveys such as Platts for a given region.[58]

Such a clause gives rise to several questions. In the first place, is such a clause enforceable and does it constitute a letter of credit.[59] Put another way, the problem is what to reference to a source outside the context of a letter of credit constitutes a non-documentary condition rendering the undertaking something other than a letter of credit, namely a simple contract to which the argument of indefiniteness or uncertainty may be raised.

It must be asked whether or not it is possible to turn to objective sources in order to determine the character of an undertaking.[60] Reference

---

[58] Platts, About Us, http://www.platts.com/AboutPlattsHome/ (last visited May 10, 2012). The terms of the letter of credit might provide "the amount of this letter of credit shall automatically fluctuate to cover any increase/decrease according to the price clause without further amendment to this credit."

[59] There may be other issues regarding such a clause, on the level of the safety and soundness of the provision, but the operative legal question is whether or not such a clause is possible within an undertaking denominated as a "letter of credit".

[60] The clearest commercial example of such a provision would be the question of whether the interest that may be charged in a negotiable promissory note can be linked to an objective formula (such as a given bank's published prime bank rate or based on a calculation predicated on U.S. Treasury obligations of a certain duration outside the "four corners" of the instrument. It is now settled that objective criteria by which a calculation may constitute a proper reference for an instrument that retains the element of negotiability. Taylor v. Roeder, 360 S.E.2d 191, 192 (Va. 1987) (concluding that a note providing for a variable rate of interest, not ascertainable from the face of the note, is not a negotiable instrument), reflects the older approach. The decision was changed by legislation within weeks of having been rendered. *See* JAMES E. BYRNE, NEGOTIABILITY: THE DOCTRINE & ITS APPLICATION IN US COMMERCIAL LAW 42 (14th ed. 2005). The 1990 Model Code version of UCC Article 3 provides that

> [i]nterest may be stated in an instrument as a fixed or variable amount of money or it may be expressed as a fixed or variable rate or rates. The

to an objective and readily available index is not something that renders the undertaking obscure or indefinite and is not "non-documentary in the sense that it is possible to make an objective verification of the data. Banks look to clocks to tell time, calendars to determine dates, and the internet (and before that printed bulletins or phone calls) to determine LIBOR.[61] Moreover, there is little difference between an undertaking to pay at a rate calculated if one were to provide a photocopy of the Platt’s rate and a situation where the bank determines what constitutes that rate. In other situations, the bank must make determinations that are technically non documentary regarding the date and time of presentation and whether or not it was timely or whether or not in some standbys an advanced payment was made to an account in the bank or an advanced payment guarantee or standby was lodged with the bank.[62] Accordingly, it is possible to link the undertaking with matters which can be objectively verified.[63]

> amount or rate of interest may be stated or described in the instrument in any manner and may require reference to information not contained in the instrument. If an instrument provides for interest, but the amount of interest payable cannot be ascertained from the description, interest is payable at the judgment rate in effect at the place of payment of the instrument and at the time interest first accrues. U.C.C. § 3-112(b) (2002).

[61] LIBOR is the London Inter-bank Offered Rate. It is the average interest rate that leading banks in London charge when lending to other banks. It is a trimmed average of interbank deposit rates offered by designated contributor banks, calculated and published by Thomson Reuters every day after 11:00 AM, London time.

[62] ISP98 Rule 4.11 (Non-Documentary Terms or Conditions) (c) provides:

> Determinations from the issuer’s own records or within the issuer’s normal operations include determinations of: (i) when, where, and how documents are presented or otherwise delivered to the issuer; (ii) when, where, and how communications affecting the standby are sent or received by the issuer, beneficiary, or any nominated person; (iii) amounts transferred into or out of accounts with the issuer; and (iv) amounts determinable from a published index (e.g., if a standby provides for determining amounts of interest accruing according to published interest rates).

ISP98, *supra* note 52, R. 411 (1999).

[63] *See, e.g.*, Korea Exch. Bank v. Standard Chartered Bank, [2005] SGHC 220 (2005) (holding that an oil price fluctuation clause that is linked to a published table and that operates without amendment controls over a specific amount and a specific tolerance stated in the appropriate SWIFT Fields for amount and amount tolerance so that the amount available under the credit can be greater or lesser than that stated). For further analysis, *see*

It is possible, however, to take another step. There is no good commercial reason that data capable of external verification cannot be undertaken in an electronic form. Documents from third parties such as certification of inspection are commonly required in commercial LCs. Moreover, some data in required documents is not readily susceptible to paper-based verification, such as the location of a vessel on a given date. In a similar vein, it may be asked whether or not verification of the objective accuracy of any representation might not be made electronically and whether or not that verification might constitute a basis for refusal. Such representations could include a bill of lading, custom documents, or inspection certificates. From here, a further step is possible. Instead of using eData for a paper document, why not verify facts heretofore not verifiable thereby reducing dependence on paper representations? To give an example, if a letter of credit called for a statement or document to the effect that goods were laden on board a named vessel at a given location on a certain date, based on sources now available and available electronically it is possible not only to determine whether the carrier issued a bill of lading and its contents, but to determine whether or not that given vessel was at the indicated location on the given date.

It may be asked whether or not an issuer or guarantor of an independent undertaking could refuse payment under current LC law and practice even if the document presented demanding payment contained terms which complied with the terms and conditions of the letter of credit. The proper answer is that the issuer or guarantor can refuse payment predicated on LC fraud or abuse.[64] A demand for payment based on shipment on board at vessel at a given location is fraudulent if the vessel is not at the location on the purported date of loading. The question is whether the guarantor or issuer can meet its burden of proving that the recital or representation was fraudulent which would amount to proving the reliability of the data and its veracity. The fact that the data is available electronically should not in itself defeat the admissibility of such evidence which ought to be treated in the same mode as would a representation in a paper medium. That question ought to be resolved on the reliability of the medium and the availability of other evidence in support of the assertion rather than the format in which the information is contained.

---

also INSTITUTE OF INT'L BANKING LAW & PRACTICE, ANNUAL SURVEY OF LETTER OF CREDIT LAW & PRACTICE, 376-85 (James E. Byrne & Christopher S. Byrnes eds. 2006).

[64] *See* UN LC Convention, *supra* note 11, arts. 19-2020; U.C.C. § 5-109 (2000).

This question arose obliquely in the context of a recent case, *MAP Marine Ltd. v. China Construction Bank Corp.*[65] In that case, a letter of credit was issued to pay for a vessel charter in connection with the shipment of goods was transferred.[66] The transferee beneficiary had unsuccessfully sought to have the credit amended to reflect payment for services connected with the charter and not the charter itself.[67] When the transferring bank refused a demand by the transferee beneficiary on the ground that the unsuccessful request to amend signaled that the drawing was fraudulent, the transferee beneficiary sued the transferring bank for wrongful dishonor.[68] Summary judgment in favor of the beneficiary was affirmed.

Of interest was the allegation by the transferring bank that the named vessel was located elsewhere on the date of the alleged loading. The appellate opinion questioned the authoritativeness of the website on which the transferring bank relied, noting that it was not an appropriate subject for judicial notice. The opinion does not disclose the site, but there are several websites that track such information. It may be wondered whether they are fit for judicial notice, but such sites provide a basis for a witness to testify as to their reliability. Moreover, there are certain sites, such as Lloyd's Register,[69] that are regarded as authoritative. Data in an online registry of that caliber would be appropriate for judicial notice.

Reference to such data opens a door to a better and more efficient instrument with the potential to reduce the possibility of commercial fraud. If the credit were payable against verification of data in a registry, the indication that the vessel was not at a given port on a given date would be a basis for proper refusal of a demand. Under such a term in the LC, it would no longer be necessary for the issuer or guarantor to prove that the information contained in the database was true or that the beneficiary or a person providing this information to the beneficiary committed "fraud," but simply a question of whether or not the data or representations reflected in the documents presented corresponded with the requirements of the credit. In this sense, the requirements of the credit would include not simply

[65] 70 A.D.3d 404 (N.Y. App. Div. 2010), *aff'd per curiam*, 78 A.D.3d 614 (N.Y. App. Div. 2010).

[66] *Id.* at 404.

[67] *Id.*

[68] *Id.*

[69] *See* Lloyd's Register; About Us, http://www.lr.org/about_us/ (last visited May 10, 2012).

examination of the statements contained in the credit but also correspondence with databases regarding those statements.

The great advantage of such an approach is that it makes available to the issuer and correspondingly the applicant, a valuable tool against beneficiary fraud.[70] From the perspective of the beneficiary the question is whether or not this requirement poses a subjective or discretionary basis by which resistance to such a provision can be defended. Where the source is not subjective, it would seem odd that the beneficiary would resist.

It may be asked whether such a condition in a letter of credit would render meaningless the independence or abstraction of the letter of credit undertaking.[71] That abstraction, however, assures payment against representations. There is no reason that these representations cannot be electronic and sited in databases that are objective as opposed to being situate in pieces of paper that are presented.

Similar possibilities would arise with respect to determinations of the objective compliance of the goods with certain norms as the result of actions by testing agencies, governmental agencies, and other third parties. The possibilities are as endless as the circumstances in which a buyer

---

[70] Or, at the least, shifts the type of fraud that must be guarded against and reduces its incidence. Fraudulent databases exist and genuine ones are capable of corruption.

[71] The notion of independence is at the heart of the modern letter of credit. A letter of credit is valuable to sellers because it assures payment on the basis of representations, including those of third parties.

> UN LC Convention Article 3 (Independence of undertaking) states:
> For the purposes of this Convention, an undertaking is independent where the guarantor/issuer's obligation to the beneficiary is not:
> (a) Dependent upon the existence or validity of any underlying transaction, or upon any other undertaking (including stand-by letters of credit or independent guarantees to which confirmations or counter-guarantees relate); or
> (b) Subject to any term or condition not appearing in the undertaking, or to any future, uncertain act or event except presentation of documents or another such act or event within a guarantor/issuer's sphere of operations. UN LC Convention, *supra* note 11.

Revised UCC Section 5-103(d) (Scope) provides "Rights and obligations of an issuer to a beneficiary or a nominated person under a letter of credit are independent of the existence, performance, or nonperformance of a contract or arrangement out of which the letter of credit arises or which underlies it, including contracts or arrangements between the issuer and the applicant and between the applicant and the beneficiary."

desires to have objective verification of a shipment of conforming goods before its bank pays. While the seller will properly resist any condition that smacks of subjectivity, it should also welcome objective verification. The limits are the objectivity of the source and a matter of encompassing or encapsulating them which assures the integrity of the undertaking.

As a result, it may be speculated that the letter of credit of the future, while remaining independent in a certain form of assurance of payment, nonetheless offers to all parties an enhanced ability to provide assurance of actual performance, reducing risk of fraud and expense inherent in the transaction. For this step to occur, determination must be made as to what sites are authoritative and objective. Into this brave new world of electronic letters of credit or independent guarantees, it is possible to project a more dependable, more certain, less expensive and more efficient mechanism to assure payment.

Can the "Formidable Shield" Last: A Re-examination of Copyright Law as a Means to Control Uncopyrighted Gray Market Goods

Ya Xia*

Introduction

Gray market goods created from unauthorized sales of genuine goods often result from economic incentives like price differences. The following scenario is typical for gray market goods: Product X is sold in Country A for $10 (USD) while priced at $20 (USD) in Country B. Where the price difference between Product X in Country A and B is big enough to cover all costs and still leave a profit margin, Product X is likely to be bought in Country A for $10 (USD) and transported from Country A to B for re-sale. In Country B, the copyright or trademark rights to Product X belong to Owner Co., Ltd. However, Distributor Co., Ltd., which takes advantage of the price differences, often distributes Product X without the authorization of Owner Co., Ltd. When Product X is redistributed in this manner, it becomes a gray market good—genuine yet unauthorized for sale in the country where it is finally sold to the consumer.

Apple products like the iPhone 4S have been frequently bought in Hong Kong and transported into Mainland China for re-sale by dealers who are incentivized by approximately $80 (USD) in profit per iPhone 4S purchased in Hong Kong and sold in China.[1] This trade certainly is not unique. On the contrary, gray market goods are considered to be a

---

* Nanjing University Law School (China), Master of Laws, 2012 Candidate; University of Wisconsin Law School, Master of Laws-Legal Institutions, May 2011; Nanjing University, combined Bachelor of Arts program of English and Law. I would like to thank Professor Anuj C. Desai for his insightful direction and Annamarie Larson for her kind help in making improvements. I owe my deepest gratitude to my parents for their selfless love and support.

[1] Chris Chang, *Parallel Importers Packing a Lot of iPhone 4S on Subway (with Video!)*, M.I.C. GADGET (Oct. 1, 2010, 2:31 PM), http://micgadget.com/8684/parallel-importers-packing-a-lot-of-iphone-4s-on-subway/; *see also* Gerry Shih & Poornima Gupta, *Tough Times in the U.S.-China iPad Smuggling Game*, REUTERS (Mar. 25, 2012, 10:21 PM), http://www.reuters.com/article/2012/03/26/us-apple-ipad-blackmarket-idUSBRE82O0G420120326 (discussing how individuals smuggling iPads from the U.S. to China are making less money than they used to, but some smuggling operations are still profitable).

"significant phenomenon."[2] Though there are no official statistics on the volume of gray market goods in the United States,[3] gray market goods could cost rights holders billions of dollars of lost sales each year. A 2008 study found that "[i]nformation technology manufacturers are losing up to US $10 billion in profits annually to the gray market, with as much as $58 billion of technology products passing through the gray market each year."[4] In addition, academic and organizational studies show that gray market goods are difficult to eliminate because their relatively low prices readily attract buyers.[5] After all, where there is profit, there is trade.

Gray market goods such as Product X directly and indirectly undermine the integrity of Owner Co., Ltd.'s business in a variety of ways, including: (1) damaging the value of Owner Co., Ltd.'s brand,[6] which may also reduce Owner Co., Ltd.'s market share; (2) undermining Owner Co., Ltd.'s quality control scheme;[7] (3) free-riding on the established reputation of Owner Co., Ltd.;[8] and (4) infringing upon Owner Co., Ltd.'s proprietary rights.[9] Therefore, intellectual property rights owners wish to protect their rights, profits and reputation. While trademark law provides one set of intellectual property rights to businesses, as Judge Barry noted in *Sebastian*

---

[2] Yongmin Chen & Keith E. Maskus, *Vertical Pricing and Parallel Imports*, 14 J. INT. TRADE & ECON. DEV., no. 1, Mar. 2005, at 1.

[3] *Id.*

[4] Press Release, KPMG & Alliance for Gray Mkt. and Counterfeit Abatement, KPMG/AGMA Survey Projects Global 'Gray Market' of $58 Billion for Information Technology Manufacturers (December 11, 2008), http://www.agmaglobal.org/press_events/news_releases.shtml.

[5] *See id.* at 374 (analyzing the consequences of gray market goods in light of the fact that they are sold under low prices).

[6] Lars H. Liebeler, *Trademark Law, Economic and Grey Market Policy*, 62 IND. L.J. 753, 756-57 (1987).

[7] Hazbo Skoko & Branka Krivokapic-Skoko, *Theory and Practice of Parallel Imports: An Essay* 8, *in* Managing the Process of Globalization in New and Upcoming E.U. Members: Proceedings of the 6th International Conference of the Faculty of Management Koper Congress Centre Bernardin, Slovenia 24-26 November 2005, at 470 (Faculty of Management Koper eds.) (2005), *available at* http://www.fm-kp.si/zalozba/ISBN/961-6573-03-9/skoko.pdf.

[8] *Id.* at 466-67.

[9] Shubba Ghosh, An Economic Analysis of the Common Control Exception to Gray Market Exclusion, 15 U. PA. J. INT'L BUS. L. 373, 374 (1994).

v. Consumer Contact,[10] "American businesses have been slow to recognize the power granted them to control the importation of gray market *copyrighted* works."[11] Acknowledging that there had been some "confusion" in trademark law in stopping importation of gray market goods, Judge Barry questioned "why plaintiffs continue to rely on those uncertain [trademark] rights when the copyright law provides such a *formidable shield*."[12] The past thirty-years of United States jurisprudence shows that Judge Barry's recommendation regarding copyright enforcement has been adopted as one of the best tools to fight against gray market goods.[13] Nonetheless, as this paper will show, the use of copyright law to protect against gray market distribution of *uncopyrightable* goods by attaching copyrightable items to these uncopyrightable goods is an improper use of copyright law protections and should be stopped.

Currently, in the United States, it is possible for copyright owners to stop importation and distribution of unprotected trademark goods by attaching copyrighted accessories to these goods if the copyright has not been exhausted under the first sale doctrine.[14] However, this practice is ineffective in Australia because Australian law deems the copyright non-infringed in this situation.[15] Furthermore, attaching copyrighted accessories to unprotected goods has been denounced by the Supreme Court of Canada.[16] Although this practice of copyright overreach—by appending copyrightable goods to uncopyrightable goods to combat gray market goods—is possible in the United States, the following analysis will show that it is not supported by United States law under both a proper interpretation of the Copyright Act and the copyright misuse doctrine.

---

[10] 664 F. Supp. 909 (D.N.J. 1987).

[11] *Id.* at 992 (emphasis added).

[12] *Id.* (emphasis added). Regarding the "confusion" in trademark law, Judge Barry explains: "a trademark owner cannot with impunity rely on its mark given the wide split of authority as to what protection the Lanham Act provides against the importation of gray market goods." *Id.* at 910.

[13] *See, e.g.*, Andrew B. Chen, *Shopping the Gray Market: the Aftermath of the Supreme Court's Decision in* Quality King Distributors, Inc. v. L'Anza Research International, Inc., 19 LOY. L.A. ENT. L.J. 573, 592-98 (1999) (discussing different methods for preventing gray market sales).

[14] *See* Quality King Distribs., Inc. v. L'anza Research Int'l Inc., 523 U.S. 135, 140 (1998).

[15] *Copyright Act* 1968 (Cth) s 44C(1) (Austl.).

[16] Euro-Excellence Inc. v. Kraft Canada Inc., [2007] 3 S.C.R. 20, paras. 84-88 (Can.).

The first section of this paper will discuss contemporary legal trends concerning copyright law and gray market goods as outlined in key United States and Canadian Supreme Court decisions. The second segment of this paper will elaborate upon how "formidable"[17] copyright law actually is by exploring the limits of United States trademark and copyright law as a shield against gray market good distribution and sales. The third part of this paper discusses Australian and Canadian responses to the issue of overreaching in copyright law in relation to gray market goods. Finally, this paper will conclude by detailing why the current tolerance of copyright overreaching to control gray market goods is contrary to the Congressional intent of United States statutory law and the copyright misuse doctrine.

I. Disparate Treatment of Copyright Law to Combat Gray Market Goods

Both the United States and Canadian Supreme Courts have confronted cases where copyright law was being used to control uncopyrightable gray market goods by attaching copyrightable accessories. Notably, these Courts have reached different conclusions, and it is critical to understand their analysis of legitimate copyright law reach to better understand the implications of current legal tools available to prevent and remedy gray market good sales.

In the seminal case *Quality King Distributors v. L'anza Research International, Inc*[18], the United States Supreme Court allowed the expansion of copyright law to protect uncopyrightable goods through the attachment of copyrightable accessories.[19] In *Quality King*, the plaintiff L'Anza, an American manufacturer of hair care products, tried to stop Quality King's unauthorized distribution of L'Anza hair care products in the United States. The products in question were made in the United States and exported by L'Anza specifically for sale in foreign markets. Quality King then purchased the products overseas, re-imported them into the United States, and sold them. Although the products themselves were not copyrightable, the labeling on the bottle was protected by copyright. Thus, L'Anza claimed that the importation and distribution of the hair care products with the attached copyrighted labels infringed on L'Anza's importation and

[17] Sebastian Int'l., Inc. v. Consumer Contact (PTY) Ltd., 664 F. Supp. 909, 922 (D.N.J. 1987).

[18] 523 U.S. 135 (1998).

[19] *See* Quality King Distribs., Inc. v. L'anza Research Int'l Inc., 523 U.S. 135 (1998).

distribution rights.[20] In other words, L'Anza tried to stop the importation and distribution of its product through its copyright monopoly over the attached labels. The California District Court and the Ninth Circuit both concluded that Quality King had infringed L'Anza's copyright.[21]

The Supreme Court did not explicitly address the issue of whether L'Anza had an enforceable copyright that could stop the distribution of the products but, instead, narrowly framed the issue to be whether Section 109 of the Copyright Act of 1976 (the "Copyright Act"), known as the "first sale doctrine," applied to "round trip" importation (i.e. whether a copyright owner can stop distribution of a *copyrighted* product *first made* in the United States, sold abroad and then re-imported into the United States for re-sale).[22] Under the first sale doctrine, discussed in detail in Part II.B, the sale of a copyrighted product, in some circumstances, terminates the copyright holder's copyright protections with regards to that product. The Court held that the first sale doctrine precluded infringement in the L'Anza round trip importation situation, thus reversing the Ninth Circuit on this narrow ground.[23]

Quality King establishes a problematic precedent for copyright law overreach as the case deals with infringement of the copyrighted labels but the Court does not directly address whether the sale of the uncopyrighted core product was an infringement of L'Anza's intellectual property rights.[24] By reversing the Ninth Circuit only on the narrow ground of the application of the first sale doctrine to round trip importation, the result of this holding is essentially the extension, as a general rule, of copyright protection to include both copyrighted materials (such as the product labels) and

[20] *Id*. at 138-40.

[21] *Id.*

[22] *Id.* The first sale doctrine is that "once the copyright owner places a copyrighted item in the stream of commerce by selling it, he has exhausted his exclusive statutory right to control its distribution." *Id.* at 152.

[23] *Id.* at 143-44. The court ultimately held that under first sale doctrine, Quality King was the lawful owners of hair care products having the copyrighted labels, and thus did not engage in copyright infringement by importing and reselling products without L'Anza's authority.

[24] *See* Quality King Distribs., Inc. v. L'anza Research Int'l Inc., 523 U.S. 135, 153 (1998) (discussing how the court's role was to correctly interpret the applicable statues with regard to importation and not to discuss the intellectual property policy behind L'Anza's arguments).

uncopyrighted materials (such as the bottles and the product inside the bottles), simply because the uncopyrighted products have a copyrighted label attached to them.[25] Because the Court might have overlooked the problem of copyright law extension to uncopyrighted goods in making its decision, the Court has opened a door for intellectual property owners to fight against gray market uncopyrighted goods by attaching copyrighted accessories.[26]

Conversely, the Canadian Supreme Court has denounced the adoption of copyright law as a means to control the importation of gray market goods where the copyrighted items were only accessories in *Kraft Canada Inc. v. Euro Excellence Inc*.[27] Importantly, this case presents facts that are very similar to those adjudicated in *Quality King*. The Canadian copyright owner, Kraft Canada Inc. ("KCI"), tried to stop sales and distribution of genuine Kraft chocolate bars in Canada by Euro-Excellence ("EE"). The chocolate bars that EE wished to sell in Canada had been purchased from Kraft Foods Schweiz AG ("KFS") and Kraft Foods Beligium SA ("KFB") in Europe.[28] In order for KCI to proceed in court under copyright law, KFS and KFB both registered copyrights on their logos and scripts in 2002,[29] the exclusive rights to which were subsequently assigned exclusively to KCI through a licensing agreement.[30] Based on the rights obtained, KCI demanded that EE cease any further sales and distribution of products to which those copyrighted logos and scripts were attached.[31] Upon EE's refusal, KCI filed a suit for copyright infringement on the grounds that the distribution of products to which copyrighted logos and scripts were attached violated its copyright.[32]

---

[25] *See id.* at 140.

[26] *See, e.g.*, Omega S.A. v. Costco Wholesale Corp., 541 F.3d 982, 987 (9th Cir. 2008), *aff'd by an equally divided court*, 131 S. Ct. 565 (2010).

[27] [2007] 3 S.C.R. 20 (Can.).

[28] *Id.* at paras. 60-63 (Bastarache, J., concurring).

[29] *Id.* at paras. 62-63; Teresa Scassa, *Using Copyright Law to Prevent Parallel Importation: A Comment on* Kraft Canada Inc. v. Euro Excellence, Inc., 85 CAN. B. REV. 409, 411 (2006).

[30] Scassa, *supra* note 31, at 411-12.

[31] *Id.* at 412.

[32] *Euro-Excellence*, *[2007] 3 S.C.R. 20*, para. 64 (Bastarache, J., concurring).

In a seven-to-two split decision, the Canadian Supreme Court ruled against KCI.[33] The majority decision was further divided. Justices Binnie, Deschamps and Rothstein held that secondary infringement (by importing for sale or distribution copies of KFS and KFB's copyrighted works into Canada) under Section 27(2)(e) of the Copyright Act of Canada was not established because secondary infringement requires there to be a primary infringement, and the licensors (KFB and KFS), who were the hypothetical infringers in this case, cannot infringe their own respective copyrights.[34] Justice Fish expressed doubt about "whether the law governing the protection of intellectual property rights in Canada can be transformed in this way into an instrument of trade control not contemplated by the *Copyright Act*," as KCI sought to do.[35] Justices Bastarache, LeBel and Charron directly pointed out that the "merely incidental presence of the copyrighted works on the wrappers of the chocolate bars does not bring the chocolate bars within the protections offered by the *Copyright Act*."[36] In other words, copyright law as a means to control gray market goods should be limited to goods with non-incidental copyrightable elements. After all, there is a substantial difference between copyrighted books and movies and copyrighted logos or pictures affixed to the wrappers of uncopyrighted products.

As these case studies clearly show, the United States and Canadian Supreme Courts have taken conflicting positions concerning the extent to which copyright law should apply to gray market goods. Following the United States Supreme Court's holding in *Quality King*, using copyright law to control uncopyrighted gray market goods by attaching copyrighted accessories is a lawful practice in the United States.[37] Nonetheless, as the concerns raised by the Canadian Supreme Court underscore, this overreaching use of copyright law goes against the spirit of the Copyright Act.

---

[33] *Id.* at para. 51 (majority opinion).

[34] *Id.* at paras. 19, 50.

[35] *Id.* at para. 56 (Fish, J., concurring).

[36] *Id.* at para. 57 (Bastarache, J., concurring).

[37] *See, e.g.*, Omega S.A. v. Costco Wholesale Corp., 541 F.3d 982, 983 (9th Cir. 2008) (foreign-made watches with a copyrighted design engraved on their underside are subject to protection under United States copyright law).

II. Controlling Gray Market Goods: United States Trademark and Copyright Law

A. Trademark Law Protections Against Gray Market Goods

As the United States and Canadian Supreme Court cases indicate, there is an urgent need to control gray market goods, even if the extent to which copyright law should be used to protect uncopyrighted goods is disputed. United States trademark law is an important tool to help intellectual property rights owners protect themselves against the damages of gray market goods. For instance, the Lanham Act grants trademark owners the exclusive right to import and distribute trademarked goods.[38] In particular, the United States Supreme Court's decision in *K-Mart Corp. v. Cartier, Inc.*[39] established that a trademark holder has the right to enlist the United States Customs Service's[40] assistance in barring the unauthorized importation of trademarked goods under the Lanham Act.[41] Furthermore, according to Section 1526 of the Tariff Act of 1930 ("Tariff Act"), it is unlawful to import foreign-manufactured trademarked goods into the United States without the written authorization of the trademark owner of the importing country.[42]

---

[38] 15 U.S.C §§ 1125(b), 1114(1), 1124 (2006).

[39] 485 U.S. 176 (1988).

[40] *Id.* The United States Customs Service, along with the Immigration and Naturalization Service, was folded under the United States Department of Homeland Security and split into the US Customs and Border Protection and the US Immigration and Customs Enforcement on March 2003. *CBP and ICE: Does the Current Organizational Structure Best Serve U.S. Homeland Security Interests? Part II and III Before the H. Subcomm. on Mgmt, Integration, and Oversight of the H. Comm. on Homeland Sec.*, 109th Cong. (2005 and 2006) (prepared statement of Art Gordon, Nat'l President of the Fed. Law Enforcement Officers Ass'n).

[41] K Mart Corp. v. Cartier, Inc., 485 U.S. 176, 186-86 (1988).

[42] 19 U.S.C. § 1526(a) (2011). The law reads:

> [I]t shall be unlawful to import into the United States any merchandise of foreign manufacture if such merchandise, or the label, sign, print, package, wrapper, or receptacle, bears a trademark owned by a citizen of, or by a corporation or association created or organized within, the United States, and registered in the Patent and Trademark Office by a person domiciled in the United States . . . unless written consent of the owner of such trademark is produced at the time of making entry.

Unfortunately, the Lanham Act and subsequent case law interpreting the Act do not protect all trademark holders. Under United States trademark law, a company may be granted a trademark that essentially functions as a monopoly on distribution of the trademarked products.[43] However, 19 CFR § 133.23(d) provides a "safe harbor" for any third party to legally distribute trademarked goods without the authorization of the trademark holder in particular circumstances.[44] Section 133.23(d)(1) states that when the trademark of the unauthorized product is owned by a foreign company that is a parent or subsidiary of the United States owner or is subject to common control or ownership with the United States owner, these unauthorized products can be distributed without the trademark owner's authorization.[45] Section 133.23(d)(2) differs from Section 133.23(d)(1) to the extent that there is only one trademark owner. Section 133.23(d)(2) details that when (1) the unauthorized products are first sold by a parent or subsidiary of the United States owner or are subject to common control or ownership of the United States owner, and (2) the unauthorized products are not physically and materially different, such unauthorized products can be distributed without the trademark owner's authorization.[46] Section 133.23(d)(3) outlines the "label" rule.[47] Pursuant to

---

[43] *E.g.*, Sneha Jain, *Parallel Imports and Trademark Law*, 14 J. INTELL. PROP. R. 14, 14 (2009).

[44] 19 C.F.R. § 133.23(d) (2011) states that "Gray market goods subject to the restrictions of this section shall be detained for 30 days from the date on which the goods are presented for Customs examination, to permit the importer to establish that any of the following exceptions" in § 133.23(d)(1)-(3) are applicable. Sections 133.23(d)(1)-(3) read:

(1) The trademark or trade name was applied under the authority of a foreign trademark or trade name owner who is the same as the U.S. owner, a parent or subsidiary of the U.S. owner, or a party otherwise subject to common ownership or control with the U.S. owner; and/or

(2) For goods bearing a genuine mark applied under the authority of the U.S. owner, a parent or subsidiary of the U.S. owner, or a party otherwise subject to common ownership or control with the U.S. owner, that the merchandise as imported is not physically and materially different, as described in §133.2(e), from articles authorized by the U.S. owner for importation or sale in the United States; or

(3) Where goods are detained for violation of §133.23(a)(3), as physically and materially different from the articles authorized by the U.S. trademark owner for importation or sale in the U.S., a label in compliance with §133.23(b) is applied to the goods.

[45] 19 C.F.R. § 133.23(d)(1) (2011).

[46] 19 C.F.R. § 133.23(d)(2) (2011).

[47] 19 C.F.R. § 133.23(d)(3) (2011).

this rule, the importation and subsequent sale of otherwise unauthorized goods is allowed when a label is applied to the goods so that customers can identify the source of the goods and distinguish them from authorized United States goods in compliance with Section 133.23(b).[48]

Simply put, the "safe harbor" exceptions created by Section 133.23(d) make it difficult for trademark owners to fight against the distribution of gray market goods using trademark law.

B. Copyright Law Protections Against Gray Market Goods

As a result of the gaps that exist in trademark law, intellectual property owners attempt to find protection under alternative legal mechanisms. Copyright law is the legal mechanism to which intellectual property owners most commonly turn when attempting to preserve their interests. However, like trademark law, the protections offered to rights holders by United States copyright law are also limited in terms of controlling gray market goods. Specifically, copyright law faces a statutory interpretation problem regarding the extent to which Section 109 of the Copyright Act,[49] which introduces the first sale doctrine, applies to copyrighted goods.

Under the United States Copyright Act, Section 106(3)[50] sets out the exclusive right to distribute,[51] and Section 602 grants the copyright owner

---

[48] 19 CFR § 133.23(b) (2011). This section reads:

> Goods determined by the Customs Service to be physically and materially different under the procedures of this part, bearing a genuine mark applied under the authority of the U.S. owner, a parent or subsidiary of the U.S. owner, or a party otherwise subject to common ownership or control with the U.S. owner (see §§133.2(d) and 133.12(d) of this part), shall not be detained under the provisions of paragraph (c) of this section where the merchandise or its packaging bears a conspicuous and legible label designed to remain on the product until the first point of sale to a retail consumer in the United States stating that: "This product is not a product authorized by the United States trademark owner for importation and is physically and materially different from the authorized product." The label must be in close proximity to the trademark as it appears in its most prominent location on the article itself or the retail package or container. Other information designed to dispel consumer confusion may also be added.

[49] 17 U.S.C § 109(a) (2006).

[50] 17 U.S.C § 106(3) (2006).

[51] 17 U.S.C § 106(3) (2011).

the exclusive right to import his or her goods into the United States.[52] Yet, these fundamentals of copyright law are qualified by the first sale doctrine presented in Section 109 of the Copyright Act, which reads, "[T]he owner of a particular copy or phonorecord *lawfully made under this title*, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord."[53] In other words, distributors can use the first sale doctrine to sell or distribute copyrighted goods without the authorization of the copyright holder because the copyright holder's rights over distribution or importation were "exhausted" (i.e., terminated) when the rights owner first sold the copyrighted items.[54]

Significantly, the first sale doctrine does not apply in every circumstance. Rather, it applies only when the good is "lawfully made under this title"[55] (i.e. "lawfully made under" the Copyright Act). Thus, the place of manufacture and place of first sale of goods determine the applicability of Section 109.

Four basic scenarios for the application of Section 109 exist and the law is not settled in all these scenarios. Scenario A is where the copyrighted product is manufactured and first sold in the United States. Scenario B is where the copyrighted product is made in the United States and first sold abroad. Scenario C is where the copyrighted product is produced abroad and first sold in the United States. Finally, Scenario D is where the copyrighted product is both manufactured and first sold abroad. The following table represents how the first sale doctrine in Section 109 applies in these four scenarios, which will be explained in greater detail below:

---

52 17 U.S.C § 602 (2006).

53 17 U.S.C § 109(a) (2006) (emphasis added).

54 Quality King Distribs., Inc. v. L'anza Research Int'l Inc., 523 U.S. 135, 152 (1998) (When the first sale doctrine applies, the owner has "exhausted his exclusive statutory right to control its distribution."); Parfums Givenchy, Inc. v. Drug Emporium, Inc., 38 F.3d 477, 480 (9th Cir. 1994) ("[U]nder the "first sale" doctrine . . . a sale of a 'lawfully made' copy terminates the copyright holder's authority to interfere with subsequent sales or distribution of that particular copy.").

55 17 U.S.C § 109(a) (2006).

Scenario	**Made**	**First Sold**	**§ 109 Apply or Not**
A	United States	United States	Yes (settled)[56]
B	United States	Abroad	Yes (settled)[57]
C	Abroad	United States	Yes (unsettled)[58]
D	Abroad	Abroad	No (unsettled) [59]

It is important to analyze gray market goods in the context of these four Section 109 scenarios to obtain a clearer picture of the potential role of copyright law in controlling gray market goods. First, courts have traditionally read "lawfully made under this title"[60] to mean "made and sold in the United States" under Scenario A.[61] Therefore, where the goods were both manufactured and first sold in the United States, the first sale doctrine is an applicable defense for the distribution of copyrighted goods without the authorization of the copyright holder. However, the first sale doctrine does not provide any special protections to gray market goods because Scenario A goods would not create sufficient price differences between products to generate an economic incentive for gray market goods.[62] More importantly, under Scenario A, since the copyright owner's right to distribute and right to import are exhausted due to the application of the first sale doctrine, copyright law would not help right-holders to control gray

[56] *See, e.g.*, BMG Music, Inc. v. Perez, 952 F.2d 318, 319 (9th Cir. 1991).

[57] Quality King Distribs., Inc. v. L'anza Research Int'l Inc., 523 U.S. 135, 139-40, 144-45 (1998).

[58] Denbicare U.S.A. Inc. v. Toys "R" Us, Inc., 84 F.3d 1143, 1149-50 (9th Cir. 1996).

[59] Omega S.A. v. Costco Wholesale Corp., 541 F.3d 982, 990 (9th Cir. 2008), *aff'd by an equally divided court*, 131 S.Ct. 565 (2010).

[60] 17 U.S.C § 109(a) (2006).

[61] *See, e.g.*, BMG Music, Inc. v. Perez, 952 F.2d 318, 319 (9th Cir. 1991).

[62] See Joseph Karl Grant, The Graying of the American Manufacturing Economy: Gray Markets, Parallel Importation, and a Tort Law Approach, 88 OR. L. REV. 1139, 1142-43 (2009).

market goods. In other words, copyright law under Scenario A cannot fill the gap of trademark law.

Under Scenario B, where the goods were manufactured in the United States and first sold abroad, courts have reached conflicting interpretations on the interplay among Sections 106(3), 109 and 602 of the Copyright Act.[63] The *Quality King* decision has attempted to clarify copyright protections concerning Scenario B goods that are manufactured in the United States, first sold abroad, and then imported back into the United States. The Supreme Court settled the issue by holding that the first sale doctrine is applicable to round trip importation.[64] Thus, since the first sale doctrine applies and the copyright owner's right to import and right to distribute would be exhausted, copyright law cannot function as a defense to control gray market goods. In this scenario, copyright law is again unable to fill the gap of trademark law to control gray market goods.

The application of the first sale doctrine to Scenario C goods that were manufactured abroad but first sold in the United States has been left to the discretion of circuit courts.[65] In this context, the Ninth Circuit cases are among the most influential circuit cases concerning copyright law and gray market goods.[66] The Ninth Circuit's interpretation of Section 109 is set out clearly in *BMG Music Inc. v. Perez*[67], where the court limited the scope of Section 109 to the traditional definition of goods "made and sold in the U.S."[68] Later, *Givenchy, Inc v. Drug Emporium, Inc.*[69] and *Denbicare U.S.A., Inc. v. Toys "R" Us, Inc.*[70] adopted an exception to the traditional

---

[63] Chen, *supra* note 13, at 578-84.

[64] Quality King Distribs., Inc. v. L'anza Research Int'l Inc., 523 U.S. 135, 143-45, 152, 154 (1998).

[65] *Id*. at 154 (Ginsburg, J., concurring) ("[W]e do not today resolve cases in which the allegedly infringing imports were manufactured abroad.").

[66] William K. Ford, *Judging Expertise in Copyright Law*, 14 J. INTELL. PROP. L. 1, 41-42 ("[T]he Second and Ninth Circuits, along with the Supreme Court and the Southern District of New York, are the most influential courts in the development of copyright law. Together, these four courts account for at least two-thirds of the principal cases in every casebook.").

[67] BMG Music, Inc. v. Perez, 952 F.2d 318 (9th Cir. 1991).

[68] *Id*. at 319.

[69] Parfums Givenchy, Inc. v. Drug Emporium, Inc., 38 F.3d 477, 482 (9th Cir. 1994).

[70] Denbicare U.S.A. Inc. v. Toys R Us, Inc., 84 F.3d 1143, 1149-50 (9th Cir. 1996).

rule that the first sale doctrine only applied to copyrighted goods made and sold in the United States, finding that goods produced abroad were subject to the first sale doctrine so long as an authorized first sale occurred in the United States.[71] In particular, these courts reasoned that if the first sale doctrine were deemed inapplicable to goods manufactured abroad, even if they were imported into the United States for their first sale with the authority of the copyright holder, "such a result would be untenable, and that nothing in the legislative history or text of Section 602 supports such an interpretation" that would give greater copyright protection to foreign-made copies than to their domestically made counterparts.[72] Therefore, in Scenario C, copyright law cannot fill the gap in trademark law for right-holders to control gray market goods because the exclusive right to distribute has been exhausted upon application of the first sale doctrine under Section 109 of the Copyright Act. However, the Ninth Circuit's approach to the first sale doctrine has not been examined by the United States Supreme Court or addressed by Congress, so the law surrounding Scenario C goods remains unsettled.

Finally, Scenario D, where the copyrighted product is both manufactured and first sold abroad, has been addressed in the recent Ninth Circuit *Omega S.A. v. Costco Wholesale Corp.* case.[73] *Omega* involved a situation where the copyright owner of the Omega watch design sued Costco for infringing the owner's distribution and importation rights under Section 106(3) and Section 602(a) of the Copyright Act.[74] The watches at issue were genuine but unauthorized "Omega Globe Design" watches manufactured abroad and initially sold abroad.[75] Costco raised the first sale doctrine as a defense.[76] The court held that the first sale doctrine was

---

[71] Denbicare U.S.A. Inc. v. Toys "R" Us, Inc., 84 F.3d 1143, 1149-50 (9th Cir. 1996); Parfums Givenchy, Inc. v. Drug Emporium, Inc., 38 F.3d 477, 482 n.8 (9th Cir. 1994).

[72] *Parfums Givenchy*, 38 F.3d at 482 n.8. The court's concern was that if the first sale doctrine were inapplicable to foreign manufactured goods, the foreign manufactured goods "would receive greater copyright protection than goods manufactured in the United States because the copyright holder would retain control over the distribution of the foreign manufactured copies even after the copies have been lawfully sold in the United States." *Id.*

[73] Omega S.A. v. Costco Wholesale Corp., 541 F.3d 982, 983 (9th Cir. 2008), *aff'd by an equally divided court*, 131 S. Ct. 565 (2010).

[74] *Id.*

[75] *Id.* at 983-84.

[76] *Id.* at 984.

unavailable as a defense, and that Costco was liable for its unauthorized importation and sale of copyrighted Omega watches.[77] More generally, the court held that when the good in question is manufactured abroad and initially sold abroad, the first sale doctrine does not apply.[78] At the Supreme Court, the Ninth Circuit's decision was affirmed without an opinion by an equally divided Court.[79] Under this scenario, since the first sale doctrine does not apply, the right to distribute has not been exhausted and copyright law can be used to stop the importation and distribution of gray market goods, thereby filling the gap in trademark law. Importantly, similar to Scenario C detailed above, goods made and initially sold abroad under Scenario D have not been directly addressed by a Supreme Court opinion or Congress; thus, Scenario D is unsettled.

Pursuant to the reasoning of the Ninth Circuit, and until the Supreme Court issues an opinion on a case relating to gray market goods that are made and first sold abroad,[80] copyright law can fill the gaps in trademark law that currently fail to protect right- holders from gray market goods, as described in Scenario D. Nonetheless, despite the critical role copyright law can play in deterring gray market goods where trademark law fails to protect goods, copyright law can only be used when the goods are subject to copyright protection.

For the purposes of this discussion, goods in international trade can be categorized into two types. Type I goods are expressly subject to copyright law, while Type II goods are not by themselves subject to copyright law but may be made subject to copyright protections by affixing a copyrighted item, such as a label, to them. Type I goods are products that are directly subject to protection by copyright law. Type I goods are "original works of authorship fixed in any tangible medium of expression" that are protected under the Copyright Act.[81] For example, music, computer games, movies, paintings, books, and even logos and scripts on wrappers

---

[77] *Id.* at 990.

[78] *See id.* at 985-90.

[79] Costco Wholesale Corp. v. Omega, S.A., 131 S. Ct. 565 (2010).

[80] The court in *Omega* noted that its decision was "not irreconcilable" with *Quality King* because *Quality King* "did not address the effect of § 109(a) on claims involving authorized importation of copies made abroad." *Id.* at 987.

[81] 17 U.S.C. § 102(a) (2006).

qualify as Type I goods.[82] Conversely, Type II goods constitute all non-copyrightable items, including tangible goods such as toys, cosmetics, and snacks that are not copyrightable.[83]

Copyright law grants the owners of Type I goods a limited monopoly to control the flow of the Type I goods. This means that a copyright holder's exclusive right to import and distribute is limited to Type I goods. However, attaching Type I goods to Type II goods when the Type I goods only make up an incidental portion of the whole good should not result in an exclusive control of the import and distribution of the whole good. This scenario creates an extreme overreach of copyright law. Although the United States currently permits this copyright overreach, Canada and Australia have realized the potential problems arising from such extensive copyright law expansion in international commercial law and have fashioned statutory remedies and case law precedent to address this issue.

III. Australian and Canadian Responses to Copyright Overreach

A. Australia's Statutory Solution to Copyright Overreach in the Context of Gray Market Goods

Prior to 1998, the Australian Copyright Act of 1968 ("Australian Copyright Act") did not set out whether copyright owners can control the distribution of uncopyrighted gray market goods with attached copyrighted accessories if the right to distribute was not exhausted.[84]

In 1998, however, Australian copyright law was amended following the *R & A Bailey & Co. Ltd. v Boccacio Pty Ltd.*[85] case, where the court allowed the use of copyright law to stop the importation of Type II gray

[82] *Id.* These goods are listed as examples of "original works of authorship fixed in tangible medium of expression" under § 102(a)(1)-(8) of the Copyright Act. *Id.*

[83] For example, utilitarian aspects of three-dimensional articles are not copyrightable. Even if a three dimensional article has both aesthetic and functional considerations, the article is not copyrightable if the artistic aspects of a work cannot be said to be "conceptually separable from the utilitarian elements." Brandir Int'l, Inc. v. Cascade Pac. Lumber Co., 834 F.2d 1142, 1145 (2d Cir. 1987).

[84] See Copyright Act 1968 (Cth) (Jan. 22, 1998), amended by Copyright Amendment Act (No. 1) 1998 (Cth), and Copyright Amendment Act (No. 2) 1998 (Cth) (Austl.).

[85] *R & A Bailey & Co. Ltd. v Boccaccio Pty Ltd.* (NSW) (1986), 84 FLR 232 (Supreme Court) (Austl.).

market goods by attaching a Type I copyrighted accessory.[86] The Australian legislature did a cost-benefit analysis and decided, as described by one commentator, that "the benefits to the consumers flowing from parallel importation, such as lower prices and increased consumer choice, outweigh any potential harm caused to the manufacturer."[87] The 1998 amendments, which were given assent on July 30, 1998,[88] discharged any potential liability for importation and distribution of a copyrighted "bundle" of Type I and Type II goods when the copyrighted item is an "accessory."[89] An accessory is defined as:

> (a) a label affixed to, displayed on, incorporated into the surface of, or accompanying, the article;
>
> (b) the packaging or container in which the article is packaged or contained;
>
> (c) a label affixed to, displayed on, incorporated into the surface of, or accompanying, the packaging or container in which the article is packaged or contained;
>
> (d) a written instruction, warranty or other information provided with the article; [or]
>
> (e) a record embodying an instructional sound recording or a copy of an instructional cinematograph film, provided with the article.[90]

As the Australian Copyright Act's 1998 amendments illustrate, Australia has expressly denied the extension of copyright law to Type II

---

[86] *Id.* at 233, 244.

[87] Leah M. Howie, *Using Copyright Law to Stop Grey-Marketed Candy: A Case Comment on* Kraft Canada, Inc. v. Euro Excellence, Inc., 21 INTELL. PROP. J. 245, 258 (2008).

[88] Copyright Amendment Act (No. 1) 1998 (Cth) (Austl.); Copyright Amendment Act (No. 2) 1998 (Cth) (Austl.).

[89] *Copyright Act* 1968 (Cth) s 44C(1). The section reads: "The copyright in a work a copy of which is, or is on, or embodied in, a non-infringing accessory to an article is not infringed by importing the accessory with the article." This section, however, was not considered to be in force until the end of 18 months after the day on which this act received the assent. *Copyright Amendment Act (No. 1)* 1998 (Cth) (Austl.). This section was listed as in force in the February 2, 2000 published compilation of the Copyright Act.

[90] *Copyright Act* 1968 (Cth) s 10 (Austl.).

goods that merely have a Type I copyrighted accessory attached as a bundle.[91] Australia's cost-benefit analysis of gray market good distribution and copyright protections firmly supports limitations on copyright law application to Type II goods, and this analysis should be applied in the United States when considering legislative measures concerning gray market goods.[92]

B. The Canadian Supreme Court's Efforts to Solve the Copyright Overreach in the Context of Gray Market Goods

Similar to the Australian legislature, the Canadian Supreme Court openly denounced the use of copyright law to control the flow of uncopyrighted gray market goods possessing copyrighted accessories in the above-referenced *Kraft* case.[93] The majority decision delivered by Justices Binnie, Deschamps and Rothstein focused upon secondary infringement analysis under Section 27(2)(e) of the Copyright Act of Canada,[94] but the concurring opinions clearly denounced the use of copyrighted accessories to control uncopyrighted goods.

In particular, Justice Fish noted that "the sole purpose of [Kraft Belgium and Kraft Schwiz] registering the copyright . . . was to mount the very attack upon [Euro-Excellence] which is currently before the court" and expressed doubt about "whether the law governing the protection of intellectual property rights in Canada can be transformed in this way into an instrument of trade control not contemplated by the *Copyright Act*."[95] Furthermore, Justice Bastarache postulated that the "*Copyright Act* . . . [is] about the protection of copyrighted works, not about the importation and sale of consumer goods in general."[96] Through statutory interpretation of Section 27(2)(e)[97] of the Canadian Copyright Act, Justice Bastarache

[91] *Id.*, s 44C(1).

[92] *See generally* Howie, supra note 89.

[93] *See* Euro-Excellence, Inc. v. Kraft Canada, Inc. [2007] 3 S.C.R. 20 (Can.).

[94] *Id*. at paras. 14-25.

[95] *Id*. at paras. 55, 56 (quoting Kraft Canada Inc. v. Euro Excellence Inc., [2004] 4 F.C.R. 410 (Can.)).

[96] *Id.* at para. 57.

[97] Copyright Act, R.S.C. 1985, c. C-42. Section 27(2) reads:

concluded that "[t]he merely incidental presence of the copyrighted works on the wrappers of the chocolate bars does not bring the chocolate bars within the protections offered by the *Copyright Act*."[98]

Justice Bastarache adopted a three-step approach to reach this conclusion, analyzing: (1) the purpose of the Canadian Copyright Act; (2) the purpose of Section 27(2) of the Canadian Copyright Act; and (3) the correct interpretation of Section 27(2)(e) of the Canadian Copyright Act.[99] Under the first step, Justice Bastarache noted that the rights of copyright owners have a "limited nature" determined by originality and the treatment of fair dealing.[100] Therefore, "copyright protection is limited to protection of legitimate economic interests which are the result of an exercise of skill and judgment, and that protection must not be extended beyond its proper limits."[101] To understand the limit of copyright law, it is necessary to acknowledge the "basic and necessary distinctions between different forms of intellectual property and their legal and economic functions."[102]

In analyzing the purpose of the Canadian Copyright Act, Justice Bastarache noted the distinction between copyright and trademark law. Justice Bastarache states that the different forms of intellectual property protection "suggest that each form of protection relies on some core normative notion which must ground the economic interest claimed."[103] Specifically, trademark law protects market share in commercial goods and the distinctiveness of a product's marketing, while "copyright protects the

---

It is an infringement of copyright for any person to
(*a*) sell or rent out,
(*b*) distribute to such an extent as to affect prejudicially the owner of the copyright,
(*c*) by way of trade distribute, expose or offer for sale or rental, or exhibit in public,
(*d*) possess for the purpose of doing anything referred to in paragraphs (*a*) to (*c*), or
(*e*) import into Canada for the purpose of doing anything referred to in paragraphs (*a*) to (*c*), a copy of a work, sound recording or fixation of a performer's performance or of a communication signal that the person knows or should have known infringes copyright or would infringe copyright if it had been made in Canada by the person who made it.

[98] [2007] 3 S.C.R. 20, para. 57.

[99] *Id.* at paras. 76-95.

[100] *Id*. at para. 76.

[101] *Id*. at para. 79.

[102] *Id.* at 82 (quoting Kirkbi AG v. Ritvik Holding Inc., [2005] 3 S.C.R. 302, para. 37).

[103] *Id.* (quoting Kirkbi AG v. Ritvik Holding Inc., [2005] 3 S.C.R. 302, para. 37).

economic gains resulting from an exercise of skill and judgment."[104] Importantly, "[i]f trademark law does not protect market share in a particular situation, the law of copyright should not be used to provide that protection, if that requires contorting copyright outside its normal sphere of operation."[105]

After determining that the purpose of copyright law restricts its application outside of its usual context of skill and judgment, Justice Bastarache analyzed the purpose of Section 27(2) of the Canadian Copyright Act. Because copyright law exists to protect only legitimate copyright owners' interests, in the context of gray market goods, Section 27(2) restricts copyright protections such that if a copyrighted work is attached to other consumer goods, "the economic gains associated with the sale of the consumer good must not be mistakenly viewed as the legitimate economic interests of the copyright holder."[106] As a result, gray market goods are not subject to the protections of Section 27(2). Indeed, Justice Bastarache argued that "to allow s. 27(2) to protect all interests . . . would upset the copyright balance."[107]

Applying the purpose of Section 27(2), Justice Bastarache then spoke on the correct interpretation of Section 27(2)(e) of the Canadian Copyright Act. According to Section 27(2)(e), copyright infringement occurs when a good is imported into Canada for a purpose forbidden under Sections 27(2)(a)-(c), including selling, renting or distributing a good to a prejudicial extent and distributing, exposing or offering a good for sale, rent or exhibition through trade.[108] Therefore, when a copyrighted Type I good is an incidental attachment to the traded Type II good, protection of the entire package of goods falls outside the scope of Section 27(2) and Section 27(2)(e) cannot be invoked.[109] However, Justice Bastarache noted that whether a copyrighted item is incidental could be decided on a case-by-case basis, taking into consideration factors like:

---

[104] [2007] 3 S.C.R. 20, paras. 82-83.

[105] *Id*. at para. 83.

[106] *Id.* at para. 85.

[107] *Id*. at para. 88.

[108] Copyright Act, R.S.C. 1985, c. C-42, s. 27.

[109] *Euro-Excellence*, [2007] 3 S.C.R. 20, para. 93.

> the nature of the product, the nature of the protected work and the relationship of the work to the product. [Also], [i]f a reasonable consumer undertaking a commercial transaction does not think that the copyrighted work is what she is buying or dealing with, it is likely that the work is merely incidental to the consumer good.[110]

IV. Copyright Overreach Should Not Be Permissible Under United States Statutory Law or the Copyright Misuse Doctrine

Neither the Australian Copyright Act nor Canadian case law is binding in the United States. Nonetheless, Australia's and Canada's approaches to limiting copyright overreach demonstrate possible models for restricting the application of copyright law to gray market goods in the United States.

In the United States, copyright law is a "formidable shield" for intellectual property owners against the introduction of gray market goods into the market, particularly where trademark law cannot protect owners.[111] For example, under current United States case law, the attachment of Type I copyrightable accessories to Type II goods that are not *per se* copyrightable can extend copyright protections to the Type II goods. Although the United States Supreme Court is silent upon this specific issue, the expansion of copyright law to govern otherwise uncopyrighted Type II goods by United States circuit courts is an illegitimate use of copyright law. This illegitimate overreach of copyright law is arguably impermissible under an appropriate statutory interpretation of the United States Copyright Act and under the doctrine of copyright misuse, which provides a complete defense against copyright infringement claims.

A. Statutory Interpretation of the United States Copyright Law

Article I, Section 8, Clause 8 of the United States Constitution gives Congress the power to grant creators limited monopolies to "promote the progress of science and useful arts, by securing for limited times to authors . . . the exclusive right to their . . . writings."[112] This clause outlines the basic policy of copyright law according to the Constitution: to promote progress

---

[110] *Id*. at para. 94.

[111] *See* Ghosh, *supra* note 9.

[112] U.S. CONST. art. I, § 8, cl. 8.

of useful arts for the general good of the society. Absent the protection offered by copyright law, authors and creators would lack incentives to produce and innovate, and our marketplace of culture and ideas would suffer.

The core concept of the Copyright Act is that a limited monopoly will best advance innovation and enable societal growth.[113] However, the boundary of a monopoly is not always obvious, which leads to interpretation problems concerning the reach of copyright law. For example, Creator A owns the copyright to software X. Does Creator A's copyright mean that no other producer can create a similarly functioning software?[114] Does Creator A's copyright allow him to dictate that a licensee may use software X only in conjunction with hardware manufactured by Creator A?[115] In another example, Creator B owns the copyrighted data processing software Z. Does Creator B's copyright allow her to forbid the data owner from disclosing data in case that disclosure will release copyrighted information regarding software Z?[116]

Similarly, the reach of copyright law in relation to gray market goods raises statutory interpretation issues regarding the Copyright Act. If Owner O holds the copyright of an accessory Type I good, does this copyright allow Owner O to block the importation and distribution of uncopyrighted Type II goods to which the Type I good is attached? The outcome of this issue depends on how a United States court interprets the text of the Copyright Act.[117] A fundamental doctrine of statutory interpretation that must be applied to the Copyright Act is "whether Congress has directly spoken to the precise question . . . [and if] the intent of Congress is clear, that is the end of the matter."[118] Also, as Chief Justice

[113] John T. Cross & Peter K. Yu, *Competition Law and Copyright Misuse*, 56 DRAKE L. REV. 427, 433 (2008).

[114] *See, e.g.*, Lasercomb Am., Inc. v. Reynolds, 911 F.2d 970, 972 (4th Cir. 1990).

[115] *See, e.g.*, Alcatel USA, Inc. v. DGI Techs., Inc., 166 F.3d 772, 777 (5th Cir. 1999).

[116] *See, e.g.*, Assessment Techs. of Wis., LLC v. WIREdata, Inc., 350 F.3d 640, 642 (7th Cir. 2003).

[117] "The starting point in statutory construction is the language of the statute itself." Yule Kim, CONG. RESEARCH SERV., 97-589, STATUTORY INTERPRETATION: GENERAL PRINCIPLES AND RECENT TRENDS 2 (2008), *available at* http://www.fas.org/sgp/crs/misc/97-589.pdf. "The Court frequently relies on 'canons' of construction to draw inferences about the meaning of statutory language." *Id.* (summary).

[118] Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 842 (1984).

Taney pointed out in 1850, "we must . . . look to the provisions of the whole law. . . ."[119] In other words, courts should also consider the "cardinal rule of construction . . . that a statute should be read as a harmonious whole, with its various parts being interpreted within their broader statutory context in a manner that furthers statutory purposes."[120]

Using these rules of statutory construction, a close look at the specific language of Sections 106(3) and 602(a)(1) of the Copyright Act, which outline the exclusive distribution and importation rights of a copyright holder, is essential to determine the correct interpretation of copyright law, particularly in relation to gray market goods.[121] Section 106(3) reads: "[the owner of copyright under this title has the exclusive rights to do and to authorize and] . . . to distribute *copies or phonorecords of the copyrighted work* to the public by sale or other transfer of ownership, or by rental, lease, or lending."[122] In addition, Section 602(a)(1) states:

> Importation into the United States, without the authority of the owner of copyright under this title, of *copies or phonorecords of a work* that have been acquired outside the United States is an infringement of the exclusive right to distribute *copies or phonorecords* under section 106, actionable under section 501.[123]

The texts of both Section 106(3) and Section 602(a)(1) clearly specify that the right to control distribution and importation of copyrighted goods is limited to the "copies of the work."[124] While a copyright entails exclusive distribution and importation rights, these rights should reside only where the United States Congress specifically created a monopoly. Since the legislature did not explicitly extend exclusive distribution and importation controls to uncopyrighted products that contain copyrighted accessories, a creator should not be entitled to such protections.

This statutory interpretation, in which the copyright monopoly does not extend to the uncopyrighted product, is consistent with the ultimate

[119] United States v. Heirs of Boisdoré's, 49 U.S. (8 How.) 113, 122 (1850).

[120] Kim, *supra* note 119, at 2.

[121] 17 U.S.C §§ 106(3), 602(a)(1) (2006).

[122] 17 U.S.C § 106(3) (2006) (emphasis added).

[123] 17 U.S.C § 602(a)(1) (2006) (emphasis added).

[124] *See* 17 U.S.C §§ 106, 602(a)(1) (2006).

purpose of copyright law, which is to encourage the creation and dissemination of creative works.[125] Limiting the reach of copyright law would also help encourage the transfer of goods and promote competition; it gives consumers more choices and makes prices cheaper. Furthermore, a textual interpretation of the Copyright Act would not hurt the legitimate interest of the copyright owners as owners maintain their entitlement to protections of their copyrighted accessories. Ultimately, actions to stop importation and distribution of uncopyrighted gray market goods by attaching copyrighted accessories are inconsistent with the public interest because those actions undermine competition and diminish the consumer's choice.

This strict textual interpretation is also consistent with the concept that different forms of intellectual property ("IP") have different functions. As previously explained, copyright law has a distinctive functioning scope to protect "economic gains resulting from an exercise of skill and judgment," while trademark law "protects market share in commercial goods."[126] Importantly, the primary purpose of controlling the importation and distribution of genuine goods is to safeguard the economic gains resulting from the market share in a certain market. The purpose is not to protect the skill and judgment of the accessories attached to those goods.[127] Therefore, trademark law is designed to offer importation or distribution protection to rights holders, and copyright law should not step in and nullify the decisions of trademark law legislators to not offer such protection.

As this analysis of copyright statutory interpretation demonstrates, using copyrighted accessories to gain distribution and importation protection for uncopyrighted Type II goods is an impermissible overreach of copyright law. However, as a practical matter, unless the United States Supreme Court sets a clear precedent rejecting the extension of copyright law to uncopyrighted goods with copyrighted accessories, it is risky and possibly costly for distributors to rely on such an analysis of statutory interpretation as a defense once a dispute is brought before a court. For example, in the *Kraft* case, Justice Bastarache reasoned against the use of copyright law to control uncopyrightable goods through incidental attached

---

[125] Cross & Yu, *supra* note 115, at 429.

[126] Euro-Excellence Inc. v. Kraft Canada Inc., [2007] 3 S.C.R. 20, para. 83 (Can.).

[127] *See id.* (reasoning that copyright law is meant to protect the copyright holder who exercises her own skill and judgment, not the tangentially-related economic interest of a person who attaches a copyrighted work to her property).

copyrighted items based on his interpretation of the statute.[128] However, Justice Rothstein, writing for the majority, viewed such statutory interpretation as the introduction of "a concept of legitimate interests to read down rights afforded by the Copyright Act," and the introduction of a new equitable doctrine or an attempt to substitute one's own policy preference in place of those of Parliament.[129] This case illustrates that the statutory interpretation argument against copyright overreach in the area of gray area goods is possible, but it is risky and uncertain.

B. The Copyright Misuse Doctrine

Congress grants copyright owners the exclusive right to reproduce their protected works, prepare derivative works, and distribute copies of, perform and publicly display their works.[130] However, the Copyright Act only addresses copyright owners' rights, not their behavior in protecting those rights, so the issue of whether a copyright owner's actions are reasonable or overreaching is not addressed until a case is presented in court. A statute simply cannot provide appropriate rules to regulate all conduct of copyright owners to protect their rights. Even the Supreme Court has recognized that attempting to define the "outer limits" of a legal doctrine is sometimes "fruitless, for each case must turn on its own facts"[131] and the reasonableness of copyright owners' conduct in enforcing their rights must be determined on a case-by-case basis.

Despite the difficulties inherent in providing regulatory rules to govern copyright holder conduct through statute, the monopoly created by copyright law should be limited because "what is needed for . . . progress is a subtle blend of competition and monopoly, with more emphasis in general on the former than the latter . . . ."[132] Empirical studies have revealed that absent regulations or other limitations on how copyright owners can protect their rights, there exist many wide-ranging examples of overprotective

[128] *Id.* at para. 57 (Bastarache, J., concurring).

[129] *Id.* at paras. 3, 7, 8 (majority opinion).

[130] 17 U.S.C. § 106 (2006).

[131] Berman v. Parker, 348 U.S. 26, 32 (1954) (noting that attempting to define the entirety of the police power is a "fruitless" endeavor and mentioning that it is not possible to create a complete definition in the abstract).

[132] F.M. Scherer & David Ross, Industrial Market Structure and Economic Performance 660 (3d ed. 1990).

behavior with regard to copyrights.[133] For example, music companies contractually forbid secondary users from dealing with competitors.[134] Importantly, we can expect many secondary users to abide by restrictive terms that limit freedom to contract with competitors when those terms are required by music companies who have high bargaining power over the secondary users.

In light of the possible abuses of copyright protection enforcement by copyright owners, it is useful to consider IP misuse doctrines as potential methods to limit copyright monopolies to reasonable protective behaviors. IP misuse doctrines are equitable defenses to IP infringement claims that are derived from the equitable unclean hands doctrine.[135] Under the doctrine of unclean hands, "courts will deny an otherwise meritorious claim where the claimant has acted so improperly that the need to punish the claimant's wrongful behavior outweighs the need to punish the defendant's allegedly unlawful conduct."[136]

The patent misuse doctrine is the first and only IP misuse doctrine acknowledged by the Supreme Court of the United States to provide equitable remedies.[137] The patent misuse doctrine was set up as precedent in the Supreme Court case *Morton Salt Co. v. G.S. Suppiger Co.*,[138] where the

[133] Victoria Smith Ekstrand, *Protecting the Public Policy Rationale of Copyright: Reconsidering Copyright Misuse*, 11 COMM. L. & POL'Y 565, 565-66 (2006) (citing a joint research project by the Electronic Frontier Foundation and a number of law schools on the "chilling effect" caused by aggressive copyright holders, and other behavior such as clickwrap and user agreements asking users not to use public domain information).

[134] *Id.* at 566.

[135] *See, e.g.*, Atari Games Corp. v. Nintendo of Am. Inc., 975 F.2d 832, 846 (Fed. Cir.1992) (explaining the relationship of doctrine of unclean hand and copyright misuse); *see also* U.S. Gypsum Co. v. Nat'l Gypsum Co., 352 U.S. 457, 465 (1957) (explaining the relationship between the doctrine of unclean hands and the patent misuse doctrine).

[136] David Scher, Note, *The Viability of the Copyright Misuse Defense*, 20 FORDHAM URB. L.J. 89, 89 (1993).

[137] 37 AM. JUR. 3d *Proof of Facts* § 8 (2011) ("[T]he 'misuse' doctrine has been expanded [from patents] to cover other forms of intellectual property, such as copyrights and trademarks. The Supreme Court has not expressly recognized copyright and trademark misuse, but has strongly suggested their validity as defenses.") (citations omitted); *see also* George Carr, *Copyright Misuse: An Overview*, 21 INTELL. PROP. LITIG. (A.B.A. Sec. of Litig.), No. 4, Summer 2010, at 1 (stating that the Supreme Court of the United States has yet to address the copyright misuse doctrine).

[138] Morton Salt Co. v. G.S. Suppiger Co., 314 U.S. 488, 493-94 (1942), *abrogated by* Ill. Tool Works Inc. v. Indep. Ink, Inc., 547 U.S. 28 (2006).

patent owner was denied a remedy for patent infringement because the patent owner tied the sale of patented goods with the sale of non-patented goods.[139] The Court determined that the issue was based on "whether a court of equity will lend its aid to protect the patent monopoly when respondent is using it as the effective means of restraining competition with its sale of an unpatented article."[140] The Court noted that the patent owner was "making use of its patent monopoly to restrain competition in the marketing of unpatented articles . . . and is aiding in the creation of a limited monopoly in the [unpatented articles]."[141] Such use of a patent to secure a monopoly not granted by patent law is forbidden and "contrary to public policy."[142] In addition, use of a patent to secure a monopoly that is against public policy as a restraint of trade is equally impermissible under equitable principles.[143] Rather, the limited monopoly granted to patent owners by the United States Constitution "excludes from it all that is not embraced in the invention" for public policy reasons.[144] The Court concluded that "[i]t is a principle of general application that courts . . . may appropriately withhold their aid where the plaintiff is using the right asserted contrary to the public interest,"[145] thereby affirming the patent misuse doctrine. Although *Illinois Tool Works Inc. v. Independent Ink*[146] later modified *Morton Salt* with respect to specific elements of patent misuse that must be affirmatively proven, rather than being presumed,[147] the basic principles in *Morton Salt* remain valid in the law of patent misuse. For example, the Federal Circuit has recently re-articulated these principles

---

[139] *Id.* at 491, 493-94.

[140] *Id*. at 490.

[141] *Id*. at 491.

[142] *Id.* at 492 ("[Public policy] equally forbids the use of the patent to secure an exclusive right or limited monopoly not granted by the Patent Office and which it is contrary to public policy to grant.").

[143] *Id.* at 492-93.

[144] *Morton* Salt, 314 U.S. at 492.

[145] *Id.*

[146] 547 U.S. 28 (2006).

[147] *Id.* at 37-43 (holding that patent misuse requires proof that the patent holder has market power in the patented product and that this market power cannot be presumed as was done in *Morton Salt*).

as: "the patentee may exploit his patent but may not use it to acquire a monopoly *not embraced in the patent*."[148]

Similar to the patent misuse doctrine, the copyright misuse doctrine is an appropriate legal defense that can be used to limit the improper exercise of a copyright owner's monopoly power.[149] Applying the Supreme Court's reasoning in *Morton Salt*, it is inappropriate to allow copyright owners to expand copyright protections to uncopyrighted goods simply by attaching copyrighted accessories.[150] Significantly, this extension of copyright protection has the effect of limiting competition by creating a monopoly over uncopyrighted goods that have copyrighted articles attached to them. Such attempts to eliminate competition also limit consumer choices and, therefore, are contrary to public policy. In addition, if a court grants the copyright owner relief in this circumstance, the court would be acknowledging a monopoly that was not provided for by the legislature when the gray market goods to which copyrighted accessories are attached are not themselves copyrightable. The copyright misuse doctrine would effectively deny the copyright owner's request for relief for infringement of a copyrighted accessory attached to an uncopyrighted good when this constitutes copyright misuse under *Morton Salt*'s public policy reasoning.

The biggest challenge to a defendant's successful application of the copyright misuse doctrine as a defense to copyright owner overreach, however, is that neither the Supreme Court nor Congress has recognized the existence of this defense. Nonetheless, the public policies behind patent and copyright law, and the similar nature of the laws themselves warrant the application of a copyright misuse defense for infringement cases that parallel current patent misuse doctrine defenses.[151] Notably, the Supreme

[148] Princo Corp. v. Int'l Trade Comm'n, 616 F.3d 1318, 1327 (Fed. Cir. 2010) (en banc) (stating, based on *Morton Salt* and various other Supreme Court cases, that this is the general rule of patent misuse established by the Supreme Court) (internal quotations omitted) (emphasis added). The Federal Circuit also reiterated that in *Morton Salt*, "[t]he Supreme Court held that the patent was unenforceable on the ground that the patentee had unlawfully used the patent 'to secure an exclusive right or limited monopoly not granted by the Patent Office and which it is contrary to public policy to grant.'" *Id.* (quoting *Morton Salt*, 314 U.S. at 492 (1942).

[149] Thomas F. Cotter, *Misuse*, 44 HOUS. L. REV. 901 (2007).

[150] *See Morton Salt,* 314 U.S. at 490.

[151] Scher, *supra* note 138, at 89.

Court acknowledges that the public policy underlying copyright law is the same as the policy underlying patent law.[152]

As a result, even though the Supreme Court has not officially recognized the copyright misuse doctrine, various circuit courts have adopted the doctrine as a complete defense against copyright infringement. One of the most cited cases that applied this doctrine is the Fourth Circuit case *Lasercomb America, Inc. v. Reynolds*.[153] In *Lasercomb*, the court found that a term in a standard licensing agreement forbidding the licensee from creating a competing product was a violation of the public policy underlying copyright law and rendered the licensor's copyright unenforceable.[154] In addressing the existence of the copyright misuse doctrine, the court declared that "[w]e are persuaded . . . that a misuse of copyright defense is inherent in the law of copyright just as a misuse of patent defense is inherent in patent law."[155] The court reached this conclusion based on the "similarity of the policies underlying patent and copyright [law]," which is to "increase the store of human knowledge and arts by rewarding inventors and authors with the exclusive rights to their works for a limited time."[156] The court emphasized that such "granted monopoly power does not extend to property not covered by the patent or copyright."[157]

Since the Fourth Circuit's decision in *Lasercomb*, several other circuits have adopted the copyright misuse doctrine. For example, the copyright misuse defense has been applied by: the Fifth Circuit in *Alcatel USA, Inc. v. DGI Technologies, Inc.*;[158] the Ninth Circuit in *Practice*

---

[152] Mazer v. Stein, 347 U.S. 201, 219 (1953) ("The economic philosophy behind the clause empowering Congress to grant patents and copyrights is the conviction that encouragement of individual effort by personal gain is the best way to advance public welfare through the talents of authors and inventors in 'Science and useful Arts.'"). Emphasizing the phrase "patents *and* copyrights" in this quote, the Fourth Circuit has opined that Supreme Court has "equated the public policies of copyright and patent." Lasercomb Am., Inc. v. Reynolds, 911 F.2d 970, 975 (4th Cir. 1990).

[153] 911 F.2d 970 (4th Cir. 1990).

[154] *Id.* at 971-72, 979.

[155] *Id.* at 973.

[156] *Id*. at 976.

[157] *Id*.

[158] 166 F.3d 772, 773 (5th Cir. 1999).

Management Information Corp. v. American Medical Ass'n;[159] the Third Circuit in *Video Pipeline, Inc. v. Buena Vista Home Entertainment, Inc.*;[160]and the Seventh Circuit in *Assessment Technologies of WI, LLC v. WIREdata, Inc*.[161] While the remaining circuits have not yet officially adopted the copyright misuse doctrine, it seems that this doctrine is gaining acceptance as a defense.[162]

The copyright misuse doctrine's "elevated profile can be attributed to society's increased dependence on licensing agreements."[163] In particular, the typical application of the copyright misuse defense involves situations where there exists: (1) blanket licensing of copyrighted works; (2) licensing agreements with anticompetitive clauses; (3) refusal to license content; and (4) tying practices.[164] However, the copyright misuse doctrine has great potential for broader applications, particularly in today's digital information society.[165] As a result, scholars believe that the copyright misuse doctrine, which is already being applied in several circuits, will be established as an accepted defense in a variety of future copyright infringement claims, barring copyright owners' claims when the owners have misused their limited monopoly in violation of the public policy concerns embodied in copyright law.[166] In fact, the recent *Omega v. Costo Wholesale* case shows that copyright law may be heading in this direction. In September 2011, the Eastern District of California granted Costo summary judgment against Omega's infringement claim on the ground of patent misuse.[167] Recall that

[159] 121 F.3d 516, 520-21 (9th Cir. 1995).

[160] 342 F.3d 195, 206 (3rd Cir. 2003).

[161] 350 F.3d 640, 647 (7th Cir. 2003).

[162] Neal Hartzog, Gaining Momentum: A Review of Recent Developments Surrounding the Expansion of the Copyright Misuse Doctrine and Analysis of the Doctrine in Its Current Form, 10 MICH. TELECOMM. TECH. L. REV. 373, 387 (2004).

[163] *Id.*

[164] Ekstrand, *supra* note 135, at 568.

[165] *Id.* at 568-69.

[166] *See* Thomas F. Cotter, *Misuse*, 44 HOUS. L. REV. 901, 901 (2007). Ekstrand, *supra* note 135, at 567-68; Kathryn Judge, Note, *Rethinking Copyright Misuse,* 57 STAN. L. REV. 901, 904 (2004).

[167] Omega S.A. v. Costco Wholesale Corp., No, CV 04-05443 TJH, slip op. at 4 (E.D. Cal. Nov. 9, 2011).

Omega had been attempting to use the copyrighted engravings to stop the importation of its watches.[168] The district court found that *one of the purposes* of the copyrighted Omega design "was to control the importation and sale of its watches containing the design, as the watches could not be copyrighted."[169] Under this circumstance, the court concluded that "Omega misused its copyright . . . by leveraging its limited monopoly in being able to control the importation of that design to control the importation of its … watches."[170] Importantly, the court set forth an expansive interpretation of copyright misuse, reasoning that although misuse had been limited to situations involving antitrust tying agreements and restrictive licensing agreements, "this is not to say that copyright misuse could not exist in other situations" in view of cases such as *Lasercomb,* which suggests a "broad rule for copyright misuse" based on public policy.[171]

This is particularly significant for gray market goods, where copyright owners are overextending their rights by attempting to control the importation and distribution of uncopyrighted Type II goods through the attachment of Type I copyrighted goods, thereby greatly undermining the public policy goals of copyright law.[172] In this context, the copyright misuse doctrine can provide an important balance between the Constitutional goal of ensuring that creators are compensated for their skill and judgment and are incentivized to innovate, while limiting copyright monopolies that hinder lawful and productive competition.

Conclusion

The incentives for intellectual property right owners to combat gray market goods are strong. As this paper reveals that, while trademark law intentionally leaves certain trademark owners' rights unprotected against gray market goods, intellectual property owners are taking advantage of the overlap between trademark law and copyright law. Intellectual property owners are using current copyright law loopholes to extend their copyright protections against gray market goods pursuant to the United States

[168] *Id.* at 1-2.

[169] *Id.* at 3.

[170] *Id.*

[171] *Id.*

[172] *See* Scher, *supra* note 138, at 105-06.

Supreme Court *Quality King* case.[173] In particular, copyright owners are attaching copyrighted accessories to uncopyrighted goods in an effort to expand their protection rights over otherwise uncopyrightable Type II products.

As this paper shows, the current overreaching effect of copyright law qua *Quality King* is illegitimate. Canada and Australia are well ahead of the United States in terms of clearly limiting the application of copyright law to uncopyrighted goods and should be emulated.[174] Furthermore, copyright overreach is not justified under United States copyright law based on statutory interpretation of the Copyright Act and application of the copyright misuse doctrine. To date, neither the Supreme Court of the United States nor Congress has addressed the issue of inappropriate copyright law expansion, but these institutions should take action to prevent the misuse of copyright law against gray market goods.

[173] *See* Quality King Distribs., Inc. v. L'anza Research Int’l. Inc., 523 U.S. 135, 153 (1998) (Ginsburg, J., concurring) (remarking that the majority opinion did not rule on whether the first sale doctrine exhausts the copyright holder’s rights for imports manufactured abroad).

[174] *See, e.g.*, Euro-Excellence Inc. v. Kraft Canada Inc., [2007] 3 S.C.R. 20, para. 57 (Bastarache, J., concurring) (“merely incidental presence of the copyrighted works on the wrappers of the chocolate bars does not bring the chocolate bars within the protections offered by the *Copyright Act*”) (Can.); *Copyright Act* 1968 (Cth) s 44C(1) (“The copyright in a work a copy of which is, or is on, or embodied in, a non-infringing accessory to an article is not infringed by importing the accessory with the article.”) (Austl.).

Reducing Ambiguity or Increasing Contracting Costs? Interpreting UCP 600 Article 16 Obligations and *Fortis Bank v. Indian Overseas*

Caitlin E. Huggins*

Introduction

Research done by the International Chamber of Commerce (ICC) in recent years suggests that as many as 70% of documents presented as letters of credit (LCs) were found discrepant, or exhibited inconsistencies from negotiated terms and deemed insufficient to allow payment to proceed.[1] This finding spurred the ICC to include more detailed directives regarding discrepant documents in their sixth, most recent revision, to international LC transaction guidelines.[2] In a unanimous vote on October 25, 2006, the Banking Commission of the ICC adopted the newest edition of the Uniform Customs and Practice for Documentary Credits, the UCP 600.[3] The new language of the UCP 600 addressed the developments in the banking,

* George Mason University School of Law, Juris Doctor 2012; Texas Tech University M.A./B.A. 2007; 2011-2012 Notes Editor of the GEORGE MASON JOURNAL OF INTERNATIONAL COMMERCIAL LAW 2011-2012; I would like to thank my fellow editors for their help and support, and Matthew Butsick for his invaluable feedback.

[1] For published references to this discrepancy issue in the years immediately preceding the issuance of new UCP 600, see International Chamber of Commerce, *ICC Response to the Basel Committee Consultative Document on "Strengthening the Resilience of the Banking System,"* annex 1(A), ICC Document No. 470/1139 (April 16, 2010) at 4, *available at* http://www.iccwbo.org/uploadedFiles/ICC/policy/banking_technique/Statements/1139%20ICC%20Position%20Paper_Basel%20Committee%20Consultation.pdf; Gary Collyer, *Introduction to UCP 600,* Commentary of Corporate Director ABN AMRO Bank N.V., and Technical Adviser to the ICC Commission on Banking Technique and Practice at 2 (2007) (noting that when work "on the revision [of UCP 500] started a number of global surveys indicated that, because of discrepancies, approximately 70% of documents presented under letters of credit were being rejected on first presentation"), *available at* http://www.internetlc.com/TradeRefs/UCP600text.pdf. *See also* Martin Shaw, *Martin Shaw Claims There Are Better Ways to Reduce Discrepancies and That the ICC Should Take Advantage of Them*, DOCUMENTARY CREDITS INSIGHT, Spring 1999 at 11 (reporting views of "observers" that at least "50% - some say up to 60% or even 70% of presentations do not comply").

[2] International Chamber of Commerce, ICC Response to the Basel Committee Consultative Document on "Strengthening the Resilience of the Banking System," annex 1(A), ICC Document No. 470/1139 (April 16, 2010).

[3] International Chamber of Commerce, *Uniform Customs and Practice for Documentary Credits (UCP 600)*, ICC Publication No. 600 (July 1, 2007) [hereinafter UCP 600].

transport, and insurance industries.[4] Moreover, to achieve the "loftier goal of enhancing the reputation of LC's," the drafters of the UCP 600 aimed to reduce the number of documents found discrepant on first presentation.[5]

The UCP 600 purports to alleviate many of the interpretation problems that existed under the UCP 500.[6] These problems included the varying understandings of what discrepancies warranted dishonor—the refusal by one party to the LC to furnish payment.[7] In addition, there has been substantial debate regarding the replacement of the "reasonable time" provision (indicating how long banks could delay notice of discrepant documents) with a maximum limit.[8] LC commentators had predicted how courts would respond to the new UCP 600 documents, but until *Fortis Bank v. Indian Overseas*,[9] commentators were left wondering exactly how courts would interpret the changes.[10]

This note focuses on the implications of the UCP 600 interpretive principles employed by Judge Hamblen in *Fortis Bank*, including his reliance on an "implicit obligation" within the UCP 600. This obligation—that rejecting banks must act in strict accord with their Return Notices—and the remedy of preclusion may operate to disadvantage multinational companies seeking the use of LCs.[11] It will discuss whether any "implicit obligation" should be read into an international code relying on local customs and common law.

---

[4] International Chamber of Commerce, Commentary on UCP 600 Article-by-Article Analysis by the UCP 600 Drafting Group, ICC Publication No. 680 (Oct., 2007).

[5] *See infra* text accompanying note 51.

[6] International Chamber of Commerce, The Uniform Customs and Practice for Documentary Credits (UCP500), ICC Publication No. 500 (Jan. 1, 1994) [hereinafter UCP 500].

[7] *See infra* text accompanying note 44.

[8] For a discussion of the litigation surrounding the "reasonable time requirement" under the UCP 500 *see* IFSA Statement of Practice: *Reasonable Time for Examination & Notice of Dishonor*, in LC RULES & LAWS: CRITICAL TEXTS 1 (James E. Byrne ed., 4th ed. 2007).

[9] [2010] EWHC 84 (Comm) (Eng.).

[10] Lisa Pietrzak, *Sloping in the Right Direction: A First Look at the UCP 600 and the New Standards as Applied to Voest-Alpine*, 7 ASPER REV. INT'L BUS. & TRADE L. 179, 180 (analyzing the potential effect of the UCP 600 on previously decided cases).

[11] UCP 600, *supra* note 3, art. 16 [hereinafter Article 16].

Part I of this note introduces LC jurisprudence, notes the specific changes brought about through the adoption of the UCP 600, and presents an overview of *Fortis Bank.* Part II will first indicate the problems faced by judges in interpreting UCP 500 provisions regarding discrepant documents and the new interpretive principles Judge Hamblen offers in *Fortis Bank.* Next, it will explore the problems faced by the interpretive principles employed in *Fortis Bank*, including the draconian measure of the preclusion doctrine and implications of local customs in regards to Judge Hamblen's implicit obligation that banks act with "reasonable promptness" upon issuance of an Article 16 return notice.[12] Part III will conclude with a discussion of the economic costs imposed when incorporating the UCP 600 into LCs and discuss the potential long-term contracting costs of Judge Hamblen's interpretation.

I. Background

The *Fortis* case involves a basic letter of credit transaction and interpretation of the UCP 600.[13] First, this section provides an overview of basic LC law, including the parties to the transaction and how litigation can arise. Second, this section addresses the construction of the UCP and outlines the changes that were made in the most recent version.[14]

---

[12] *Fortis Bank*, [2010] EWHC 84 (Comm) at [74].

[13] As the first case to interpret UCP 600 interpretations of *Fortis Bank* focuses substantially on the changes between the UCP 500 and UCP 600. This note does not discuss the changes relating to the right of reimbursement owed by an Issuing Bank to a Nominated or Confirming bank in respect to a negotiated or honored LC codified in Articles 7, 8, 13 and 16. For a discussion of issues surrounding this aspect of *Fortis Bank* see Edwin Borrini, David Fricker & Amy Kho, *UCP 600: Confirming Banks and Nominated Banks*, Jones Day Commentary, Nov. 4, 2009, at 2-3, *available at* http://www.martindale.com/members/Article_Atachment.aspx?od=93563&id=833158&filename=asr-833198.UCP600.pdf.

[14] This note will focus primarily on only those changes that are applicable to *Fortis Bank*. For a discussion of all the subsequent changes see Richard Dole, *The Effect of UCP 600 Upon U.C.C. Article 5 With Respect to Negotiation Credits and the Immunity of Negotiating Banks from Letter-Of-Credit Fraud*, 54 WAYNE L. REV. 735, 763 (2008).

A. Overview of a Letter of Credit Transaction

Fortis Bank provides a traditional example of LC litigation and the following provides background for such transactions.[15]

1. What is a Letter of Credit?

A typical LC arises in an international commercial transaction and involves three contractual obligations and three separate parties.[16] First, a seller may wish to sell goods to a buyer in another country.[17] Because he does not know the buyer, a seller may have concerns that the buyer may become insolvent or refuse to pay for the goods which would leave the seller with the burden of retrieving the goods (or even initiating a lawsuit) in a foreign jurisdiction.[18] Likewise, a buyer may similarly not trust a seller's solvency or reliability resulting in a bilateral monopoly between the parties.[19] The issue could be resolved if the parties had some form of assurance that they will receive payment or shipment for the goods they are requesting.[20] A commercial LC[21] will serve this end by substituting the credit of the bank for that of the buyer.[22] The first underlying contractual obligation is that between the buyer and seller.[23] Second, there exists a contractual agreement between an issuing bank[24] and its customer (typically the buyer of goods in the underlying contract), referred to as the applicant.[25]

---

[15] *See* Gao Xiang & Ross Buckley, *The Unique Jurisprudence of Letters of Credit: Its Origin and Sources*,4 SAN DIEGO INT'L L.J. 91, 94-98 (2003) (providing examples of LC litigation in varying context, included discrepant documents under which *Fortis* falls).

[16] *Id.* at 100-01.

[17] U.C.C. § 5-102(a)(10) (1995).

[18] Xiang & Buckley, *supra* note 15, at 92.

[19] *Id.*

[20] *Id.* at 93-97.

[21] This note addresses only commercial LCs. For description and full historical significance of the commercial letter of credit and standby letter of credit distinction *see* Xiang & Buckley, *supra* note 15, at 100-01.

[22] *See id.* at 110-13.

[23] *Id*.

[24] U.C.C. § 5-102(a)(9) (1995).

[25] U.C.C. § 5-102(a)(2) (1995).

Finally, there exist the obligations created by the commercial LC[26] itself whereby the issuer undertakes to pay the beneficiary, upon a complying presentation[27] of required documents.[28]

This LC is a distinct transaction from the underlying contract between the buyer and seller.[29] Notably, the LC operates independent of any underlying contractual obligations.[30] This arrangement is beneficial to international commercial activity, since neither party controls both the goods and money at the same time, reducing the chance of misrepresentations by contracting parties.[31] In addition, beneficiaries are required to produce complying documents to the issuing bank before payment by the applicant is sent. [32] The potential risk surrounding these types of transactions is effectively reduced.[33]

Although LCs tend to reduce transaction costs and risk inherent in international commercial trade, they occasionally create problems. LCs create obligations that are documentary in nature, and banks have unique requirements under an LC regarding the presentation and acceptance of LC documents.[34] The issuing bank only has an obligation to pay once the beneficiary has presented documents under the LC which comply with its terms and conditions.[35] There may also exist a confirming bank[36] which, on

---

[26] This note will address specifically commercial LCs. For a discussion of standby LCs and discrepant document return see *id.* at 100-01.

[27] *See infra*, text accompanying note 50.

[28] U.C.C. § 5-102(a)(3) (1995).

[29] Xiang & Buckley, *supra* note 15, at 100-03.

[30] For a full discussion of the independence principle underlying LC transactions see Joseph J. Ortego & Evan H. Krinick, *Letters of Credit, Benefits and Drawbacks of the Independence Principle*, 115 BANKING L. J. 487, 490-96 (1998).

[31] *See* Xiang & Buckley, *supra* note 15, at 110-13.

[32] Janet Koven Levit, Bottom-Up Lawmaking Through a Pluralist Lens: The ICC Banking Commission and the Transnational Regulation of Letters of Credit, 57 EMORY L.J. 1147, 1167 (2008).

[33] Although the seller may face a decreased risk, the increase in claims of discrepant documents and potential obligations this creates, as discussed herein may mitigate these benefits.

[34] *See* Xiang & Buckley, *supra* note 15, at 100.

[35] *Id.*

authorization or request of the issuing bank, may honor an LC upon presentation by the beneficiary.[37] The UCP directs that if an issuing bank determines that the presentation is compliant, it must honor the LC.[38] If the presentation does not comply, then the bank may ask the applicant for a waiver of the discrepancies[39] or give notice of dishonor.[40] This notice must state that the bank is refusing to honor or negotiate,[41] list each discrepancy that justifies dishonor,[42] and describe what the issuing bank intends to do with the documents themselves.[43] If a confirming bank is involved, it will forward documents to the issuing bank once documentary conditions are met by the beneficiary.[44] Subsequently, upon certification both the applicant and beneficiary are directed to proceed with the underlying transaction.[45]

2. What governs Letter of Credit litigation?

There are two major sources of law governing LCs: Article 5 of the Uniform

---

[36] U.C.C. § 5-102 (a)(4) (1995).

[37] Xiang & Buckley, *supra* note 15, at 100.

[38] UCP 600, *supra* note 3, art. 15(a).

[39] UCP 600, *supra* note 3, art. 16(b).

[40] UCP 600, *supra* note 3, art 16.

[41] UCP 600, *supra* note 3, art. 16(c)(i).

[42] UCP 600, *supra* note 3, art. 16(c)(ii).

[43] UCP 600, *supra* note 3, art. 16(c)(iii).

[44] This note will only address the time frame surrounding presentation, notice of refusal, and return of the documents. For a thorough discussion of the historic use of rejection notices and conformity of presentations *see* Elizabeth Adodo, *Conformity of Presentation Documents and Rejection Notice in Letters of Credit Litigation: A Tale of Two Doctrines*, 36 HONG KONG L.J. 309, 322, 334 (2006) (discussing the principle of strict compliance in relation to document presentation and the subsequent validity of a rejection notice and the corrosive effect the tolerance by banks in regards to examination time frames may have).

[45] For a full introduction to the origin of LC law see Xiang & Buckley, *supra* note 15, at 92-108.

Commercial Code ("UCC") and the Uniform Customs and Practice for Documentary Credits.[46] In the U.S., LC transactions are governed by the UCC,[47] but international customs and practices reflected in the UCP are sometimes referenced (and in fact were explicitly incorporated in the latest version of UCC Article 5).[48] Additionally, parties may mutually agree to have the LC governed by the UCP.[49] This note will focus on contracts that have incorporated by reference the UCP through an LC's terms and conditions, as these are the majority of LCs.[50]

3. What is a discrepant document and how does this impede an LC transaction?

As discussed above, a document may be declared discrepant when it does not comply with contractual terms or international business practice.[51] When a bank declares a document discrepant, it is required under the UCP to give prompt notice of dishonor and to specify the exact provisions on which it is relying in dishonoring an LC ("return notice").[52] If a bank fails to specify a discrepancy in a return notice, then it is estopped from later

[46] Paolo S. Grassi, Letter of Credit Transactions: The Banks' Position in Determining Documentary Compliance: A Comparative Evaluation Under U.S., Swiss, and German Law, 7 PACE INT'L L. REV. 81, 103 (1995).

[47] See generally id. at 103-07.

[48] U.C.C. § 5-116(c) (1995) ("except as otherwise provided in this subsection, the liability of an issuer, nominated person, or adviser is governed by any rules of custom or practice, such as the Uniform Customs and Practice for documentary Credits").

[49] U.C.C. § 5-116(a) (1995); *See also* Atari, Inc. v. Harris Trust & Sav. Bank, 599 F. Supp 592, 594 (N.D. Ill, 1984) (noting that since the parties had expressly adopted the 1974 revision of the UCP in the letter of credit the UCP would control where the UCP was in conflict with other statutory interpretation).

[50] For a comparison of court's interpretation under the UCP and the UCC and the potential effect the UCP 600 will have on such reliance on international banking standards see Dole, *supra* note 14, at 763.

[51] UCP 600, *supra* note 3, art. 2 ("Complying presentation" means a presentation that is in accordance with the terms and conditions of the credit, the applicable provisions of these rules and international standard banking practice).

[52] UCP 600, *supra* note 3, art. 16; *see also* Offshore Trading Co., Inc. v. Citizens Nat. Bank of Fort Scott, Kan., 650 F. Supp. 1487, 1494 (D. Kan. 1987) (applying Kansas law) (citing to UCP 500 art. 16(e), noting that if the notice of dishonor did not state the discrepancies the issuer was precluded from claiming that the documents were nonconforming).

asserting the discrepancy.[53] Thus, failure to promptly issue a return notice may result in the bank's obligation to honor a disputed LC and remit payment.[54]

Courts have construed the UCP 500 to require strict compliance with the underlying contractual terms and conditions.[55] Strict compliance means that minor misspellings or typographical error within the LC warrants dishonor by the other party to the LC.[56] The UCP 600 diverges from this strict compliance principle by explicitly stating that minor errors such as a mistake in the address line (except the country) are not dishonorworthy discrepancies.[57] Although the change was intended to streamline the process and incorporate what most banks were already doing,[58] the result was mixed.[59]

---

[53] UCP 600, *supra* note 3, art. 16(f) ("If an issuing bank or a confirming bank fails to act in accordance with the provisions of this article, it shall be precluded from claiming that the documents do not constitute a complying presentation").

[54] *Id.*

[55] *See* (compliance) Crocker Commercial Services v. Countryside Bank, 538 F. Supp 1360, 1376 (N.D. Ill. 1981) (applying Illinois law) (holding that an inconsistency between a document required by the credit and a document not required by the credit could not produce a discrepancy that would justify dishonoring the LC); Integrated Measurement Systems, Inc. v. Int'l Commercial Bank of China, 757 F. Supp. 938, 946 (N.D. Ill 1991) (applying Illinois law) (noting that a one digit difference between the description of the goods in the invoice and that in the LC did not justify the bank's refusal of the documents). *See also* (promptness) Agri Export Corp. v. Universal Sav. Ass'n 767 F. Supp. 824, 838 (SD Tex. 1991) (applying Texas law) (holding that the preclusive provision of UCP art 16(e), which barring the issuer from later raising discrepant claims, had been enacted by the issuer's failure to comply with its obligation under Article 16(d) to "promptly" notify the beneficiary of the discrepancies on which it based refusal).

[56] See G.T. McLaughlin, The Standard of Strict Documentary Compliance in Letter of Credit Law: An American Perspective, 1 J. BANKING & FIN. L. & PRAC. 81, 87 (1990).

[57] UCP 600, *supra* note 3, art. 14(j) (noting that "when the addresses of the beneficiary and applicant appear in any stipulated document they need not be the same as those stated in the credit or in any other stipulated document, but must be within the same country as the respective addresses mentioned in the credit").

[58] International Chamber of Commerce, *Commentary on UCP 600*, *supra* note 3, art 14.

[59] Discussed *infra*, at Section II.

B. Changes in the UCP 600 Article 16

To overcome the rise in discrepant documents and to account for more recent international practices regarding LCs, the UCP 600 included several changes to the handling of and responsibilities regarding discrepant documents.[60] This section proceeds by describing the relevant UCP provisions, including Article 14 of the UCP 500,[61] and the changes to the language through Article 16 of the UCP 600.[62]

1. Article 14 of the UCP 500

UCP 500 Article 14, entitled "Discrepant Documents and Notice," provides that banks may dishonor documents if they appear to not be in compliance with terms and conditions of the LC.[63] Furthermore,

> If the Issuing Bank and/or Confirming Bank, if any, or a Nominated Bank acting on their behalf, decides to refuse the documents, it must give notice to that effect by telecommunication or, if that is not possible, by other expeditious means, without delay but no later than the close of the *seventh banking day* following the day of receipt of the documents. ii. Such notice must state all discrepancies in respect of which the bank refuses the documents and must also state whether it is holding the documents at the disposal of, or is returning them to the presenter.[64] (emphasis added)

This bright-line rule requires the bank to issue a notice of return within seven business days, but the rule omits the obligation of the issuing bank claiming discrepancy to physically return the documents, and any time

---

[60] These changes are codified in the UCP 600, *supra* note 3, art. 7, 8, 12, 14, 16.

[61] UCP 500, *supra* note 6, art. 14.

[62] UCP 600, *supra* note 3, art. 16.

[63] UCP 500, *supra* note 6, art. 14(B). In full UCP 500 art. 14(B) states:

upon receipt of the documents the Issuing Bank and/or Confirming Bank acting on their behalf must determine on the basis of the documents alone whether or not they appear of their face to be in compliance with the terms and conditions of the Credit. If the documents appear on their face not to be in compliance with the terms and conditions of the Credit, such banks may refuse to take up the documents. *Id.*

[64] UCP 500, *supra* note 6, art. 14(D)(i).

frame for such return. The UCP 500 did not state any timeframe for this unstated obligatory return of discrepant documents.[65]

2. Article 16 of the UCP 600

UCP 500 Article 14 was replaced by UCP 600 Article 16, entitled "Discrepant Documents, Waiver and Notice," which alleviated some of the specific problems associated with UCP 500 Article 14 but failed to address the issuing bank's obligation regarding physical return of the disputed documents.[66] It did, however, provide some clarity in return notices:

> c. When a [bank] decides to refuse to honor or negotiate, it must give a single notice to that effect to the presenter. The notice must state a) that the bank is holding the documents pending further instructions from the presenter; or b) that the issuing bank is holding the documents until it receives a waiver from the applicant and agrees to accept it, or receives further instructions from the presenter prior to agreeing to accept a waiver; c) or that the bank is returning the documents; or d) that the bank is acting in accordance with instructions previously received from the presenter. [67]

The UCP 600 is silent with regard to the amount of time allowed between issue of a return notice and the physical return of the disputed documents. Both the UCP 500 and UCP 600 offer preclusion as the remedy when a bank "fails to act in accordance with provisions of this article."[68] Although both the UCP 500 and 600 provide a guideline for banks and courts in determining discrepant documents, they fail to articulate additional obligations that may arise, such as an obligation to remit payment once an LC is issued.[69]

---

[65] *Id.*

[66] UCP 600, *supra* note 3, art. 16.

[67] *Id.* art. 16(c)(i), 16(c)(iii).

[68] *Compare id.* art. 16(f), *with* UCP 500, *supra* note 6 art. 14(E).

[69] *Id.*

C. Statement of the Case

Because *Fortis Bank* represented the first judicial interpretation of the UCP 600, the professional business world monitored its progress through the English courts.[70] This section first outlines the facts of the case, the arguments made by each party, and the reasoning by which Judge Hamblen construes an "implicit obligation" into the UCP 600 Article 16. Then it discusses Judge Hamblen's use of preclusion as the remedy for a violation of this new "implicit obligation."

1. Fortis Bank v. Indian Overseas

An applicant requested Indian Overseas Bank ("IOB"), to issue LCs in connection with certain purchase contracts between the applicant and a third party.[71] Each LC was subject to the UCP 600 and contained a request from IOB to Fortis Bank ("Fortis") to advise the beneficiary and stated that Fortis could add its confirmation (thereby making it the confirming bank).[72] IOB rejected the majority of the documents presented and refused to pay the beneficiary.[73] IOB issued notice of return under UCP 600 Article 16(c)(iii)[74] and subsequently Fortis requested that IOB return the documents.[75] After various exchanges between the banks, Fortis finally requested that IOB return the documents immediately.[76] Eventually each of the documents was returned by IOB, but not before 89 to 104 days had

[70] Several firm websites and business journals reported on the impact *Fortis Bank* would have on their own practices. *See, e.g.*, Edwin Borrini, David Fricker & Amy Kho, *UCP 600: Confirming Banks and Nominated Banks*, Jones Day Commentary, Nov. 4, 2009, at 2-3 *available at* http://www.martindale.com/members/Article_ Atachment.aspx?od=93563&id=833158&filename=asr-833198.UCP600.pdf. *See also* Collyer, *supra* note 1, at 3.

[71] Fortis Bank v. Indian Overseas Bank, [2010] EWHC 84, 8-13 (Comm) (Eng.).

[72] This was a new use of the UCP 600 language relating to the right of reimbursement owed by an issuing bank to a nominated or conforming bank in respect of a negotiated or honored credit. For a discussion of the issues *Fortis Bank* brought to the forefront regarding this right of reimbursement see Borrini, Fricker & Kho, *supra* note 70, at 2-3.

[73] All subsequent discrepancies except one were found invalid, but nonetheless the preclusion principle was applied. For a discussion of why this creates a stricter interpretation of UCP 600 than what was previously used under the UCP 500 *see id.* at 4.

[74] Discussed *infra* at 22.

[75] *Fortis Bank,* [2010] EWHC 84 (Comm) at 25-28.

[76] *Id.* at 6-29.

passed since the first set of documents was rejected, and 34 days after the second set Fortis had requested returned.[77] The issue facing the court was whether the preclusion principle[78] applied in relation to a bank's inaction subsequent to the issuance of a compliant return notice.[79] In other words, is there an inherent obligation that IOB act in accordance with its disposal notice and to do so with "reasonable promptness?"[80]

IOB contended that the drafters of the UCP 600 intended to restrict preclusion only to acts banks make prior to the issuance of a disposal notice, and that acts following this issuance fell outside the scope of Article 16(f).[81] It further submitted that there is no need to make compliance a contractual obligation since, as a general matter, banks do act as stated.[82]

Fortis countered that IOB was obligated to return the documents within a "reasonable time" and that not creating an inherent obligation would defeat the purpose of the UCP to create certainty and uniformity.[83] It also argued that international banking practice required that in this context, "reasonable time" meant "reasonable promptness."[84] In addition, Fortis contended that IOB's interpretation would prejudice a beneficiary's ability to promptly protect its own interests, by eliminating its ability to re-present new, compliant documents.[85]

Judge Hamblen agreed with Fortis that a contractual requirement to issue a return notice necessarily involves an obligation to comply with such notice.[86] In regards to the changes to the UCP 600, the court noted that IOB lacked a sufficient banking reason to explain why the new rules should be

---

[77] *Id.*

[78] UCP 600, *supra* note 3, art. 16(f).

[79] The court found that the Return Notice issued by Fortis bank had fully complied with UCP 600, *supra* note 3, art. 16(c)(iii). *See Fortis Bank*, [2010] EWHC 84 (Comm) at 6-29.

[80] *Id.* at 23-54.

[81] *Id.* at 6-29.

[82] *Id.* at 65.

[83] *Id.* at 10-25.

[84] *Fortis Bank,* [2010] EWHC 84 (Comm) at 30.

[85] *Id.* at 31-39.

[86] *Id.* at 48-59.

interpreted differently.[87] Ultimately, the court was persuaded by the argument of detriment to beneficiary's rights if the bank failed to deal with the presented documents in a timely manner.[88] Judge Hamblen reached this result by implying a term into UCP 600 that a bank is obligated to act in accordance with the disposal statement it has made in its Article 16 return notice and to return documents with "reasonable promptness."[89] Applying the English common law standard in construing implicit obligations,[90] Judge Hamblen held that:

1) It is both reasonable and equitable to require an issuing bank to act in accordance with the mandatory disposal statement it has made under the contract;

2) This is necessary to complete contractual circle and create an enforcement mechanism for this standard of conduct;

3) It is so obvious "it goes without saying" that when an issuing bank makes a disposal statement it must actually do what it says it will do;

4) It is easy to clearly express "and the bank must act in accordance with such statement" by adding it to the end of Article 16(c)(iii);

5) There is no contradiction between this implied wording and the expressed wording.[91]

Furthermore, Judge Hamblen explicitly rejected IOB's argument that a term could only be implied if IOB could satisfy the strict test for implication from usage or custom, and instead relied on background to

---

[87] *Id.*

[88] *Id.*

[89] *Id.* at 67, 71.

[90] These considerations are 1) it must be reasonable and equitable; 2) it must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it; 3) it must be so obvious that 'it goes without saying'; 4) it must be capable of clear expression; 5) it must not contradict any express term of the contract. *See* BP Refinery (Westernport) Pty Ltd v. Shire of Hastings [1977] 180 CLR 266, 282-83.

[91] *Fortis Bank*, [2010] EWHC 84 (Comm) at 64-66.

establish reasonable expectations of the parties.[92] He avoided the "overly compartmentalized" approach of construing one section of the UCP and construed strict timely performance as an integral part of the UCP and Article 16 as a whole.[93] In particular he noted that the five-day[94] maximum for review before a return notice would be meaningless if there was no time constraint on subsequent actions.[95] This overcame IOB's contention that local conditions or customs may make prompt action difficult or impossible, and that if something were to arise which created a *force majeure* event, then UCP 600 Article 36 could be relied upon.[96]

2. Fortis Bank's Remedy: The Preclusion Principle[97]

The UCP 600 is not without an enforcement mechanism. Article 16(f) states "if an issuing bank or a confirming bank fails to act in accordance with the provision of this article, it shall be *precluded* from claiming that the documents do not constitute a complying presentation."[98] Ultimately, per the implicit obligation, Judge Hamblen wrote into Article 16(c)(iii) an obligation to act with reasonable promptness upon issuance of a return notice.[99] Therefore IOB was precluded from relying on any relevant discrepancy.[100] The preclusion provision of Article 16(f) has been

---

[92] *Id.* at 69-70.

[93] *Id.* at 66.

[94] A shorter time than the seven days allowed under the UCP 500, *supra* note 6, art. 14.

[95] *Fortis Bank*, [2010] EWHC 84 (Comm) at 72. Judge Hamblen goes on to explain that this is congruent with a finding by the ICC DOCDEX Decision No. 242 with regards to a documentary credit under UCP 500. In that case the experts settling the dispute noted that an obligation to return documents without delay and be expeditious means was a "minimal standard." He further notes that were this case to be decided under the UCP 500 a court would conclude in line with ICC DOCDEX Decision No. 242 that there was an implicit obligation to return documents in accordance with a return notice in a reasonable time frame. He notes that the same analysis must apply to the obligation which he just held exists in UCP 600.

[96] *Fortis Bank*, [2010] EWHC 84 (Comm) at 76.

[97] This note will only address the preclusion principle outlined in the UCP 600. Similar principles are outlined in the U.C.C. § 5 1-108:8 and UCP 500, *supra* note 6, art. 14(E).

[98] UCP 600, *supra* note 3, art. 16(f).

[99] *Fortis Bank*, [2010] EWHC 84 (Comm) at 76.

interpreted as amounting to an enforcement mechanism for an issuer's failure to timely meet its *obligations* under the letter of credit.[101]

Applying the preclusion principle to neglecting implicit obligations is not new. In *Petra International Banking Corp. v. First American Bank of Virginia*[102] the Fourth Circuit noted that "the right to reject is accompanied by the obligation to return the documents, as received, to the bank."[103] The court in this case had considered what remedies a customer has when an issuing bank inadvertently accepts nonconforming documents under an LC.[104] The court held that failing to object to the documentary discrepancies in timely fashion waived an issuing bank's right to subsequently rely on such a claim.[105] Therefore, the Fourth Circuit attached preclusion as the remedy for the unstated but implicit obligation to return documents in a "timely fashion."[106]

Both *Fortis Bank* and *Petra* indicate that courts are likely to preclude reliance on discrepancy claims when not asserted within a reasonable time frame.[107] These implicit obligations, as *Fortis Bank* intimates, may become more widespread under the UCP 600.

III. Analysis

Judge Hamblen's interpretation does not seem a far reach from a customary implicit obligation, but it does create several disadvantages this

---

[100] *Id.* at 88-92; *See also* UCP 600, *supra* note 3, art. 16(f) ("If an issuing bank or a confirming bank fails to act in accordance with the provisions of this article, it shall be precluded from claiming that the documents do not constitute a complying presentation").

[101] *See* Clarendon, Ltd. v. State Bank, 77 F.3d. 631, 637 (2nd Cir. 1996) (noting that if an issuing bank failed to act in accordance with obligations under UCP 500 art. 16(d) then it was precluded from claiming the documents were not in accordance with terms and conditions of the credit, even where the beneficiary knowingly presented deficient documents).

[102] 758 F. Supp. 1120 (4th Cir. 1991).

[103] *Id.* at 1134 (citing Dorf Overseas, Inc. v. Chemical Bank, 91 A.D.2d 895 (N.Y. 1983)) (the bank was subsequently precluded from relying on claims that the LC was discrepant).

[104] *Id.* at 1128.

[105] *Id.* at 1129.

[106] *Id.* at 1128.

[107] *Id*; *Fortis Bank*, [2010] EWHC 84 (Comm) at 76.

for multinational corporations who rely on LCs to contract with companies in foreign countries. The UCP utilizes clear language to create clarity in the field of LC law. If judges continue to infer other implicit obligations and attach the preclusion principle to such obligations, they might create more uncertainty regarding parties' obligations in LC transactions.[108] Additionally, the "reasonable promptness" standard strays from the more common "reasonable time" interpretations used previously in LC case law and could make banks tentative in dealing with stranger companies or entering an LC transaction—something the UCP 600 attempts to mitigate.

A. Timeline of Obligation Under the UCP

Under the UCP 500 banks were given a "reasonable time" to examine documents to determine discrepancies before returning them to the beneficiary.[109] This ambiguity created litigation around the issuance of notices of return.[110] Unlike the UCP 500, the UCP 600 includes no reasonable time provision and instead sets a maximum of five banking days to review documents before they are required to issue Article 16 return notices.[111] Nowhere does UCP 600 use the term "reasonable promptness," though punctual payment is a stated goal of the UCP 600.[112] As discussed

---

[108] This note focuses on the ramifications of merely the 'reasonable promptness' implicit obligation that is apparent in *Fortis Bank*, and leaves open the possibility that other courts could utilize this interpretation method in construing implicit obligations in other areas.

[109] UCP 500, *supra* note 6, art. 14.

The Issuing Bank, the Confirming Bank, if any, or a Nominated Bank acting on their behalf, shall each have a *reasonable time, not to exceed seven banking days* following the day of the receipt of the documents, to examine the documents and determine whether to take up or refuse the documents and to inform the party from which it received the documents accordingly. *Id.* (emphasis added).

[110] *See* Pietrzak, *supra* note 10, at 186-95 (reviewing the case law involved in determining ambiguities from "reasonable time not to exceed seven business days").

[111] UCP 600, *supra* note 3, art. 14(B).

A nominated bank acting on its nomination, a confirming bank, if any, and the issuing bank shall each have a maximum of five banking days following the day of presentation to determine if a presentation is complying. This period is not curtailed or otherwise affected by the occurrence on or after the date of presentation of any expiry date or last day for presentation. *Id.*

[112] *See* UCP 600, *supra* note 3, Introduction. In fact, the restriction to five banking days regarding time of review may indicate the desire of the drafters to increase promptness and elevate this goal.

supra, the UCP 600 does not mention any subsequent obligations on banks who have issued return notices to act within any time period to comply with such notices—neither "reasonable time" nor a bright-line rule.[113]

Any obligation regarding a specific time frame for return of documents disadvantages those companies who may find minor discrepancies under the stated terms of the LC but who fail to return the documents within an unknown timeframe which will be based on the future interpretation of local judges. These companies are then precluded from relying on even valid discrepancies.[114]

B. *Fortis Bank* and Article 16 Interpretation

It is clear that Judge Hamblen's inclusion of an implicit obligation of "reasonable promptness" is an addition to the UCP 600 as written. Such additional obligations diverge from interpretation principles which rely solely on the UCP 600 language.[115] Instead, Judge Hamblen relied on common law and stated banking practices to construe this "reasonable promptness" timeframe.[116] This could be problematic in future construction of the UCP 600, as it may allow local banking customs, in a possibly non-mutual forum, to control questions of interpretation.

1. Construing Subsequent Acts of the Bank: An Implicit Obligation

In construing a new document like the UCP 600, judges often revert to an earlier version of the document to understand the purpose of any changes made.[117] Courts also use commentary to inform their decisions. However, it is strange that a court would look strictly to words from the UCP 500 and then to local customary law regarding "implicit obligations" to construe the "promptness" requirement as an implicit obligation.[118]

---

[113] *See supra* text accompanying note 64.

[114] *See supra* text accompanying note 52.

[115] UCP 600, *supra* note 3, art. 16(c)(iii) (articulating the exact time frame and what is to be included in a return notice).

[116] *Fortis Bank*, [2010] EWHC 84 (Comm) at 64-80.

[117] Dole, *supra* note 14, at 763.

[118] *Fortis Bank*, [2010] EWHC 84 (Comm) at 36-45.

First, Judge Hamblen looks to the words of the UCP 500 noting that Article 14(e) states that if an issuing bank or confirming bank "fails to hold the documents at the disposal of, or return them to the presenter" then the preclusion principle is applicable to claims of discrepancy.[119] The problem with this approach is that the drafters of the UCP 600 intentionally did not include this statement, possibly to create more flexibility in the receiving bank's ability to properly handle documents. In addition, the LC at issue incorporated the terms of the UCP 600, not 500, and if the precedent is to continually look to the UCP 500 for interpretative guidance then the UCP 600's power to streamline LC transactions may be undermined.[120]

Second, Judge Hamblen turns to English law regarding implying obligations into contracts. Specifically, he cites cases which denote that England is prepared to imply English law principles into international codes.[121] This will disadvantage foreign banks who contract around LC terms and conditions, particularly those LCs which articulate specific forum and choice of law.[122] This introduces uncertainty into these negotiations by creating different legal obligations for UCP incorporated contracts, and this uncertainty could potentially impact the way banks negotiate an LC. In addition, these banks must factor into their costs the fear of preclusion, the contractual remedy for this new non-contractual obligation.

2. Extra-contractual Obligations and Contractual Enforcement Mechanisms: Non-compliance and Preclusion

In utilizing the preclusion principle of Article 16, Judge Hamblen ignores IOB's objection to the use of such a draconian remedy and instead

---

[119] *Id.* at 22.

[120] Although it is not new to look to previous versions of the UCP for interpretative guidance it may not be the wisest approach. *See* George P. Graham, *International Commercial Letters of Credit and Choice of Law: So Whose Law Should Apply Anyway?*, 47 WAYNE L. REV. 201, 214-20 (2001).

[121] *Fortis Bank*, [2010] EWHC 84 (Comm) at 22 (citing Seaconsar v. Bank Markazi, 1 Lloyd's Rep 36, 39 [1999] (Eng.)).

[122] Choices of law and forum selection clauses are common in LC transactions. *See* George P. Graham, *International Commercial Letters of Credit and Choice of Law: So Whose Law Should Apply Anyway?*, 47 WAYNE L. REV. 201, 213 (2001). For a discussion of forum selection shopping in international transactions *see* Melissa A. Waters, *Mediating Norms and Identity: The Role of Transnational Judicial Dialogue in Creating and Enforcing International Law*, 93 GEO. L.J. 487, 511-12 (2005).

cites the historic use of preclusion under the UCP for justification of such a measure.[123] Although it is logical that an obligation should be followed by some sort of remedy to ensure compliance, it is not clear that the UCP 600 was intended to rely exclusively on preclusion as a remedy for non-compliance with non-contractual obligations.[124] In fact, UCP 600 is silent regarding whether its five-day deadline for examination of documents can give rise to preclusion.[125] Past interpretations of the UCP 500, which implicate preclusion of claims, has utilized a strict interpretation of any articulated obligation within the UCP.[126] Judge Hamblen makes a two-step jump. First, he imposes an obligation from local law into an international code, where none is expressly contained. Second, he employs the contractual remedy articulated in the international code to enforce this implicit obligation.[127] This kind of analysis could complicate LC contracts particularly for multinational corporations and impact their ability to predict and negotiate around assumed obligations arising under an LC. If judges enforce local custom with international law, then banks must contract around the possibility of these new obligations.[128]

C. Local Interpretation and a "Reasonable Promptness" Timeframe

Having raised some issues that arise out of the "implicit obligation" construed by Judge Hamblen, this note will discuss how his requirement of "reasonable promptness" rather than the traditional "reasonable time" will serve to inject further uncertainty into future LC transactions.

---

[123] *Fortis Bank*, [2010] EWHC 84 (Comm) at 18-26, 54.

[124] *See* Integrated Measurement Sys., Inc. v Int'l Commercial Bank, 757 F. Supp. 938, 946 (N.D. Ill. 1991), later proceeding 1991 WL 136010 (N.D. Ill.) (applying Illinois law) (construing UCP 400 art. 16 and holding that Article 16 required that a bank dishonoring a credit must give notice without delay, stating the discrepancies and describing why the bank refuses the documents and is precluded from claiming the documents are discrepant if it fails to do so).

[125] *See* Dole, *supra* note 14, at 763.

[126] *See* Petra Int'l Banking Corp. v. First Am. Bank of Va., 758 F. Supp. 1120, 1134 (4th Cir. 1992) (holding that the preclusion principle was triggered by the issuer's violations of its Article 16(d) obligations).

[127] *Fortis Bank*, [2010] EWHC 84 (Comm) at 27-35, 72.

[128] *See* discussion *supra*, at 14.

1. Discussion of "reasonable promptness"

Fortis contended that in construing an obligation to act in accordance with a return notice, the court should utilize a "reasonable promptness" standard since this is what was meant by "reasonable time" in this context.[129] Judge Hamblen substantiated this claim with reference to the UCP 500[130] noting,

> Given that it is established banking practice to act promptly in such circumstances, and given the obvious importance of priority processing of documents following a return notice or instruction, a reasonable time in this context means with *reasonable promptness.*[131]

He further reasoned that such a standard would be able to account for local conditions which may make prompt action difficult, and noted *force majeure* clauses will contain an "escape hatch" when action is impossible.[132] He rested his new "reasonable promptness" standard on the use of such a standard in international banking practices and held that the "number of weeks" following IOB's delay in returning the documents violates "reasonable promptness."[133]

This interpretation is problematic for two reasons. First he relied on international banking practice, but then made assumptions about local conditions, thereby leaving contracting parties unclear about which—the international standard, or specific local conditions—will control. Second, he gives no guidance regarding the case-by-case analysis implied in a "reasonable promptness" standard.

By construing a "reasonable promptness" standard in accord with international banking law, Judge Hamblen has incorporated additional language that the UCP (all versions) regarding purpose of such a document.[134] However, it is unclear that the drafters intended this standard

---

[129] *Fortis Bank*, [2010] EWHC 84 (Comm) at 71.

[130] Specifically Judge Hamblen references the ICC DOCDEX Case Decision No. 242, *infra* note 95.

[131] *Fortis Bank*, [2010] EWHC 84 (Comm) at 75 (emphasis added).

[132] *Id.*

[133] *Id.* at 84.

[134] International Chamber of Commerce, *Commentary on UCP 600*, *supra* note 3, at 3.

to be "read" into the UCP. In fact, nearly every document regarding LCs uses "reasonable time" as the standard and refuses to infer a stricter standard.[135] Although Judge Hamblen referred to the prompt five-day length of time allowed for issuance of a return notice within the Article 14, that standard may not have been intended for subsequent actions by banks beyond issuance notice.

However, the crux of Judge Hamblen's opinion articulates a UCP 500 interpretation in which "reasonable time" in the words of the text was interpreted to mean "reasonable promptness."[136] Relying on interpretive methods used for UCP 500, may result in incompatible results considering the numerous revisions to the UCP 600.[137] In other words, if courts simply rely on their own interpretative methods developed under UCP 500 contracts, the purpose of UCP 600, in implementing new international banking standards, will be undermined.

2. Application in LC Context: Outside the Article 16 Parameters

This principle, whereby courts simply revert back to UCP 500 obligations where the UCP 600 is unclear, will make corporations weary of future LC-contracting, something the UCP was designed to avoid.[138] In addition, Judge Hamblen's application of the Article 16 preclusion principle to outside implicit obligations is troublesome. What follows are two areas of the UCP 600 in which uncertainty in underlying "implicit obligations" may increase contracting costs: foreign banks may be uncertain of unwritten contractual terms; and the timeframe for negotiations may increase.[139]

---

[135] *See* U.C.C. § 5-108 (noting that an "issuer has *reasonable time* after presentation…" and is "precluded from asserting as a basis for dishonor any discrepancy if *timely* notice is not given") (emphasis added); UCP 500 *supra* note 6, art. 13(B) (noting that banks' shall have "reasonable time not to exceed seven banking days" to inform the party from which t received the documents about claimed discrepancies) (emphasis added). *See also* Pietrzak, *supra* note 10, at 186-95 (discussing use of intentionally vague "reasonable time" standards to allow for case-by-case flexibility and to avoid strict bright line rules which would disadvantage banks by restricting their discrepancy claims to arise to quickly).

[136] *Fortis Bank*, [2010] EWHC 84 (Comm) at 74-76 (after analogizing the case at hand to ICC DOCDEX Decision No. 242, Judge Hamblen proceeds to assume that a similar analysis under UCP 600 would result in this same "reasonable promptness" standard).

[137] *See supra* text accompanying notes 67, 68.

[138] *See* International Chamber of Commerce, *Commentary on UCP 600*, *supra* note 3, at 3.

[139] *Id*.

One ambiguous area is under Article 14's examination of document's provisions whereby data in a document "when read in context with the credit, the document itself and international standard banking practice, need not be identical to, but must not conflict with, data in that document."[140] Two parts of this new standard may be implicated under Judge Hamblen's analysis regarding the UCP 600. First, "international standard banking practice" may be construed, at least in England, as incorporating English common law. Second, "not in conflict with" may revert back to UCP 500 analysis, whereby stricter interpretations for discrepancy than those intended by the UCP 600 were utilized to define when a document did not comply.[141]

Another area of the UCP 600 which may suffer from Judge Hamblen's analysis is Article 15 in regards to complying presentations. Article 15 states that "when an issuing bank determines that a presentation is complying, it must honor."[142] If there is confusion surrounding the compliant document, in regards to which international banking standard, or particular venue's common law applies, then this will increase uncertainty in the field. This provision in particular is important since the UCP 600 was the first to define "honor" and to use it as a substantial requirement on banks and not merely a descriptive term for payment under another LC obligation.[143]

Although not exclusive, these areas demonstrate potential issues of UCP 600 interpretation if courts are to use Judge Hamblen's common law obligation and UCP 500 approach to construing the new terms.[144]

IV. LCs and Recognizing Local Custom: Future Contracting Costs

The ICC seeks to increase the use of LCs in international transactions.[145] This goal stems from the desire to reduce uncertainty and

---

[140] *Id.* art. 14(d).

[141] *See id.*

[142] UCP 600, *supra* note 3, art. 15 (a) goes on to prescribe the same obligations for confirming and nominated banks insofar as they must forward the documents to the issuing bank when compliance is determined. *See also id.* art. 15(c).

[143] *See* Dole, *supra* note 14, at 742 (discussing the new term honor, and the issuer's duty under these obligations).

[144] *See supra* text accompanying note 35.

increase the effective use of LCs in facilitating international trade.[146] With this end in mind, the UCP is created for use by courts to construe international banking standards in a uniform way to increase predictability and reduce negotiating costs regarding incorporation of agreed upon standards into a contract.[147] Under UCP 500, courts tended to lean towards a strict compliance principle, where LCs were dishonored at the slightest variation from stated terms and conditions.[148] However, adoption of a case-by-case reasonableness analysis, coupled with the UCP 600 broader terms, could shift courts towards a system in which the international banking standards play a more predominate role in court interpretations of UCP principles.[149] Directing courts to a case-by-case reasonableness analysis requires that courts imply local customs into the explicit terms of the UCP, and as demonstrated by *Fortis*, may result in unanticipated—and non-negotiated—implicit obligations.[150] Such implicit obligations could have the detrimental effects of increasing contracting costs and uncertainty regarding the underlying obligations, thereby contributing to the unraveling of LC law.

A. The Goals of the UCP: International Commercial Norms

Did *Fortis* adequately incorporate international banking practices in construing the UCP 600? Judge Hamblen's reliance on local common law to construe "implicit obligations," indicates that it did not. However, this raises the question of how international norms are to be used in interpreting a codified international code such as the UCP. Viewing the UCP as a "bottom up" approach to law-making may be the first step towards understanding how to construe ambiguities such an instrument may

---

[145] See Joseph D. Gustavus, Letter of Credit Compliance Under Revised UUCC Article 5 and UCP 500, 114 BANKING L.J. 55, 62-67 (1997).

[146] International Chamber of Commerce, ICC Response to the Basel Committee Consultative Document on "Strengthening the Resilience of the Banking System," annex 1(A), ICC Document No. 470/1139 (Apr. 16, 2010) at 4, available at http://www.iccwbo.org/uploadedFiles/ICC/policy/banking_technique/Statements/1139%20 ICC%20 Position%20Paper_Basel%20Committee%20Consultation.pdf.

[147] *Id.*

[148] *See* Pietrzak, *supra* note 10, at 187.

[149] *Id.* at 188-94.

[150] *See* discussion *supra* at 15.

create.[151] "Bottom up" refers to an approach whereby rules and regulations are created by the members of a trade or practice intimately familiar with its inner workings. [152] This may be contrasted with a "top down" approach employed in much of international law, whereby laws are created by policy makers and may not reflect the informal normative development in which community-based norms become the governing framework for a particular trade.[153] Janet Levit, the first to interpret the "bottom up" approach in the context of the UCP, has provided a framework whereby the UCP—through the frequency with which banks adhere to its regulations as well as incorporate explicitly the rules of the UCP into their contractual negotiations—has become hard law.[154] Levit opines that the rules created by private actors and public technocrats enforce a body of law that better reflect and shape the practice of international financial parties.[155]

When considering this bottom-up view, it is difficult to see where local common law, such as that utilized by Judge Hamblen, has a place in interpreting the UCP. The legitimacy of the UCP depends not on the ratification by the independent parties, but through the courts use of such designated customs.[156] A better way to incorporate these customs would seem to be references to the ICC Opinions,[157] which can be used to assess whether an international custom exists. By not referring back to local customary law, a judge would strengthen the "international banking practice" that is itself codified in the UCP and promoted throughout its judicial opinions.

---

[151] Janet Koven Levit, A Bottom-Up Approach to International Lawmaking: The Tale of Three Trade Finance Instruments, 30 YALE J. INT'L L. 125, 133-36 (2005).

[152] For an in-depth discussion of how letters of credit law, including the UCP, plays an imperative role in the transnational legal landscape see *id.* at 133-36; Levit, *supra* note 31, at 1214-22.

[153] Levit, *supra* note 31, at 1214-22.

[154] Levit, *supra* note 151, at 141.

[155]*Id.* at 209.

[156] *Id.* at 215.

[157] These opinions articulated by the drafters of the UCP articulate the specific "international business practices" which are codified in the UCP itself. As a member of the ICC these are *available at* http://www.iccwbo.org/id6042/index.html#Longlife.

B. Transaction Costs in LC Negotiations

Future cases outside of *Fortis Bank* will indicate whether the UCP 600 drafters left too many ambiguities that leave room for judges to incorporate local customs and common law into the UCP itself. However, if Judge Hamblen's interpretation proves to be consistent with the future interpretations, then significant transaction costs may be imposed on contracting parties. With uncertainty surrounding the use of international custom versus local common law, banks will be encouraged to contract more precisely into one or the other[158]— a step beyond just incorporating the UCP 600 as the banks did in *Fortis Bank*. This entails an increase in contract costs as "battle of the form" style contracting ensues.[159]

Despite this initial increase in negotiating costs, it is foreseeable that utilizing a bottom-up law making approach, such as the ICC does, these newly developed norms would be codified in any subsequent version of the UCP, thereby mitigating these costs.[160] However, this benefit of the bottom-up approach seems to come at a cost. The legitimacy the UCP 600 strived for in increasing effective use of LCs in international transactions may be undermined by local custom and common law being utilized by courts for interpretation of UCP terms.[161]

Conclusion

The ICC's previous production of several versions of the UCP led to the ease of international transactions, but also the rise in interstate litigation regarding the mechanics of LCs.[162] This included debate over what constituted a "reasonable time"[163] as well as litigation surrounding what

[158] This may include incorporating specific provisions regarding time frame on return of documents, especially since the UCP 600 allows banks to expressly exclude certain provisions and manifest include their own provisions. *See* UCP 600, *supra* note 3. The need for banks to therefore be clear in the negotiating phase regarding these time frames will increase the cost of negotiating.

[159] For a discussion surrounding LC transaction and contracting costs generally see William Fox, INTERNATIONAL COMMERCIAL AGREEMENTS: A PRIMER ON DRAFTING, NEGOTIATING AND RESOLVING DISPUTES 5-33 (Kluwer Law International) (2009).

[160] *See* Levit, *supra* note 151, at 140-56.

[161] International Chamber of Commerce, *Commentary on UCP 600*, *supra* note 4.

[162] *See* Levit, *supra* note 32, at 1168-72.

[163] *See* Pietrzak, *supra* note 10, at 186-87; Levit, *supra* note 32, at 1214-22.

constituted the "international banking standards" the UCP was meant to codify. The new UCP 600 promised better incorporated norms of international practice[164] and indeed provided a much improved set of guidelines to navigate the identification and handling of discrepant documents.[165] Beyond the explicit obligations, the "implicit obligation"[166] that Judge Hamblen prescribed to banks to act in accordance with their Article 16 return notice may unnecessarily burden banks during contract negotiations. These kinds of uncertainties were not intended by the drafters under the UCP 600.[167]

In addition to the obvious imposition of further obligations on contracting parties, the use of English common law[168] and UCP 500 interpretative principles[169] will further complicate future UCP 600 usage. In addition, the use of local common law and customs places unique emphasis on contracting around forum selection and choice of law clauses, and will further burden contracting parties.

The analysis performed by Judge Hamblen will create ambiguities in interpreting and applying the UCP 600, and will ultimately increase initial contracting costs. By relying on local custom, *Fortis Bank* differs significantly from its predecessors that interpreted the UCP 500.[170] This reliance will ultimately undermine the stated purpose of the UCP 600—to streamline and increase the use of LC transactions.[171] Judge Hamblen's interpretation disadvantages multi-national corporations in initial contract negotiations and could create uncertainty in LC law, which the UCP 600

---

[164] *See* Dole, *supra* note 14, at 742; International Chamber of Commerce, *Commentary on UCP 600*, *supra* note 4, at 27.

[165] UCP 600, *supra* note 3, art. 14-16.

[166] *See supra* text accompanying note 120.

[167] *See* Dole, *supra* note 14, at 747; International Chamber of Commerce, *Commentary on UCP 600*, *supra* note 4, at 27-28.

[168] *Fortis Bank*, [2010] EWHC 84 (Comm) at 71.

[169] *Id.* at 77.

[170] *See* Joseph D. Gustavus, *Letter of Credit Compliance Under Revised UUCC Article 5 and UCP 500*, 114 BANKING L.J. 55, 62-67 (1997) (offering an overview of UCP 500 interpretations regarding international standard banking practice).

[171] *See* International Chamber of Commerce, *Commentary on UCP 600*, *supra* note 4, at 5.

was designed to mitigate.[172] New obligations based on local custom and enforced utilizing the internationally recognized ICC rules could potentially affect many areas of multinational contract negotiation and become costly for banks and companies alike who operate utilizing LCs to facilitate trade in an ever-growing international marketplace.

[172] *Id.*

From Your Land to Mine: The Benefits of Applying the First Sale Doctrine to Goods Manufactured Abroad

Kaitlyn E. Amundsen*

Introduction

A domestic manufacturer with an American copyright produces a good in the United States. The manufacturer then sells the good to a domestic retailer, who sells the good to consumers. If this case arose in any jurisdiction in the United States, the first sale doctrine codified in 17 U.S.C. § 109(a) would protect the retailer from copyright infringement. The first sale doctrine prevents a copyright owner who puts a product into the "stream of commerce" from possessing an exclusive statutory right to control subsequent distribution of that product.[1]

In a second situation, a foreign manufacturer with an American copyright produces a good. The manufacturer then sells the good to a retailer in the United States, who sells the good to consumers. The copyright owner sues the retailer for a copyright violation. If this case arose in the Third or Ninth Circuits, 17 U.S.C. § 109(a) would provide a first sale defense to the retailer; these circuits would rule that because the copyright owner already made an initial sale of the product in the United States, he or she could not claim copyright infringement on subsequent sales.[2]

In a final case, a foreign manufacturer produces a good with an American copyright. The manufacturer sells the good to a distributor abroad, who then sells to retailers and consumers in the United States. The copyright owner sues the distributor for copyright infringement. If this case arose in the Third Circuit, 17 U.S.C. § 109(a) would provide a defense to

* George Mason University School of Law, Juris Doctorate Candidate, May 2013; Notes Editor, GEORGE MASON JOURNAL OF INTERNATIONAL COMMERCIAL LAW, 2012-2013; Georgetown University, Edmund A. Walsh School of Foreign Service, B.S. International Politics, May 2010. I would like to thank my supportive family for their patience, understanding, love, and invaluable feedback. I would also like to thank the editors and members of the Journal of International Commercial Law who made timely publication of this Note possible.

[1] Quality King Distribs., Inc. v. L'anza Research Int'l, Inc., 523 U.S. 135, 152 (1998).

[2] Omega S.A. v. Costco Wholesale Corp., 541 F.3d 982, 986 (9th Cir. 2008); Sebastian Int'l Inc. v. Consumer Contacts (PTY) Ltd., 847 F.2d 1093, 1098-99 (3d Cir. 1988).

the distributor.[3] However, if this case arose in the Second or Ninth Circuits, the copyright owner would prevail.[4] If this scenario presented itself in any other circuit, both parties have an equal opportunity to triumph.

The highlighted discrepancy in appellate courts' rulings on various fact patterns regarding copyrighted goods has been a recent point of contention in American courts. In the United States, it is well settled that the first sale doctrine protects sellers from violating copyrights once a domestic first sale has been made.[5] According to the first sentence of § 109(a), which reads:

> [n]otwithstanding the provisions of [§] 106(3),[6] the owner of a particular copy or phonorecord[7] lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord,[8]

copyright owners cannot control the subsequent sales of their products once they are placed into the stream of commerce.[9]

The current dispute revolves around whether § 109(a) should be read to apply extraterritorially. The language of the statute invites

---

[3] *Sebastian Int'l Inc.*, 847 F.2d at 1098-99.

[4] John Wiley & Sons, Inc. v. Kirtsaeng, 654 F.3d 210, 222 (2d Cir. 2011); *Omega S.A.*, 541 F.3d at 985.

[5] Quality King Distribs., Inc., 523 U.S. at 136.

[6] Section 106(3) reads as follows:

Subject to [§§] 107 through 122, the owner of copyright under this title has the exclusive rights to do and to authorize any of the following: . . . (3) to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending . . . . 17 U.S.C. § 106(3) (2006).

[7] "Phonorecords" are material objects in which sounds, other than those accompanying a motion picture; or other audiovisual work, are fixed by any method now known or later developed, and from which the sounds can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device. The term "phonorecords" includes the material object in which the sounds are first fixed. 17 U.S.C. § 101 (2006).

[8] 17 U.S.C. § 109(a) (2006).

[9] Quality King Distribs., Inc., 523 U.S. at 152.

interpretation, specifically regarding the phrase "lawfully made under this title."[10] The circuit courts that have ruled on this issue have applied the statute differently, either interpreting the phrase to mean "lawfully made in America" or "lawfully made under an American copyright."[11] In evaluating these interpretations, the courts have also examined other sections of Title 17 where the phrase "lawfully made under this title" has applied to both domestic and foreign works.[12] The Supreme Court has not yet resolved this circuit split.

This Note examines the circuit split with respect to the first sale doctrine. It proposes that circuit courts as well as the Supreme Court should allow the first sale doctrine to provide a defense to goods with American copyrights that are manufactured abroad and then imported into the United States, thereby reading "lawfully made under this title" as "lawfully made under an American copyright." This will protect domestic consumers from paying higher prices for goods and from potentially engaging in copyright infringement. The proposed language will also reduce the risk that American jobs will be lost to outsourcing and decrease the incentive for American copyright owners to manufacture abroad.

In Part I, this Note examines 17 U.S.C. § 109(a) and how the circuit courts have interpreted this statute. In Part II, this Note analyzes how each interpretation affects copyright owners, consumers, and the American job market. Part III argues that the Third Circuit's ruling, which extends the first sale doctrine to goods manufactured abroad and imported into the United States, is preferable and consistent with the purpose behind the Copyright Act. Part III also demonstrates how this interpretation benefits consumers and the American job market while ensuring that copyright owners benefit from their work as they deserve. Finally, Part IV offers a legislative solution that aligns with the preferable court ruling and clarifies how the statute should be interpreted.

---

[10] John Wiley & Sons, Inc. v. Kirtsaeng, 654 F.3d at 225-26 (Murtha, J., dissenting).

[11] Michael Stockalper, Is There a Foreign "Right" of Price Discrimination Under U.S. Copyright Law? An Examination of the First-Sale Doctrine as Applied to Gray-Market Goods, 20 DEPAUL J. ART., TECH. & INTELL. PROP. L. 513, 533 (2010).

[12] John Wiley & Sons, Inc., 654 F.3d at 219.

I. Background

A. The Copyright Act and the First Sale Doctrine

The Copyright Act originates from article I, section 8 of the Constitution.[13] It gives Congress the authority "to promote the [p]rogress of [s]cience and useful [a]rts, by securing for limited [t]imes to [a]uthors and [i]nventors the exclusive [r]ight to their respective [w]ritings and [d]iscoveries."[14] The Copyright Act's goal is to balance the interests of copyright owners with the interests of the public.[15] The Copyright Act is aimed at encouraging creativity by ensuring that copyright owners control the terms by which their products enter the stream of commerce[16] while also enabling members of the public to benefit from that creativity after exclusive control has ended.[17] Under the Copyright Act, copyright holders can control and exploit their ideas while members of society can take advantage of the flow of commerce.[18]

Chapter 5 of Title 17 of the United States Code contains remedies available to copyright owners who believe that they have been victims of copyright infringement.[19] Section 501 states that "[a]nyone who violates any of the exclusive rights of the copyright owner as provided by [§§] 106 through 122" or violates § 602 infringes on a copyright.[20] The remedies available to copyright owners include injunctions,[21] the impoundment and disposition of infringing articles,[22] damages and profits,[23] and costs and

---

[13] Sebastian Int'l Inc. v. Consumer Contacts (PTY) Ltd., 847 F.2d 1093, 1095 (3d Cir. 1988).

[14] U.S. CONST. art. I, § 8, cl. 8.

[15] *Sebastian Int'l Inc.*, 847 F.2d at 1095.

[16] Stockalper, *supra* note 11, at 513.

[17] *Sebastian Int'l Inc.*, 847 F.2d at 1095.

[18] *Id.*

[19] 17 U.S.C. § 502 (2006); 17 U.S.C. § 503 (2006); 17 U.S.C. §504 (2006); 17 U.S.C. § 505 (2006).

[20] 17 U.S.C. § 501 (2006).

[21] 17 U.S.C. § 502.

[22] 17 U.S.C. § 503.

[23] 17 U.S.C. § 504.

attorney's fees.[24] According to the United States Copyright Office, copyright holders have the option of filing civil suits in federal district courts.[25] Alternatively, if copyright owners believe that the alleged violator engaged in willful infringement for profit, a United States Attorney may choose to commence a criminal proceeding against the alleged infringer.[26]

In addition to remedies for copyright owners, Title 17 of the United States Code also provides protection to retailers and consumers.[27] The first sentence of § 109(a) is commonly known as the "first sale doctrine."[28] In *Quality King Distributors, Inc. v. L'anza Research International, Inc.*,[29] the Supreme Court explained the rationale behind the first sale doctrine, stating that when a copyright owner puts a product into the "stream of commerce" by making an initial sale of the item, the owner "has exhausted his exclusive statutory right to control its distribution."[30]

The first sale doctrine prohibits copyright owners from regulating the transfer of their products once those goods have entered the market.[31] It enables those who have lawfully purchased a copyrighted work to resell it unlimitedly.[32] Consumers and retailers can confidently participate in commerce and benefit from copyright owners' ideas and products by knowing that these owners will not hamper their market exchanges.[33]

---

[24] 17 U.S.C. § 505.

[25] *Can I Use Someone Else's Work? Can Someone Else Use Mine?*, U.S. COPYRIGHT OFFICE (Oct. 6, 2009), http://www.copyright.gov/help/faq/faq-fairuse.html.

[26] *Id.*

[27] *See* 17 U.S.C. § 109(a) (2006); *see also* John Wiley & Sons, Inc. v. Kirtsaeng, 654 F.3d 210, 211-12 (2d Cir. 2011).

[28] See John Wiley & Sons, Inc., 654 F.3d at 212 n.1.

[29] 523 U.S. 135 (1998).

[30] *Id.* at 152.

[31] Sebastian Int'l Inc. v. Consumer Contacts (PTY) Ltd., 847 F.2d 1093, 1095 (3d Cir. 1988).

[32] *John Wiley & Sons, Inc.*, 654 F.3d at 211-12.

[33] Brief for Retail Indus. Leaders Ass'n et al. as Amici Curiae Supporting Petitioner at 5, Costco Wholesale Corp. v. Omega, S.A., 131 S. Ct. 565 (2010) (No. 08-1423).

The American judicial system has protected the first sale doctrine for over a century. In *Bobbs-Merrill Co. v. Straus*,[34] the Supreme Court held that "the exclusive statutory right to vend applied only to the first sale of the copyrighted work."[35] The Court explained that copyright holders do not have a right to control future sales of their products.[36] This ruling prohibited copyright owners from controlling prices on subsequent sales of their items.[37] This holding is now codified in § 109(a) of Title 17 of the United States Code.[38]

B. The Circuit Split Surrounding the First Sale Doctrine

The confusion regarding the interpretation of the first sale doctrine revolves around the phrase "lawfully made under this title."[39] Courts differ on whether this phrase means "lawfully made in the United States" or "lawfully made under an American copyright."[40] The differences in interpretation have led some courts to hold that the first sale doctrine only applies to goods manufactured within the country,[41] while other courts believe that the doctrine also extends to goods manufactured abroad.[42]

In 1988, the Third Circuit was presented with a case that required it to interpret the first sale doctrine. In *Sebastian International Inc. v. Consumer Contacts (PTY) Ltd.*,[43] the plaintiff produced goods in the United States and sold them to the defendant abroad.[44] The defendant then re-sold

---

[34] 210 U.S. 339 (1908).

[35] Quality King Distribs., Inc., 523 U.S. at 141.

[36] *Bobbs-Merrill Co.*, 210 U.S. at 351.

[37] *John Wiley & Sons, Inc.*, 654 F.3d at 212 (explaining the ruling in *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339 (1908)).

[38] *Id.* at 212 n.1.

[39] *Id.* at 225-26 (Murtha, J., dissenting).

[40] Stockalper, *supra* note 11, at 533.

[41] *John Wiley & Sons, Inc.*, 654 F.3d at 224; Omega S.A. v. Costco Wholesale Corp., 541 F.3d 982, 985, 990 (9th Cir. 2008).

[42] Sebastian Int'l Inc. v. Consumer Contacts (PTY) Ltd., 847 F.2d 1093, 1099 (3d Cir. 1988).

[43] 847 F.2d 1093 (3d Cir. 1988).

[44] *Id.* at 1094.

the goods in the United States.[45] The Third Circuit held that "when [the] plaintiff made and then sold its copies, it relinquished all further rights 'to sell or otherwise dispose of possession of the copy'" because the copyright owner had already received compensation through the purchase price.[46] Under this ruling, when goods are manufactured abroad, American copyright owners are prohibited from benefitting twice by receiving compensation from purchasers while also limiting importation into the United States.[47]

Twenty years later, the Ninth Circuit faced its most recent opportunity to interpret the first sale doctrine. In *Omega S.A. v. Costco Wholesale Corp.*,[48] Omega sold its copyrighted watches to distributors abroad.[49] Third parties then sold the watches to a company in the United States; the company sold the watches to Costco, who then sold them to consumers.[50] Omega, arguing that it did not authorize the importation of the watches back into the country, sued Costco.[51] The Ninth Circuit held for Omega, ruling that § 109(a) does not apply to goods manufactured abroad.[52]

The Ninth Circuit used several rationales to justify its ruling. First, the court considered its precedent, including *BMG Music v. Perez*;[53] the court in *BMG Music* originally held that "lawfully made under this title" only extends first sale protection to copies made and sold in the United States.[54] Secondly, the court in *Omega S.A.* did not want to allow the Copyright Act to apply extraterritorially.[55] Extraterritoriality prevents

[45] *Id.*

[46] *Id.* at 1098-99.

[47] *Id.* at 1099.

[48] 541 F.3d 982 (9th Cir. 2008).

[49] *Id.* at 984.

[50] *Id.*

[51] *Id.*

[52] *Id.* at 985.

[53] 952 F.2d 318 (*9th Cir*. 1991).

[54] *Omega S.A.*, 541 F.3d at 985-86.

[55] *Id.* at 986.

American courts from using American law embodied in the Copyright Act to regulate conduct that occurs abroad.[56] According to the Ninth Circuit,

> [t]o characterize the making of copies overseas as "lawful[] . . . under [Title 17]" would be to ascribe legality under the Copyright Act to conduct that occurs entirely outside the United States, notwithstanding the absence of a clear expression of congressional intent in favor of extraterritoriality.[57]

Finally, the court stated that applying § 109(a) to foreign-made goods would make 17 U.S.C. § 602[58] meaningless.[59] Section 602(a) concerns the importation of copyrighted goods, and states that importing these products without a copyright owner's permission is a copyright infringement.[60] The Ninth Circuit argued that § 602(a) would no longer be necessary if § 109(a) applied to goods produced abroad "because importation is almost always preceded by at least one lawful foreign sale that will have exhausted the distribution right on which § 602(a) is premised."[61]

The Ninth Circuit created an exception to its holding that has not been followed by the other circuits. This exception allows § 109(a) to provide first sale protection to goods manufactured abroad if the first sale occurs domestically.[62] Short of that exception, the Ninth Circuit holds that § 109(a) should not be applied to goods manufactured abroad.[63] In this case, Omega first sold its copies abroad, so the exception did not apply.[64] Therefore, to rule in alignment with its binding precedent and its view

---

[56] Stockalper, *supra* note 11, at 529.

[57] *Omega S.A.*, 541 F.3d at 988.

[58] Section 602 is utilized "as a tool against the unauthorized importation of nonpiratical copies." *Id.* at 986.

[59] *Id.*

[60] 17 U.S.C. § 602(a)(1) (2006).

[61] *Omega S.A.*, 541 F.3d at 986.

[62] *Id.*

[63] *Id.* at 990.

[64] *Id.* at 984-85, 986.

against extraterritoriality, in *Omega S.A.* the Ninth Circuit held that the first sale doctrine did not provide a defense for Costco.[65]

Recently, the Second Circuit had the opportunity to rule on the issue of “whether the first sale doctrine . . . applies to copyrighted works produced outside of the United States but imported and resold in the United States.”[66] In *John Wiley & Sons, Inc. v. Kirtsaeng*,[67] the Second Circuit interpreted the phrase “lawfully made under this title” to mean “lawfully made in the United States,” thus failing to extend the first sale doctrine to goods manufactured abroad.[68]

In conducting its analysis, the court in *John Wiley & Sons, Inc.* examined other parts of Title 17 in which the phrase “under this title” applied to both domestic and foreign works.[69] The court explained that § 104(b)(2),[70] which also contains the phrase “under this title,” applies copyright protection to works published both domestically and abroad.[71] In addition, § 1006(a),[72] which concerns royalty payments under the Audio Home Recording Act, also utilizes the phrase “lawfully made under this title.”[73] When considering the interpretation of § 1006(a), the court

---

[65] *Id.* at 985.

[66] John Wiley & Sons, Inc. v. Kirtsaeng, 654 F.3d 210, 212 (2d Cir. 2011).

[67] 654 F.3d 210 (2d Cir. 2011).

[68] *Id.* at 224.

[69] *Id.* at 219-20.

[70] “The works specified by [§§] 102 and 103, when published, are subject to protection under this title if- . . . (2) the work is first published in the United States or in a foreign nation that, on the date of first publication, is a treaty party . . . .” 17 U.S.C. § 104(b)(2) (2006).

[71] *John Wiley & Sons, Inc.*, 654 F.3d at 219-20.

[72] The royalty payments deposited pursuant to [§] 1005 shall, in accordance with the procedures specified in
[§] 1007, be distributed to any interested copyright party- (1) whose musical work or sound recording has been- (A) embodied in a digital musical recording or an analog musical recording lawfully made under this title that has been distributed, and (B) distributed in the form of digital musical recordings or analog musical recordings or disseminated to the public in transmissions, during the period to which such payments pertain; and (2) who has filed a claim under [§] 1007. 17 U.S.C. § 1006(a) (2006).

[73] John Wiley & Sons, Inc., 654 F.3d at 220.

analyzed how the United States Copyright Office expects the distribution of royalty payments to apply to recordings manufactured both in and out of the United States.[74]

These interpretations of other sections of Title 17, however, did not persuade the Second Circuit to rule in favor of applying § 109(a) to goods manufactured abroad. In explaining its decision, the Second Circuit conceded that "[t]he relevant text is simply unclear"[75] and questioned why Congress did not explicitly state in § 109(a) that the statute should only apply domestically.[76] Ultimately, the court decided that § 109(a) should not provide protection to goods manufactured outside of the United States.[77] The court concluded that "lawfully made under this title" means lawfully made where the Copyright Act is applicable and thus § 109(a) does not apply to goods manufactured abroad.[78]

C. The Supreme Court's Failure to Resolve the Circuit Split

Currently, the circuit courts have ambiguous guidance but not a binding ruling from the Supreme Court. The Supreme Court has faced this issue twice, but has yet to lay down a law regarding whether or not § 109(a) should apply to goods manufactured abroad.

In *Quality King Distributors, Inc. v. L'anza Research International, Inc.*, the Court answered the question of "whether the 'first sale' doctrine endorsed in § 109(a) is applicable to imported copies" in the affirmative.[79] The situation in *Quality King Distributors, Inc.* was similar to that in the Third Circuit case *Sebastian International Inc.* In *Quality King Distributors, Inc.*, the goods in question were first manufactured domestically by L'anza and then sold to a foreign purchaser.[80] The goods

---

[74] *Id.*

[75] *Id.*

[76] *Id.* at 220 n.38.

[77] *Id.* at 221.

[78] *Id.* at 222.

[79] Quality King Distribs., Inc. v. L'anza Research Int'l, Inc., 523 U.S. 135, 138 (1998).

[80] *Id.* at 139.

were later imported back into the United States and re-sold domestically without L'anza's authorization.[81]

The Court ruled in line with the Third Circuit in *Sebastian International Inc.*, holding that because the domestic distributors legally owned copies of L'anza's goods, the distributors did not infringe on L'anza's copyright by reselling them.[82] However, in her concurrence, Justice Ginsburg emphasized that the Court did not solve the problem of potential copyright infringement when goods are manufactured abroad and then sold domestically; this case involved goods that were manufactured in the United States, sold abroad, and then re-imported back into the country.[83] Therefore, even though the Court could have issued a ruling that would have affected the application of § 109(a) to goods manufactured abroad, it chose not to do so in this case.

Despite the fact that the Supreme Court's decision in *Quality King Distributors, Inc.* did not directly solve the issue of first sale protection when goods are manufactured overseas, the Court offered dictum[84] that has been interpreted by various courts in subsequent § 109(a) cases.[85] The dictum mentioned a hypothetical in which the Court determined that if an author gave exclusive American distribution rights to one publisher and exclusive British distribution rights to another, "only those [goods] made by the publisher of the United States edition would be 'lawfully made under this title' within the meaning of § 109(a)."[86] Thus, some circuits have

---

[81] *Id.*

[82] *Id.* at 143.

[83] *Id.* at 154 (Ginsburg, J., concurring).

[84] Even in the absence of a market allocation agreement between, for example, a publisher of the United States edition and a publisher of the British edition of the same work, each such publisher could make lawful copies. If the author of the work gave the exclusive United States distribution rights-enforceable under the Act-to the publisher of the United States edition and the exclusive British distribution rights to the publisher of the British edition, however, presumably only those made by the publisher of the United States edition would be "lawfully made under this title" within the meaning of § 109(a). 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 an action under § 602(a) (or, for that matter, to an action under § 106(3), if there was a distribution of the copies). *Id.* at 148 (majority opinion).

[85] John Wiley & Sons, Inc. v. Kirtsaeng, 654 F.3d 210, 217-18 (2d Cir. 2011).

[86] Quality King Distribs., Inc., 523 U.S. at 148.

interpreted this hypothetical to mean that the first sale doctrine does not protect American copyrighted goods that are manufactured abroad.[87]

The Supreme Court faced this issue again twelve years later, when the Ninth Circuit case of *Costco Wholesale Corp. v. Omega S.A.*[88] appeared before the Court. Unfortunately, the Court also failed to establish a binding precedent in this case, since an equally divided Court affirmed the Ninth Circuit's ruling.[89] Therefore, unless the Court decides to deliver an authoritative rule on this subject, the circuit courts still have the freedom to interpret § 109(a) as they choose.

III. Analysis

A. Rulings' Effects on Copyright Owners, Consumers, and the American Job Market

1. The Effect of the Second and Ninth Circuits' Rulings on Copyright Owners

The Second and Ninth Circuits' rulings do not provide a first sale defense if an American copyrighted good is manufactured abroad, initially sold abroad, and then imported into the United States.[90] Therefore, this interpretation gives copyright holders an incentive to manufacture their products abroad instead of domestically[91] because doing so gives them the power to control importation of their products.[92] This interpretation also provides broader copyright protection to goods manufactured abroad compared to those manufactured domestically.[93]

Justice Ginsburg noted the potential desire of copyright owners to manufacture abroad in her question to Omega during oral argument in

---

[87] John Wiley & Sons, Inc., 654 F.3d at 218.

[88] 131 S. Ct. 565 (2010), aff'd by an equally divided court.

[89] *Id.* at 565.

[90] *John Wiley & Sons, Inc.*, 654 F.3d at 222; Omega S.A. v. Costco Wholesale Corp., 541 F.3d 982, 985 (9th Cir. 2008).

[91] *John Wiley & Sons, Inc.*, 654 F.3d at 227-28 (Murtha, J., dissenting).

[92] *See* Sebastian Int'l Inc. v. Consumer Contacts (PTY) Ltd., 847 F.2d 1093, 1099 (3d Cir. 1988).

[93] *Omega S.A.*, 541 F.3d at 989.

Omega S.A. when she asked: "what earthly sense would it make to prefer goods that are manufactured abroad over those manufactured in the United States?"[94] Counsel for Omega responded that "it doesn't create any sort of a preference," yet he was unable to provide any evidence showing why there would be no partiality towards goods manufactured abroad.[95] The Ninth Circuit attempted to resolve this issue by creating an exception that enables retailers and consumers to use the first sale defense when foreign-manufactured copies are initially sold lawfully and domestically.[96] This exception provides first sale protection to retailers and consumers who sell goods that are produced abroad but initially sold in the United States.[97] However, the Ninth Circuit still does not provide protection to these sellers if an initial lawful sale occurs abroad.

The Second and Ninth Circuits' interpretations will encourage and enable copyright holders to engage in price discrimination, which can "maximize investment in different markets in terms of advertising and distribution and may allow manufacturers to eke every last cent out of their goods" at the expense of American consumers.[98] These decisions enable copyright holders to charge higher prices in the United States than abroad without fear that imported goods will force prices down.[99] On the contrary, if first sale protection applies to goods manufactured abroad, copyright owners can still sell their products for lower prices in international markets, but American consumers can also benefit by purchasing these less expensive goods from the American market once lower-priced goods are imported. Finally, the Second and Ninth Circuits' rulings also give copyright owners control over importation, and enable copyright owners to control American distribution rights even if a product has been sold multiple times abroad.[100]

---

[94] Transcript of Oral Argument at 33-34, Costco Wholesale Corp. v. Omega S.A., 131 S. Ct. 565 (2010) (No. 08-1423).

[95] *Id.* at 34.

[96] *Omega S.A.*, 541 F.3d at 989.

[97] *Id.* at 986.

[98] Justin Yedor, Case Comment, *Lacking Swiss Precision: The First-Sale Doctrine in* Costco v. Omega, 6 DUKE J. CONST. L. & PUB. POL'Y SIDEBAR 126, 139 (2011).

[99] Lindsay R. Aldridge, Recent Development, Costco v. Omega *and the First Sale Doctrine*, 12 N.C. J. L. & TECH. 325, 337 (2011).

[100] *E.g., Omega S.A.*, 541 F.3d at 989.

2. The Effect of the Second and Ninth Circuits' Rulings on Domestic Consumers and the American Job Market

As the dissent in *John Wiley & Sons, Inc.* discusses, giving copyright holders "unlimited power" to regulate and direct all transactions regarding copies of their products would "create high transaction costs and lead to uncertainty in the secondary market."[101] Before selling a product in the United States, an owner would have to determine if a copy of the product originated in the United States or abroad.[102] If the copy was made abroad, the first sale protection would not apply and the potential seller would have to seek out and receive permission from the copyright holder before selling the product, which would be difficult and burdensome.[103]

Retailers and consumers who do not know where a product was made would risk being liable for copyright infringement when they sold and bought any product that was manufactured abroad, even if the good was "manufactured and authorized for unrestricted sale by the [American] copyright owner."[104] Consumers would be burdened by the fact that they might not know where goods were made and therefore not know if they are violating copyright when purchasing certain goods, perhaps causing them to buy less so as to not risk a lawsuit.[105]

While it may seem as though individual purchasers will not change their buying habits and only corporate consumers will fear a potential lawsuit, the prosecution of illegal downloads of music may shed some light on how copyright infringement by individuals can also be punished. Individuals have been the defendants in lawsuits and subsequently punished for illegally downloading music; for example, in Arizona, a college student received a sentence that included a $5400.00 fine for illegally downloading music and movies from the Internet.[106] In 2009, another individual was

---

[101] John Wiley & Sons, Inc. v. Kirtsaeng, 654 F.3d 210, 227 (2d Cir. 2011) (Murtha, J., dissenting).

[102] *Id.*

[103] *Id.*

[104] Brief for Retail Indus. Leaders Ass'n, *supra* note 33, at 18.

[105] Aldridge, *supra* note 99, at 338-39.

[106] *Teen Convicted of Illegal Net Downloads*, MSNBC.COM (Mar. 7, 2005, 8:43 PM), http://www.msnbc.msn.com/id/7122133/ns/technology_and_science-tech_and_gadgets/t/teen-convicted-illegal-net-downloads/#.TwC6O0qzwoc.

fined $1.9 million for illegally downloading music.[107] These cases show that individuals can be, and are, prosecuted for widespread copyright infringement. While not every individual who illegally downloads music faces a lawsuit, every illegal downloader bears a risk that he or she may be punished for the violation. Similarly, individuals who engage in copyright infringement by buying and selling goods manufactured abroad without permission from the copyright owner may also be prosecuted. The threat of a lawsuit may cause potential consumers to think twice before buying and selling items that may have been produced abroad. If these lawsuits occur frequently, commerce in the American market may be hampered.

The Second and Ninth Circuits' rulings will also harm American consumers by forcing them to pay higher prices for goods produced within the United States.[108] Even though copyright owners sell their products more cheaply in other countries, American consumers will not benefit from those lower prices if the goods cannot be imported into the United States.[109] Domestic consumers would ultimately pay higher prices if retailers are not allowed to sell cheaper imported goods in the domestic market.[110] American consumers, then, would not be able to buy goods at competitive prices.[111] Additionally, the Second and Ninth Circuits' interpretation of the first sale doctrine may cause copyright holders to produce more abroad so that they can control importation into the United States, thereby sending American jobs overseas and negatively impacting the American job market.[112]

As a result of the Second and Ninth Circuits' rulings, retailers and consumers will not know whether they are protected by the first sale doctrine unless they can confirm that goods were manufactured

---

[107] Elianne Friend, *Woman Fined to Tune of $1.9 Million for Illegal Downloads*, CNN JUSTICE (June 18, 2009), http://articles.cnn.com/2009-06-18/justice/minnesota.music.download.fine_1_jury-instructions-fined-sheryl-crow?_s=PM:CRIME.

[108] Aldridge, *supra* note 99, at 338.

[109] Yedor, *supra* note 98, at 139.

[110] Aldridge, *supra* note 99, at 338.

[111] Stockalper, *supra* note 11, at 532.

[112] Aldridge, *supra* note 99, at 341.

domestically.[113] In addition, Americans may lose jobs to workers overseas as more copyright holders choose to produce their goods abroad.[114]

3. The Effect of the Third Circuit's Ruling on Copyright Owners, Domestic Consumers, and the American Job Market

A significant portion of goods sold domestically are originally produced abroad and then imported into the United States.[115] For example, from January to December in 2011, approximately 2.67 trillion dollars[116] worth of goods were imported into America.[117] The Third Circuit's ruling will enable retailers to continue to purchase and resell these foreign-manufactured goods in the United States without liability arising from copyright infringement.[118]

The American economy thrives on an "aftermarket."[119] Aftermarkets, which result from the resale of goods, enable consumers to buy and resell used items to others.[120] Usually, consumers who resell items do so at lower prices than the wholesale market price.[121] American

---

[113] Brief for Pub. Knowledge et. al as Amici Curiae Supporting Petitioner at 6, Costco Wholesale Corp. v. Omega, S.A., 131 S. Ct. 565 (2010) (No. 08-1423).

[114] Aldridge, *supra* note 99, at 341.

[115] Brief for Retail Indus. Leaders Ass'n, *supra* note 33, at 9.

[116] This amount reflect[s] the movement of goods between foreign countries and the 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, and U.S. Foreign Trade Zones. They include government and non-government shipments of goods and exclude shipments between the United States and its territories and possessions, transactions with U.S. military, diplomatic and consular installations abroad, U.S. goods returned to the United States by its Armed Forces, personal and household effects of travelers, and in-transit shipments.

U.S. International Trade in Goods and Services, August 2011, U.S. CENSUS BUREAU & U.S. BUREAU OF ECONOMIC ANALYSIS, A-1 (May 10, 2012, 8:30 AM), http://www.census.gov/foreign-trade/Press-Release/current_press_release/ft900.pdf.

[117] *Id.*

[118] Brief for Retail Indus. Leaders Ass'n, *supra* note 33, at 9.

[119] *See id.* at 11.

[120] *See id.* at 11-12.

[121] See id.

consumers purchase numerous items through resale every day, including books, compact discs, DVDs, and video games.[122] It is estimated that in 2009, retail commerce in copyrighted works reached $881 billion; the purchase and rental of DVDs reached $16.4 billion; and book sales reached $16.7 billion in the United States.[123] In addition to consumers who themselves resell goods that they no longer need or use, stores such as T.J. Maxx and Marshalls, as well as pawnbrokers, auction houses, and online marketplaces, also resell goods.[124]

These participants in the aftermarket are able to confidently engage in the reselling of items because they know that they are protected from copyright infringement by the first sale doctrine.[125] The aftermarket spreads commercial items across socioeconomic levels and allows consumers to benefit from the cheaper sale of used products.[126] The Third Circuit's ruling would encourage the continuance and growth of the aftermarket by relieving the fear that by reselling their items, consumers will potentially be engaging in copyright infringement. Individuals have been sued for copyright infringement by the music industry,[127] so it is very possible that individuals will be prosecuted for copyright infringement because of their participation in aftermarkets as well.

Because it will not hinder importation, the Third Circuit's ruling will enable domestic consumers to access more affordable goods while requiring retailers to lower prices.[128] If § 109(a) can apply to goods manufactured abroad and initially sold either domestically or abroad, copyright owners will not be able to successfully engage in price discrimination.[129] If copyright owners sell their goods abroad for less, and those goods can be imported into the United States at cheaper prices, then retailers will be forced to lower their prices at home to remain competitive members of the

---

[122] *Id.* at 10.

[123] *Id.* at 10-11.

[124] Brief for Pub. Knowledge, *supra* note 113, at 11, 26-27.

[125] *Id.* at 11, 26.

[126] Brief for Retail Indus. Leaders Ass'n, *supra* note 33, at 11-13.

[127] E.g., Friend, supra note 107; Teen Convicted of Illegal Net Downloads, supra note 106.

[128] Aldridge, *supra* note 99, at 338.

[129] *Id.* at 337.

market.[130] The opportunity to buy imported goods at lower prices saves consumers billions of dollars annually.[131] These savings will be protected if other circuit courts and the Supreme Court follow the Third Circuit's ruling.

Additionally, copyright owners receive compensation for a good regardless of whether it is sold domestically or abroad.[132] Therefore, the owners do not need the power to limit importation as a form of compensation because they have already received compensation through the purchase price from the initial buyer. Thus, by adopting the Third Circuit's interpretation, the courts will not disadvantage copyright owners. Finally, if the courts forbid the first sale doctrine from applying to goods manufactured abroad, manufacturers will have incentives to move facilities and jobs overseas "to strengthen control over distribution."[133] The Third Circuit's ruling, however, will remove the incentive to produce goods abroad and may ultimately keep jobs in the United States.[134]

B. The Proper Application of the First Sale Doctrine

Courts have conceded that § 109(a) can be interpreted in two different ways due to the lack of jurisprudence and in the absence of congressional action.[135] By following the Third Circuit's interpretation, courts will protect retailers' and consumers' abilities to purchase and sell goods in a competitive market while prohibiting copyright holders from taking advantage of and expanding the Copyright Act to obtain a double profit. The following analysis supports the conclusion that the Third Circuit's ruling can, and should, apply to American goods manufactured abroad.

1. The Original Intent of the Copyright Act

The purpose behind the Copyright Act is to allow copyright owners to control the terms by which their goods enter the market; therefore, it does

---

[130] *Id.* at 338.

[131] Brief for Pub. Knowledge, *supra* note 113, at 26.

[132] Sebastian Int'l Inc. v. Consumer Contacts (PTY) Ltd., 847 F.2d 1093, 1099 (3d Cir. 1988).

[133] Brief for Pub. Knowledge, *supra* note 113, at 13.

[134] *See id.*

[135] *See* John Wiley & Sons, Inc. v. Kirtsaeng, 654 F.3d 210, 220 (2d Cir. 2011); *Sebastian Int'l Inc.*, 847 F.2d at 1097.

not follow that owners should also have the right to control the movement of those goods once they have entered the stream of commerce.[136] The goal of the Copyright Act is to protect copyrighted goods, yet copyright owners are now trying to utilize copyright law to obtain a double profit.[137] The courts should not allow copyright owners to manipulate the Copyright Act in this way at the expense of retailers, consumers, and the American economy.

The 94th Congress considered the first sale doctrine when it revised the Copyright Act in 1976. The Senate and the House reports explained that the first sale doctrine allows the transfer of goods once a copyright owner makes an initial sale.[138] The reports did not specify that the first sale doctrine could only be a defense when goods with an American copyright are manufactured domestically.[139] Therefore, Congress did not consider restricting the first sale defense to only apply to goods manufactured in the United States.

2. The Plain Language of the Statute

Section 109(a) does not explicitly refer to a product's place of manufacture.[140] Rather, it focuses on whether a copy was legally made under American copyright law contained in Title 17 of the United States Code.[141] Therefore, as Judge Murtha articulated in his dissent in *John Wiley & Sons, Inc.*, "the lawfulness of the manufacture of a particular copy should be judged by U.S. copyright law."[142] According to the Supreme Court, the plain language of a statute should be followed unless that reading would result in absurd consequences that Congress could not have intended.[143] As seen in the House and Senate reports, Congress did not

---

[136] Stockalper, *supra* note 11, at 513.

[137] Brief for Retail Indus. Leaders Ass'n, *supra* note 33, at 34.

[138] H. REP. NO. 94-1476, at 79 (1976), *reprinted in* 1976 U.S.C.C.A.N. 5659, 5693; S. REP. NO. 94-473, at 71-72 (1975).

[139] H. REP. NO. 94-1476, at 79; S. REP. NO. 94-473, at 71-72.

[140] *John Wiley & Sons, Inc.*, 654 F.3d 210, 226 (2d Cir. 2011) (Murtha, J., dissenting).

[141] *Id.*

[142] *Id.*

[143] Pub. Citizen v. U.S. Dep't of Justice, 491 U.S. 440, 470 (1989) (Kennedy, J., concurring).

intend for the first sale doctrine to only apply domestically.[144] Additionally, absurd results do not arise by following the plain language of this statute, but by interpreting it to apply only to goods manufactured in the United States. Congress could have worded § 109(a) to read "lawfully made under this title in the United States," but it did not, and therefore the product's place of manufacture is explicitly excluded from the text.[145] While copyright owners would prefer to block the importation of goods they manufacture abroad, the statute does not expressly give them the authority to do so.[146]

In addition, under the common law, restraints on trade have never been limited by the place of manufacture, and therefore should not be restricted now when the statute does not require it.[147] In order to protect consumers and prevent copyright owners from obtaining a double reward, § 109(a) should be interpreted to apply the protection of the first sale doctrine to goods manufactured domestically and abroad, and "lawfully made under this title" should be read as "lawfully made under an American copyright."

3. Reconciliation with § 602(a) of the Copyright Act

Courts have expressed concern that § 109(a) is at odds with § 602(a)[148] of the Copyright Act.[149] One interpretation of the relationship between the two statutes is that § 602(a) allows copyright holders to prevent the importation of copies of their products into the United States.[150] The second interpretation, which the Third Circuit chose to follow, reasons that § 602(a) does not expand a copyright holder's importation rights, but

---

[144] H. REP. NO. 94-1476, at 79; S. REP. NO. 94-473, at 71-72.

[145] Brief for Retail Indus. Leaders Ass'n, *supra* note 33, at 27.

[146] Sebastian Int'l Inc. v. Consumer Contacts (PTY) Ltd., 847 F.2d 1093, 1097 (3d Cir. 1988).

[147] *John Wiley & Sons, Inc.*, 654 F.3d at 227 (Murtha, J., dissenting).

[148] Importation into the United States, without the authority of the owner of copyright under this title, of copies or phonorecords of a work that have been acquired outside the United States is an infringement of the exclusive right to distribute copies or phonorecords under [§] 106, actionable under [§] 501. 17 U.S.C. § 602(a) (2006).

[149] *See* Omega S.A. v. Costco Wholesale Corp., 541 F.3d 982, 986 (9th Cir. 2008); *Sebastian Int'l Inc.*, 847 F.2d at 1097.

[150] *Sebastian Int'l Inc.*, 847 F.2d at 1097.

"serves only as a specific example of those rights subject still to the first sale limitation."[151]

By interpreting § 109(a) to apply to goods manufactured abroad under a lawful American copyright, § 602(a) will not be rendered meaningless[152] as some courts fear.[153] Rather, § 602(a) will still apply to piratical[154] copies, to copies of products that have not had an initial sale, and to copies that were not manufactured under Title 17 of the United States Code.[155] Additionally, nothing concerning § 602 suggests that the statute is meant to restrict or give copyright holders control over importation.[156] Therefore, copyright owners should not be given that power.

4. Reconciliation with the *Quality King Distributors, Inc.* Dictum

If the courts interpret § 109(a) to apply to goods manufactured abroad, they will not contradict the dictum in *Quality King Distributors, Inc.* First, the dictum does not reference a product's place of manufacture and thus should not be considered in cases where goods were produced abroad.[157] Secondly, in the *Quality King Distributors, Inc.* hypothetical, the Court examined a situation in which a copyright owner gave American distribution rights to one publisher and British distribution rights to another publisher.[158] In the scenario, the British publisher's rights fell under British copyright law.[159] In the cases at hand, however, the goods manufactured

---

[151] *Id.*

[152] *See Omega S.A.*, 541 F.3d at 986 ("[T]he application of § 109(a) after foreign sales would 'render § 602 virtually meaningless' as a tool against the unauthorized importation of nonpiratical copies because importation is almost always preceded by at least one lawful foreign sale that will have exhausted the distribution right on which § 602(a) is premised.").

[153] John Wiley & Sons, Inc. v. Kirtsaeng, 654 F.3d 210, 228 (2d Cir. 2011) (Murtha, J., dissenting).

[154] "Piratical" articles are "copies or phonorecords made without any authorization of the copyright owner." S. REP. NO. 94-473, at 151 (1975).

[155] *John Wiley & Sons, Inc.*, 654 F.3d at 228 (Murtha, J., dissenting).

[156] Brief for Pub. Knowledge, *supra* note 113, at 23.

[157] *John Wiley & Sons, Inc.*, 654 F.3d at 228 (Murtha, J., dissenting).

[158] Quality King Distribs., Inc. v. L'anza Research Int'l, Inc., 523 U.S. 135, 148 (1998).

[159] Brief for Retail Indus. Leaders Ass'n, *supra* note 33, at 32.

abroad are affixed with American copyrights and therefore still come under American copyright law.[160] Additionally, rather than conflicting with Supreme Court rulings, the application of § 109(a) to goods manufactured abroad as well as domestically will align with the Court's century-old intent as it was stated in *Bobbs-Merrill Co*.[161]

5. Consistency with Other Sections of Title 17 of the United States Code

Other sections of Title 17 utilize the phrase "under this title" and apply to products manufactured both at home and overseas. For example, § 104(b)(2) applies copyright protection to works published domestically and abroad.[162] The language in § 104(b)(2) explicitly reads that works are protected "under this title" if they are "first published in the United States or in a foreign nation that, on the date of first publication, is a treaty party."[163] In addition, § 1006(a)(1)(A) applies to recordings manufactured both in and out of the United States.[164] Section 1006(a)(1)(A), which concerns royalty payments, contains the language "lawfully made under this title,"[165] and under this statute the United States Copyright Office does not restrict its distribution of royalties just to recordings produced domestically.[166]

The text of § 109(a) should not be interpreted differently than other statutes in Title 17 of the United States Code. Since other statutes in Title 17 contain the phrase "under this title" and are applied to domestic and foreign-made goods, § 109(a) should have the same application. A different interpretation should not be followed especially when the results would be more harmful than beneficial. Congress could have added "lawfully manufactured under this title" to § 109(a), but it did not.[167] Therefore, it did

---

[160] *Id*.

[161] *See John Wiley & Sons, Inc.*, 654 F.3d at 212 (explaining *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339 (1908)) ("[T]he owner of a copyright could not impose price controls on sales of a copyrighted work beyond the initial sale.").

[162] *Id.* at 219-20 (explaining 17 U.S.C. § 104(b)(2) (2006)).

[163] 17 U.S.C. § 104(b)(2).

[164] John Wiley & Sons, Inc., 654 F.3d at 220.

[165] 17 U.S.C. § 1006(a)(1)(A) (2006).

[166] John Wiley & Sons, Inc., 654 F.3d at 220.

[167] *Id.* at 226 (Murtha, J., dissenting).

not intend to limit the application of the first sale doctrine just to works manufactured domestically.[168]

6. Copyright Owners and Double Compensation

Copyright owners must be fairly compensated for their work.[169] However, they receive adequate compensation regardless of whether the first sale of their product occurs at home or abroad.[170] The Third Circuit recognized this when it stated that "[n]othing in the wording of [§] 109(a), its history or philosophy, suggests that the owner of copies who sells them abroad does not receive a 'reward for his work.'"[171]

Additionally, nothing in Title 17 of the United States Code implies that copyright holders should receive a larger award if their products are initially sold abroad rather than domestically.[172] However, this windfall would occur if copyright owners receive both the purchase price of their goods and an importation limitation privilege."[173] The best way to remove the opportunity for copyright holders to obtain a double profit at the expense of retailers and consumers is to apply the first sale doctrine to goods manufactured domestically and abroad.

7. Prevention of Large Lawsuits

Copyright violators may be liable for damages of up to $150,000.00.[174] Therefore, the amount of money that retailers or consumers could pay in damages if they lost a copyright infringement suit would be significant, which may be "highly disruptive to commerce generally."[175] The threat of such large lawsuits outweighs the profit that retailers may obtain by importing cheaper goods from abroad and selling them in the

---

[168] *Id.* at 226-27.

[169] *See* Sebastian Int'l Inc. v. Consumer Contacts (PTY) Ltd., 847 F.2d 1093, 1096-97, 1099 (3d Cir. 1988).

[170] *Id.* at 1099.

[171] *Id*.

[172] *Id.*

[173] *Id.*

[174] Brief for Pub. Knowledge, *supra* note 113, at 15-16.

[175] Brief for Retail Indus. Leaders Ass'n, *supra* note 33, at 18-19.

United States.[176] Therefore, businesses will likely cease importing goods, or at least do so less frequently, and will no longer offer discounted goods to consumers.[177]

Retailers and consumers may buy and sell less, especially low-value goods, if the risk of copyright infringement is high.[178] The fear of these lawsuits may not have stopped people from engaging in commercial transactions yet, but this may change if copyright holders file more cases and the Supreme Court or the majority of the circuit courts start ruling in favor of them. By allowing the first sale doctrine to apply to goods manufactured abroad, consumers will be able to purchase goods in a competitive market with competitive prices and resell goods that they no longer need to those who can benefit from them.

A copyright holder can simply obtain a copyright by paying a fee of under $50.00.[179] In addition, a copyright holder does not even need to copyright an entire product, but just an element of it, to potentially acquire the rights over the importation market of the product.[180] Once a person secures a copyright, the holder potentially has a "high value of absolute control over [his or her] product" if the product is manufactured abroad unless the courts interpret § 109(a) to apply a first sale protection to goods produced overseas.[181]

8. Ability to Contract

While there are numerous alternative remedies available to copyright owners who want to control future distribution of their goods,[182] they have the option to contract with buyers before releasing their products into the market. Then, even if § 109(a) protects a retailer or consumer who agreed not to sell a product in the United States, the copyright owner might have a remedy under contract law.[183] For example, a United States

---

[176] *Id.* at 19.

[177] *Id.*

[178] Brief for Pub. Knowledge, *supra* note 113, at 19.

[179] *Id.* at 14.

[180] *Id.* at 21.

[181] *Id.* at 14.

[182] *See* Stockalper, *supra* note 11, at 539-44.

[183] H. REP. NO. 94-1476, at 79 (1976), *reprinted in* 1976 U.S.C.C.A.N. 5659, 5693.

copyright owner may produce a product abroad and sell it to a retailer abroad. The two parties can form a contract prohibiting the retailer from selling the product in the United States. If the retailer sells the product domestically in spite of the contract, the first sale doctrine may protect the retailer from copyright infringement. However, the copyright owner may have a remedy under contract law.

Justice Sotomayor recognized this at oral argument in *Omega S.A.* when she suggested that "if foreign manufacturers are concerned about receiving compensation for the right to sell their goods in the United States, they could address this using contract law."[184] The 94th Congress also recognized this in its 1976 report, stating that buyers and sellers can contract regarding further distribution of goods.[185] Therefore, the first sale doctrine does not need to be misinterpreted to resolve this issue since contract law provides a remedy.

While copyright owners can contract to protect their interests regarding future sales of their goods, retailers and consumers cannot similarly contract to protect themselves from potential copyright infringement lawsuits. This further supports the conclusion that in order to balance copyright holders' and consumers' interests, the courts should allow the first sale doctrine, which is a consumer's greatest defense against potential copyright infringement, to apply to goods manufactured abroad.

C. A Legislative Solution

The best solution may lie not with the courts, but with Congress. In *Quality King Distributors, Inc.*, the Supreme Court emphasized that it is the duty of the courts to interpret the Copyright Act as it is written.[186] Additionally, even when they decide on different interpretations, the circuit courts agree that Congress should clarify the statute if it is unhappy with their rulings.[187] Therefore, it may be necessary for Congress to amend the statute to allow the courts to rule in a way that protects consumers and the American economy. If Congress does choose this course of action, the first sentence of 17 U.S.C. § 109(a) should be re-written as follows:

---

[184] Yedor, *supra* note 98, at 135.

[185] H. Rep. No. 94-1476, at 79.

[186] Quality King Distribs., Inc. v. L'anza Research Int'l, Inc., 523 U.S. 135, 153 (1998).

[187] John Wiley & Sons, Inc. v. Kirtsaeng, 654 F.3d 210, 222 (2d Cir. 2011); Sebastian Int'l Inc. v. Consumer Contacts (PTY) Ltd., 847 F.2d 1093, 1099 (3d Cir. 1988).

> Notwithstanding the provisions of § 106(3), the owner of a particular copy or phonorecord lawfully made **in the United States, or lawfully manufactured in a foreign country and imported into the United States, with a United States copyright**, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord.

This amendment will provide clarity to the courts while protecting American consumers and the American job market.

Conclusion

The Supreme Court may or may not ultimately rule that § 109(a) provides first sale protection to goods manufactured abroad. Therefore, other circuits can take advantage of this uncertainty to enforce a rule that is consistent with the plain language of the statute, protects consumers' rights, and weakens the control that copyright owners have over goods that are manufactured abroad. This preferable interpretation is consistent with the application of other sections of Title 17 of the United States Code that contain the same language. It also prevents copyright holders from obtaining privileges that they were not meant to have while still allowing them to benefit from their work. Unlike other interpretations that overly benefit copyright owners while harming consumers, the Third Circuit's interpretation of the first sale doctrine protects retailers, consumers, and the American job market without harming copyright owners.

Thus, without further guidance, the courts should consider how the Third Circuit's interpretation balances the interests of both copyright owners and the public. Alternatively, to guarantee the proper interpretation, Congress should amend the statute to include the words "lawfully made in the United States, or lawfully manufactured in a foreign country and imported into the United States, with a United States copyright." This interpretation of the first sale doctrine aligns most closely with the purpose behind the Copyright Act while positively impacting the American economy.