

PRICE DISCRIMINATION IN THE TEXTBOOK  
MARKET: AN ANALYSIS OF THE POST-  
*QUALITY KING* PROPOSALS TO PREVENT  
AND DISINCENTIVIZE REIMPORTATION  
AND ARBITRAGE

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I. INTRODUCTION

Price discrimination in the textbook industry is a traditional practice that is currently threatened by the recent internet explosion and the lack of effective solutions to prevent and decrease the incentives for reimportation and arbitrage.<sup>1</sup> The textbook market is unique from other markets in which price discrimination exists<sup>2</sup> because the factors that contributed to textbook market price discrimination in the past are changing with the increased prevalence of the internet. Textbook publishers have historically engaged in price discrimination,<sup>3</sup> which had succeeded because the distance between the United States and foreign markets and the absence of the internet had obscured substantial price differences and means of locating foreign textbook distributors. However, the internet has facilitated the discovery, location, and purchase of cheaper textbooks from overseas, which has greatly increased the possibility of reimportation and arbitrage.<sup>4</sup> Reimporting and arbitraging

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<sup>1</sup> “Arbitrage is the process whereby profit motivated traders buy a good in markets where the price is low and resell in markets where the price is higher.” Ken Heather, *Price Discrimination—Are We Being Exploited?*, 6 TEACHING BUS. & ECON. 6 (2002), available at [http://findarticles.com/p/articles/mi\\_qa3889/is\\_200210/ai\\_n9137062/print](http://findarticles.com/p/articles/mi_qa3889/is_200210/ai_n9137062/print). See also MICHAEL L. KATZ & HARVEY S. ROSEN, MICROECONOMICS 438 (McGraw Hill 3d ed. 1998) (Arbitrage is “[t]he process whereby customers whom the firm charges low prices make purchases that they then resell to customers who would otherwise have to pay high prices.”).

<sup>2</sup> See *infra* Part II for examples.

<sup>3</sup> See *Are College Textbooks Priced Fairly?: Hearing Before the Subcomm. on 21st Century Competitiveness of the House Comm. on Education and the Workforce*, 108th Cong. (2004) (testimony of Marc L. Fleischaker, Legal Counsel, National Association of College Stores), available at [http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=108\\_house\\_hearings&docid=f:94936.wais.pdf](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=108_house_hearings&docid=f:94936.wais.pdf) [hereinafter *Hearing*].

<sup>4</sup> Compare what is happening in the textbook industry to what happened in the pharmaceutical industry when the advent of the internet reduced the transaction costs of reimporting cheaper pharmaceuticals from Canada.

behavior has already begun, and is expected to increase.<sup>5</sup> Though price discrimination is considered unfair, especially by those who pay higher prices, it can be advantageous from an economic welfare standpoint.<sup>6</sup> Therefore, it is important to examine the textbook market to determine whether ways exist to prevent or disincentivize reimportation and arbitrage so that textbook publishers can continue to price discriminate.

Discriminatory pricing practices exist in the textbook industry, as U.S. textbook publishers sell textbooks to overseas distributors at prices lower than the textbooks they sell to U.S. distributors.<sup>7</sup> While this practice has proven profitable in the past, its current and future profitability is unclear. Before the internet gained prominence in everyday life, transaction costs created by the sheer distance between the United States and foreign markets prevented reimportation and arbitrage.<sup>8</sup> The transaction costs of locating cheaper textbooks in foreign markets outweighed potential savings (resulting from reimporting textbooks for personal use) and arbitrage profits (resulting from selling cheaper textbooks obtained from overseas at prices closer to those offered in the United States). However, the internet has greatly reduced transaction costs by virtually eliminating geographic borders, as one can easily

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The Internet dramatically altered the potential for pharmaceutical arbitrage. The transaction cost of importing a prescription from Canada dropped to a small fraction of the arbitrage savings. . . . These factors multiplied the possible arbitrage market. The potential number of buyers for cross-border arbitrage jumped from several million Americans living near the Canadian border to the entire wired population of the United States.

Kevin Outterson, *Pharmaceutical Arbitrage: Balancing Access and Innovation in International Prescription Drug Markets*, 5 *YALE J. HEALTH POL'Y L. & ETHICS* 193, 277 (2005).

<sup>5</sup> *Hearing, supra* note 3 (testimony of Marc L. Fleischaker).

<sup>6</sup> *See infra* Part II.

<sup>7</sup> National Association of College Stores, *FAQs on College Textbooks*, July 2005, [http://www.nacs.org/common/research/faq\\_textbooks.pdf](http://www.nacs.org/common/research/faq_textbooks.pdf) [hereinafter *FAQs on College Textbooks*] (“Lower prices on college textbooks are available overseas because some U.S. publishers have sold these titles to wholesalers or retailers abroad at prices that are greatly reduced in comparison to those available to U.S. college stores and other retailers.”).

<sup>8</sup> U.S. GOV. ACCOUNTABILITY OFFICE, *REPORT TO CONGRESSIONAL REQUESTERS, College Textbooks: Enhanced Offerings Appear to Drive Recent Price Increases* 24 (July 2005), available at <http://www.gao.gov/new.items/d05806.pdf> [hereinafter *GAO REPORT*]. *See also* Michael J. Meurer, *Copyright Law and Price Discrimination*, 23 *CARDOZO L. REV.* 55, 68 n.43 (2001) (“Transportation cost is a factor that supports geographic price discrimination for some products. For low value products, the transaction costs of arbitrage may exceed the profit to resellers.”).

surf the internet to ascertain the international market prices for textbooks without leaving the luxury of his own home.<sup>9</sup>

Though U.S. purchases from foreign distributors may have been limited in the past because of the lack of awareness that such discriminatory pricing occurred and that lower prices existed overseas, this is no longer the situation. In October 2003, the *New York Times* published an article discussing such discriminatory pricing practices.<sup>10</sup> With the publication of this article, knowledge of price discrimination in the textbook market swept college campuses.<sup>11</sup> “[T]he cat is [now] out of the bag,”<sup>12</sup> and it is uncertain for how long such practices can continue to be profitable as the instances of reimportation increase.

Reimportation occurs when a good is exported to a foreign market and then imported back into the domestic market.<sup>13</sup> Such goods are sometimes referred to as “gray market goods.”<sup>14</sup> Textbook industry reimportation happens when customers in the

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<sup>9</sup> See Heather, *supra* note 1 (“Now the internet has made people more aware of price differences.”).

<sup>10</sup> Tamar Lewin, *Students Find \$100 Textbooks Cost \$50, Purchased Overseas*, N.Y. TIMES, Oct. 21, 2003, at A4.

<sup>11</sup> See Editorial, *Students Overcharged on Textbooks*, THE STANFORD DAILY WIRE, Oct. 27, 2003.

<sup>12</sup> Editorial, *High-Priced College Textbooks*, N.Y. TIMES, Oct. 25, 2003, at A1.

<sup>13</sup> The general definition of “reimport” is “[t]o bring back into a country.” THE AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE (Houghton Mifflin Co. 2000), available at <http://www.dictionary.com>.

<sup>14</sup> Gray market goods (a.k.a. parallel imports) are genuine goods, lawfully acquired abroad, which are sold in the United States without the consent of the United States copyright or trademark owner. Such goods are usually either manufactured in the United States, for export, and diverted back to the domestic market; or manufactured abroad and imported into the United States.

Bryan P. Stanley, Note, *Preventing the Import of Gray Market Goods in Light of Quality King Distributors, Inc. v. L'anza Research International, Inc.*, 38 WASHBURN L.J. 871, 871 (1999). Textbooks belong in the former category—they are manufactured in the United States and not abroad. See also *Parfums Givenchy, Inc. v. C&C Beauty Sales, Inc.*, 832 F. Supp. 1378, 1382 n.1 (C.D. Cal. 1993) (“[G]oods that are intended to be sold outside the United States but which are imported into this country without the consent of the owner of the United States trademark or copyright associated with the good.”); Elie Dugan, Note, *United States of America, Home of the Cheap and Gray: A Comparison of Recent Court Decisions Affecting the U.S. and European Gray Markets*, 33 GEO. WASH. INT'L L. REV. 397, 397 (2001) (“[G]ray goods’ are neither legal nor illegal. . . . [T]hey have been placed in a particular market without the approval of the company or individual who owns the copyright.”). While the term “gray market goods” refers to both goods manufactured in the United States and then reimported, as well as goods manufactured abroad and then imported, this analysis focuses on textbooks that are manufactured in the United States and then reimported.

United States purchase, from foreign distributors, textbooks intended for international distribution; thus, the textbooks re-enter the United States.<sup>15</sup> Reimportation of textbooks is driven not only by the increased ease in finding textbooks on the international market, but also by a general rise in textbook prices.<sup>16</sup> Reimportation on a small scale occurs when students reimport textbooks for personal use.<sup>17</sup> While this decreases revenue for textbook publishers, it is not their most urgent concern. Reimportation occurs on a much larger scale when individual students, student groups, and college bookstores reimport textbooks in bulk for resale at a price point midway between the foreign purchase price and the U.S. market price.<sup>18</sup> Textbook publishers lose revenue as these business-savvy arbitragers capture arbitrage profits and U.S. students capture more consumer surplus.<sup>19</sup> As reimportation becomes more popular, textbook publishers must take action or risk substantial diminution in revenue.

If textbook publishers wish to continue their discriminatory pricing behavior, they must find ways either to prevent reimportation and arbitrage, or to decrease the incentives to engage in such behavior. Following the Supreme Court decision, *Quality King Distributors v. L'anza*, no federal copyright cause of action exists against the foreign distributor who sells to the U.S. distributor or retailer or against the U.S. distributor or retailer who reimports.<sup>20</sup> After *Quality King*, Robert W. Clarida considered how to prevent reimportation; his suggestions included manufacturing abroad so that a federal copyright cause of action still exists<sup>21</sup> and restricting distribution by contract.<sup>22</sup> According to Clarida, textbook publishers may also attempt to lessen incentives to reimport by limiting potential arbitrage-related profits. This may be accomplished by decreasing the price differential<sup>23</sup> and distinguishing between do-

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<sup>15</sup> GAO REPORT, *supra* note 8, at 24.

<sup>16</sup> *See infra* note 79.

<sup>17</sup> *See, e.g.*, Lewin, *supra* note 10, at A4.

<sup>18</sup> *Id.*

<sup>19</sup> Consumer surplus is "[t]he difference between what a consumer is willing to pay and what she has to pay." KATZ & ROSEN, *supra* note 1, at 110. In contrast, producer surplus is the amount of income the textbook publishers receive in excess of their cost. *Id.* at 132.

<sup>20</sup> *Quality King Distrib. v. L'anza Research Int'l*, 523 U.S. 135 (1998).

<sup>21</sup> *See* Robert W. Clarida, *Fighting the Gray Market: How to Stop Parallel Imports Despite Quality King Ruling*, 4.8 INTELL. PROP. STRATEGIST 1 (May 1998).

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

mestic and foreign products.<sup>24</sup> While these suggestions may prove successful as applied to other industries, as applied to the textbook industry, they will most likely fail. Restricting distribution by contract is the most promising solution. However, contract restrictions can be problematic and textbook publishers may be forced to either end price discrimination or cease all sales to foreign distributors<sup>25</sup> to prevent the loss in revenue due to reimportation.

This note will discuss how textbook publishers cannot easily prevent nor disincentivize the reimportation of textbooks and thus will have to cease their discriminatory pricing practices or forego foreign sales. If they do not, they will continue to lose revenue. Part II will illustrate that a price differential exists between textbook prices in the United States and those in the international market; this differential, as it is due to demand, rather than cost, characteristics, is the result of textbook publishers' discriminatory pricing behavior. Part III demonstrates that reimportation of textbooks occurs on both the small and large scale, that decreasing transaction costs and increasing textbook prices have driven the reimportation, and that this reimportation decreases revenues for textbook publishers, as surplus is captured by arbitrageurs and the ultimate consumer, the U.S. student. Part IV explains that textbook publishers' efforts to prevent and disincentivize reimportation will most likely fail, leading publishers to either cease discriminatory pricing or to end international sales altogether, in order to prevent lost revenue. In conclusion, Part V suggests that students may actually be hurt by a price increase, if textbook publishers are forced to end discriminatory pricing.

## II. TEXTBOOK PUBLISHERS ENGAGE IN DISCRIMINATORY PRICING PRACTICES

The price differential that exists between the textbooks sold in the United States and those sold overseas arises from textbook publishers' discriminatory pricing practices. Though textbook prices in a few, specific overseas countries are higher than those in the United States, for the most part, textbook prices are higher in the United States than they are overseas.<sup>26</sup> Price discrimination

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<sup>24</sup> *Id.*

<sup>25</sup> *Id.*

<sup>26</sup> See GAO REPORT, *supra* note 8, at 22. In developing countries, textbooks will be sold at prices lower than those in the United States because incomes are generally too low for students to buy textbooks at U.S. prices. However, textbook prices may be higher in

occurs when a firm sells the same<sup>27</sup> good to different consumers at different prices, adjusted for the difference in costs.<sup>28</sup> If two goods are perfect substitutes, then they are assumed to be the same.<sup>29</sup>

Price discrimination is by no means limited to the textbook industry. For example, airlines charge business travelers higher prices than they charge leisure travelers,<sup>30</sup> train tickets are more expensive for trips taken during peak times,<sup>31</sup> movie theaters provide senior citizen ticket discounts,<sup>32</sup> and donuts purchased by the dozen are cheaper than those purchased individually.<sup>33</sup>

For price discrimination to be profitable, several conditions must be satisfied. First, the firm must be a price maker.<sup>34</sup> Second,

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countries that have a higher standard of living than the United States, such as Scandinavian countries. *Id.*

<sup>27</sup> Though “same” is the term most often used when describing price discrimination, price discrimination also occurs when “similar products are sold at prices that do not reflect differences in cost.” Sofronis K. Clerides, *Price Discrimination with Differentiated Products: Definition and Identification*, 42.3 WESTERN ECON. ASS'N INT'L ECON INQUIRY, 402, (July 1, 2004). This is the case when similar products are perfect substitutes.

<sup>28</sup> JEFFREY CHURCH & ROGER WARE, *INDUSTRIAL ORGANIZATION: A STRATEGIC APPROACH* 157 (2000); KATZ & ROSEN, *supra* note 1, at 437. If prices differ because of differences in the cost structure of producing the good, then it is not price discrimination. Price discrimination occurs because of the differences in the demand structure. If the differences in price are due to the cost structure rather than the demand structure, though a price differential may exist, it is not due to price discrimination. *See also* Meurer, *supra* note 8, at 58 (“A seller price discriminates by charging different prices to buyers when the price difference cannot be explained by a cost difference in supplying the copyrighted work. Given identical versions of a work that have identical production and distribution costs, any price difference amounts to price discrimination.”).

<sup>29</sup> *But cf.* Heather, *supra* note 1. Heather makes a claim that the same products sold in two different geographic locales are not necessarily perfect substitutes. *Id.* While this might hold for a car that is not easily shipped from one place to another, this is not the case in the textbook market. Textbooks are easily shipped from place to place. Therefore, textbooks from overseas are not perfect substitutes just because of where they are located in comparison to the purchaser.

<sup>30</sup> GAO REPORT, *supra* note 8, at 27. Based on the day the purchaser is planning to travel, airlines can identify the type of traveler. Business travelers usually travel during the week, whereas leisure travelers travel during the weekend. Because business travelers must travel, they are willing to pay higher prices for tickets. By charging more for flights during the week, airlines can extract some of this surplus from business travelers. Because tickets are nontransferable, arbitrage is prevented. *See also* Heather, *supra* note 1, at 4 (“[S]ince business people feel they must travel whereas leisure consumers feel it to be less imperative, those in business will tolerate a higher price.”).

<sup>31</sup> Heather, *supra* note 1, at 1.

<sup>32</sup> Meurer, *supra* note 8, at 58.

<sup>33</sup> CHURCH & WARE, *supra* note 28, at 130.

<sup>34</sup> KATZ & ROSEN, *supra* note 1, at 138. “When the quantity that a firm buys or sells significantly affects the price that the firm faces, the firm is known as a price maker because it can influence the price through its choice of quantity.” *Id.* at 409. A firm that has

the firm must be capable of distinguishing between different customers.<sup>35</sup> Finally, the consumer must not be able to engage in arbitrage.<sup>36</sup> In the textbook industry, the conditions necessary for profitable price discrimination no longer prevail as they once did. The third condition, arbitrage, has been affected by the increased presence of the internet, as it has become easier for arbitrageurs to search for and purchase cheaper textbooks from overseas through foreign-based websites.<sup>37</sup> Nonetheless, evidence of discriminatory pricing behavior by textbook publishers still exists.<sup>38</sup> How long such practices can exist, however, is unknown.

Price discrimination may be broken into three different categories: first-degree, second-degree, and third-degree price discrimination. First-degree, or perfect, price discrimination is possible when the seller is aware of each individual purchaser's valuation of

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the ability to influence the market price has market power. *Id.* In contrast, a firm that is a price taker "chooses its actions under the assumption that it cannot influence the prices of the output that it sells." *Id.* at 300. A firm without market power cannot influence the price of output. "For example, no single sour cherry farmer is large enough to influence the price of cherries." *Id.* at 300. Without market power, "the price of all units of all goods will be driven down to the level of costs by competition, and price discrimination cannot arise." CHURCH & WARE, *supra* note 28, at 160.

<sup>35</sup> KATZ & ROSEN, *supra* note 1, at 438. A firm price discriminates by charging different prices to different consumers based on their different willingness to pay. However, if the potential price discriminator (the firm) cannot identify which consumer is which, it cannot charge different prices based on the consumer's valuation of the product. *Id.*

<sup>36</sup> *Id.* If consumers can engage in arbitrage, then those with a higher valuation of the product will be less willing to purchase it at a higher price because an arbitrageur who has procured it at a lower price will sell to the consumer at a price lower than the consumer's valuation. *Id.*

<sup>37</sup> *FAQs on College Textbooks*, *supra* note 7 ("The Internet has made it possible for foreign wholesalers and distributors to pass along lower prices on textbooks to U.S. consumers . . .").

<sup>38</sup> Christos Cabolis et al., *A Textbook Example of International Price Discrimination 2* (Yale ICF Working Paper No. 05-26, Sept. 2005), available at <http://www.econ.uncy.ac.cy/papers/3-2005.pdf>.

The law of one price states that identical goods should have identical prices in different countries once the prices are expressed in common currency units. . . . In principle, the market for university textbooks satisfies all the conditions that are necessary for the law of one price to hold at least approximately. The physical product is perfectly homogenous; shipping costs are relatively small; pricing information is available online; and the potential savings from engaging in arbitrage are substantial. Nonetheless, the evidence [they] present shows the existence of very large differences in prices of textbooks across countries.

*Id.* at 1–2.

the good and can prevent arbitrage.<sup>39</sup> The seller can capture the total surplus by charging each purchaser his exact valuation for the good, as long as the purchaser's valuation exceeds the seller's marginal cost.<sup>40</sup>

From an economic viewpoint, first-degree price discrimination should be encouraged, because it allows a "perfectly discriminating, profit-maximizing monopolist [to produce] the total-surplus-maximizing amount of output."<sup>41</sup> However, from an equity perspective, first-degree price discrimination is unfair, since it favors producers and disfavors consumers. Total surplus is maximized, but total surplus consists entirely of producer surplus. Because producers charge individual consumers their individual valuations of the good, consumer surplus is zero.<sup>42</sup> In the absence of first-degree price discrimination, however, consumer surplus is higher. When a producer must charge a uniform price, the surplus is allocated to the consumers with valuations greater than the price. However, when price discrimination occurs, this consumer surplus is captured by the producer.

Second-degree price discrimination is based on hidden buyer characteristics.<sup>43</sup> All buyers purchase essentially the same physical good, but the seller can charge different prices based on hidden characteristics.<sup>44</sup> For example, the same software may be sold for personal and commercial use. Because the buyer who purchases for personal use values the product less, the seller will charge him a lower price but will restrict his use to personal use only, e.g., through a license or contract. The commercial use purchaser will

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<sup>39</sup> Meurer, *supra* note 8, at 68. See also CHURCH & WARE, *supra* note 28, at 161 ("In first-degree, or perfect, price discrimination, a firm has perfect information on the willingness to pay of each consumer.").

<sup>40</sup> Meurer, *supra* note 8, at 69. For example, if the seller's marginal cost of producing one donut is thirty cents, and buyers A, B, and C value a donut at twenty, thirty, and forty cents, respectively, seller will sell to B and C for thirty and forty cents, but will not sell to A since twenty cents is below his marginal cost. Selling to A would be unprofitable. See also CHURCH & WARE, *supra* note 28, at 163 ("Since the firm has extracted all of the consumer surplus, profits are equal to total net surplus, or the sum of consumer and producer surplus.").

<sup>41</sup> KATZ & ROSEN, *supra* note 1, at 441.

<sup>42</sup> *Id.*

<sup>43</sup> Meurer, *supra* note 8, at 71.

<sup>44</sup> "Second-degree price discrimination is the name given to price discrimination schemes in which the firm knows that consumers differ in ways that are important to the firm but it is unable to identify individual consumers so as to be able to discriminate directly." CHURCH & WARE, *supra* note 28, at 166. Firms provide a "menu" of choices and consumers then "self-select" by choosing different menu choices. *Id.*

be charged a higher price and will not be limited by such a license or contract.<sup>45</sup> Another common example of second-degree price discrimination involves movie pricing. A seller may charge a movie viewer different prices, depending on when the viewer wants to watch the movie and upon what medium.<sup>46</sup>

Third-degree price discrimination is the type of price discrimination that exists in the textbook industry. This discrimination is possible when various groups value a good differently and the seller can charge each group a different price based on each group's valuation of the good.<sup>47</sup> Whereas in the typical first-degree price discrimination situation the supplier sells to different buyers at different prices based on buyers' individual positions on the same demand curve (charging higher prices to those who value the good more and are higher up on the demand curve),<sup>48</sup> textbook publishers can charge different prices because of the existence of distinct demand curves. In the textbook industry situation, the demand curve in the United States differs from that overseas.<sup>49</sup>

Textbook publishers divide purchasers into two separate groups based on geography—those purchasing textbooks within the United States, who value textbooks highly, and those purchasing textbooks overseas, who value textbooks less.<sup>50</sup> Relying upon the geographic location of the separate groups, textbook publishers can identify distinct demand curves and charge prices based on these.<sup>51</sup> In addition, historically, the distance between geographic locations has prevented arbitrage.<sup>52</sup> By basing prices on purchasers' geographic locations, and by preventing arbitrage, textbook

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<sup>45</sup> See *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447, 1449 (7th Cir. 1996).

<sup>46</sup> Meurer, *supra* note 8, at 73. (“A movie viewer can choose between a first-run or second-run showing in the theater, or pay-per-view, premium cable, free cable, free broadcast, or videotape presentation on television. The price of these choices usually declines with the viewing date.”).

<sup>47</sup> Meurer, *supra* note 8, at 69.

<sup>48</sup> *CHURCH & WARE*, *supra* note 28, at 162.

<sup>49</sup> See *infra* note 61.

<sup>50</sup> *GAO REPORT*, *supra* note 8, at 21.

<sup>51</sup> Third-degree price discrimination, or market segmentation, “can be implemented when the monopolist knows the market demand for different groups.” *CHURCH & WARE*, *supra* note 28, at 164.

<sup>52</sup> Third-degree price discrimination also requires that the firm with market power can stop arbitrage between the two groups. *Id.*

publishers divert surplus from consumers to themselves (the producers).<sup>53</sup>

Evidence supports the argument that textbook publishers engage in third-degree price discrimination. A price differential exists, as both anecdotal<sup>54</sup> and empirical<sup>55</sup> evidence demonstrate a substantial difference in the prices for textbooks in the United States as compared to other countries.<sup>56</sup> A price differential is not dispositive evidence of price discrimination because the differential could be caused by differences in supply characteristics. In the case of textbook publishing, however, demand rather than supply characteristics cause price variations. Supply characteristics cannot explain the variations in price because production costs of the textbooks sold in the United States do not differ from those sold over-

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<sup>53</sup> If textbook publishers could not charge the two groups different prices and they wanted to continue overseas sales, they would have to price textbooks based on the lower overseas value. Therefore, purchasers in the United States would capture more of the surplus in the form of consumer surplus and the textbook publishers would capture less producer surplus. The consumer surplus is “[t]he difference between what a consumer is willing to pay and what she has to pay.” KATZ & ROSEN, *supra* note 1, at 110. Producer surplus is the income a firm receives of what it “would require to supply a given number of units.” *Id.* at 132.

<sup>54</sup> See *Hearing, supra* note 3, at 16 (“[M]any textbooks sold for distribution overseas are priced at 20–40 percent of the price for textbooks sold for distribution in North America.”).

<sup>55</sup> See, e.g., Cabolis et al., *supra* note 38, at 11, 14 (comparing prices for textbooks available on both amazon.com and amazon.co.uk, finding that “there exist substantial price differences in textbook prices across countries, with the U.S. being the most expensive and the U.K. the cheapest.”); Karen Clay & Choon Hong Tay, *Cross-Country Price Differentials in the Online Textbook Market 2* (Carnegie Bosch Institute, Working Paper, 2001) (Results from regression analysis indicated “that textbooks were substantially cheaper in major foreign online bookstores than in major United States online bookstores.”).

<sup>56</sup> Simple comparisons between prices for textbooks available at both amazon.com and amazon.co.uk show the difference in prices, which are often significant.

“Lehninger Principles of Biochemistry, Third Edition,” for example, lists for \$146.15 on the American Amazon site, but can be had for \$63.48, plus \$8.05 shipping, from the British one. And “Linear System Theory and Design, Third Edition” is \$110 in the United States, but \$41.76, or \$49.81 with shipping, in Britain.

Lewin, *supra* note 10, at A4. Also, a search on both amazon.com and amazon.co.uk conducted by the author on October 12, 2005 for the textbook *Principles of Economics*, by N. Gregory Mankiw, a popular book used in introductory college economics courses, resulted in a similar finding. On amazon.com, the price of the book was \$138.95. On amazon.co.uk, the price was £38.99, equivalent to \$68.19, about half the price of that on amazon.com. Though the UK edition was an “international edition” and had even more pages than its U.S. counterpart, it is unlikely that there are any significant differences between the two editions that account for the price differences.

seas.<sup>57</sup> This is because those sold overseas are almost always printed in the United States.<sup>58</sup> In addition, transportation costs are not substantial and even if they were, this would suggest that textbook prices would be lower in the United States.<sup>59</sup> Finally, there is no reason that marketing and distribution costs would be prohibitively higher overseas than they are in the United States.<sup>60</sup> Instead, textbook publishers make country-specific pricing decisions based on the “local market conditions and the willingness and ability of students to purchase the textbook.”<sup>61</sup> Clearly, textbook publishers price textbooks differently overseas than in the United States because demand is lower overseas.<sup>62</sup>

In the past, textbook publishers profited from third-degree discriminatory pricing because they determined the willingness of consumers to pay in different countries and then charged different prices to the respective sets of consumers. The success of this practice rested on the geographic distance between countries, which re-

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<sup>57</sup> Cabolis et al., *supra* note 38, at 14.

<sup>58</sup> *Id.*

<sup>59</sup> *Id.*

<sup>60</sup> *Id.* In addition, though certain textbooks sold on the international market are paperback versions of hardcover textbooks sold in the United States, which suggests that production costs do differ, the Cabolis study compared the prices for a hardcover textbook in the United States to the same hardcover textbook in the U.K. The Cabolis study illustrated the price differential with the same production costs. *Id.* at 11.

<sup>61</sup> GAO REPORT, *supra* note 8, at 22. Publishers consider the following factors in determining how to price textbooks: income levels, the cost of living, the role of textbooks in the classroom, intellectual property protections, the strength of the local currency, and the prices of competing textbooks sold in the marketplace. *Id.* The role a textbook plays in the classroom varies with differing college education culture.

[T]he most likely explanation [for the difference in demand in the U.S. from the demand in other countries] lies in the culture of college education in different countries. In the United States the textbook is an integral part of college education. In most courses instruction centers around a single textbook that contains most of the material, as well as exercises and practice problems. The textbook is the main reference for students and it is usually labeled as “required” for the course. In the U.K., textbooks are not used in the same way. Students are usually given a list of books that are meant to be study aids rather than mandatory textbooks. Thus students feel much less of an obligation to buy particular books, meaning that willingness to pay for textbooks is lower than in the United States.

Cabolis et al., *supra* note 38, at 16.

<sup>62</sup> The demand curve for textbooks in foreign markets is lower than that in the United States. Therefore, to make additional sales in foreign markets, textbook publishers must price specifically to foreign demand. While the higher U.S. demand combined with limited market power allows textbook publishers to price above marginal cost, the lower foreign demand requires that textbook publishers charge closer to their marginal cost if they are to make any sales in the foreign market at all.

stricted buying and selling between various consumer groups.<sup>63</sup> Publishing companies have defended these practices, arguing that foreign sales would be impossible if textbook prices were not pegged to local market conditions,<sup>64</sup> and that international sales, even at prices lower than those in the United States, decrease prices in the United States.<sup>65</sup>

While the welfare effects of third-degree price discrimination are less clear than those of first-degree price discrimination, it can be argued that third-degree price discrimination in the textbook industry is also economically favorable, though equitably unfair. Third-degree price discrimination is economically favorable because it allows textbook publishers to sell textbooks in foreign markets. Publishers would be unable to do this unless they could sell at prices pegged to local demand. Total output increases because publishers increase output for foreign markets, and the output for the U.S. market remains the same. Because of the increase in total output, average costs are lowered, allowing for a reduction of prices in the United States.<sup>66</sup>

To students in the United States, this practice may seem unfair. Why should U.S. students be forced to pay higher prices so that publishers can recoup costs, whereas foreign students benefit from lower prices? However, U.S. students are likely unaware that elimination of this practice would increase their costs. If publishers were forced to charge U.S.-equivalent prices in foreign markets, demand and sales in these markets would dissipate, resulting in higher prices for U.S. students.

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<sup>63</sup> GAO REPORT, *supra* note 8, at 21.

<sup>64</sup> Lewin, *supra* note 10, at A4.

<sup>65</sup> GAO REPORT, *supra* note 8, at 23. “[P]ublishers . . . estimated that international sales make up from 5 to 15 percent of their total revenues. Some publishers speculated that without the added revenues from international sales, they would feel more cost pressure and would have to either increase U.S. prices or invest less in certain products.” *Id.* See also Lewin, *supra* note 10, at A4 (According to Allan Adler, the lawyer for the Association of American Publishers, “each extra copy sold overseas, even at a low price, helps to spread the high costs of putting out a new textbook.”).

<sup>66</sup> Lewin, *supra* note 10, at A4.

III. EXISTENCE OF PRICE DIFFERENTIAL  
LEADS TO REIMPORTATION

A. *Frequency of Reimportation Will Increase*

Any textbooks that are reimported into the United States to exploit the price differential place the profitability of discriminatory pricing practices in danger. Though the National Association of College Stores (NACS) estimated that five percent of sales to purchasers in the United States were being made by overseas distributors as of June 2004, the NACS estimated that this number would grow.<sup>67</sup> The reduction in search costs due to the rising popularity of internet commerce, as well as the escalating prices of textbooks in general, have contributed, and will continue to contribute to, the increasing trend of reimportation.

1. *Reduction in Search Costs*

Search costs have decreased because the internet simplifies the browsing of domestic and foreign distributors' websites to compare prices and to determine which websites are offering the cheapest textbooks.<sup>68</sup> With just a few clicks of a mouse, one can easily search the internet for less expensive textbooks. Instead of only searching amazon.com, one can also search amazon.co.uk. The decrease in search costs has created a greater incentive for individual students to purchase textbooks from foreign distributors for personal use, and for arbitrageurs to purchase textbooks in bulk from foreign distributors to sell for profit.<sup>69</sup>

The reduction of search costs has created a greater incentive for individual students to purchase textbooks from foreign distributors, reimporting them for personal use.<sup>70</sup> If the difference in price between a textbook found at the college bookstore and amazon.com is fairly minimal, a student may still choose to purchase a text-

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<sup>67</sup> *Hearing, supra* note 3, at 16–17 (“We would estimate that textbooks purchased from sources originating overseas account for approximately 5 percent of textbooks which are sold, and that number is likely to grow.”).

<sup>68</sup> The internet allows for a decrease in the cost of acquiring price information in different markets, allowing for easier reimportation, to the chagrin of exporters. Matthew B. Myers, *Incidents of Gray Market Activity Among U.S. Exporters: Occurrences, Characteristics, and Consequences*, 30 J. INT'L BUS. STUD. 105 (1999).

<sup>69</sup> That “‘gray market’ sales are taking off on campuses” reflects that students are capitalizing on the increased incentive. Lewin, *supra* note 10, at A4.

<sup>70</sup> *See id.* (“Many students, individually, have begun to compare the textbook prices posted on American sites like Amazon.com, with the lower prices for the same books on foreign sites like Amazon.co.uk.”).

book from the college bookstore. Reimporting for individual use may be too much of a hassle—the amount of money that would be saved is small and may not even outweigh the added transaction costs of shipping and handling, arrival delays, and return difficulties.<sup>71</sup> However, because the price differential between textbooks in the U.S. bookstore and foreign online bookstores is more significant, students may find it worthwhile to incur transaction costs of purchasing textbooks via the internet from overseas vendors,<sup>72</sup> especially if one transaction cost, the search cost, has decreased because of the internet.

Like the individual student purchasing for personal use, arbitrageurs can benefit from a reduction in search costs. The profitability of arbitrage depends on transaction costs, since arbitrage will only be profitable if transaction costs are less than the existing price differential.<sup>73</sup> An arbitrageur's profits are limited by the price differential.<sup>74</sup> Any transaction costs incurred by the arbitrageur will decrease profits. Search costs are a type of transaction cost; thus, a reduction in search costs makes arbitrage more lucrative. Arbitrageurs profit more from the arbitrage of multiple textbooks than a single student might save on the purchase of one textbook. Therefore, a small reduction in transaction costs will quickly cause arbitrage profits to outweigh transaction costs, creating enhanced incentive for arbitrage.

Individual students and student groups have become arbitraging entrepreneurs, reimporting textbooks from overseas to sell to students in the United States at prices higher than those overseas,

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<sup>71</sup> Even if a student purchases a textbook from amazon.com, the effect on textbook publishers is negligible as the student is still paying the U.S. price, though perhaps slightly discounted.

<sup>72</sup> Transaction costs involved when dealing with an online vendor are search costs (searching the website for the proper textbook and edition instead of going to a shelf in the college bookstore where the exact textbook is available), shipping costs, delay in arrival (textbooks may arrive after the start of classes), and return hassles. If only a few dollars are saved, then it is unlikely that a student will purchase textbooks online. However, when the price differential is substantial, online purchasers are more likely, and college bookstores will lose more customers to the internet. Therefore, college bookstores will purchase from overseas as well so that they can offer lower prices. Textbook publishers will be selling more books at the lower overseas prices than the higher U.S. prices.

<sup>73</sup> CHURCH & WARE, *supra* note 28, at 160.

<sup>74</sup> The lowest price at which an arbitrageur can resell a good is the price he paid for the good. If the arbitrageur sells at any price lower than this, he will lose money since he will not recoup the amount he paid for the good. The highest price for which an arbitrageur can resell a good is the price ordinarily charged in the market where valuation is greater. Charging a higher price will spur the consumer to purchase a non-gray market good.

while still undercutting the U.S. price.<sup>75</sup> In addition, college bookstores have begun to stock their shelves with textbooks reimported from overseas distributors, to their own benefit as well as that of students who purchase at prices lower than the usual U.S. prices.<sup>76</sup> College bookstores have an incentive to engage in such behavior because of the allure of some arbitrage profits and the ability to offer lower prices to students who have increasingly viewed the college bookstore with distaste because of exorbitant textbook prices.<sup>77</sup> Therefore, geographic third-degree price discrimination allows for arbitrage, “[giving] rise to gray markets whereby low priced goods intended for foreign markets are sold in the domestic market.”<sup>78</sup>

## 2. *Increasing Prices of Textbooks in General*

The recent increase in textbook prices<sup>79</sup> provides further impetus for students to purchase textbooks from overseas for personal

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<sup>75</sup> See Lewin, *supra* note 10, at A4.

At one prestigious university, a sophomore imported 30 biology books from England [in the fall of 2003] and sold them outside his classroom for less than the campus bookstore price, netting a \$1,200 profit. Next semester, if all goes well, he plans to expand his operation. . . . At other colleges, Asian students have banded together to take advantage of textbook prices in Taiwan, Singapore and Malaysia, which are even lower than those in Europe.

*Id.*

<sup>76</sup> “[S]ome U.S. retailers have engaged in reimportation on a large scale by ordering textbooks for entire courses at lower prices from international distribution channels.” GAO REPORT, *supra* note 8, at 24.

“I buy from Amazon.co.uk and from sources in the Far East, and I knew more and more students were doing the same thing, individually,” said Tom Frey, owner of the University Bookstore at Purdue University, who sells the new books from overseas at the same price as a used American book. . . . “We buy from the U.K., France, Israel and the Far East,” said Bob Crabb of the University of Michigan Bookstores. “As long as publishers are offering books at less than half the price that’s available here, we’ll take advantage of it. It’s great for students.”

Lewin, *supra* note 10, at A4.

<sup>77</sup> *FAQs on College Textbooks*, *supra* note 7. See also *Hearing*, *supra* note 3, at 16 (Upon learning of cheaper prices overseas, college students would complain that college bookstores were “price gouging.”). By reimporting textbooks and offering them at lower prices, college bookstores dispel the notion that they are price gouging and attract students back into the stores.

<sup>78</sup> Meurer, *supra* note 8, at 140.

<sup>79</sup> See, e.g., GAO REPORT, *supra* note 8, at 8 (“College textbook prices have risen at double the rate of inflation for the last two decades . . . . The average growth in college textbook prices has been 6 percent per year since academic year 1987-1988”); *id.* at 10 (“Increases in college textbook prices were particularly high for the academic years 1989-1990 and 2001-2002, at 9 percent and 8 percent respectively. Since 2001-2002, the

use, and for arbitrageurs to purchase textbooks from overseas in bulk in order to meet the U.S. demand for cheaper textbooks. The increase in prices can be attributed to the bundling of the actual textbook with “bells and whistles,” such as workbooks and CD-ROMs,<sup>80</sup> and the increased frequency of revisions.<sup>81</sup> Because of the increase in U.S. prices, the estimated 20 to 40 percent price discount for textbooks distributed and sold overseas<sup>82</sup> creates a lucrative opportunity to save and make money, as this price discount often greatly outweighs transaction costs.

### B. *Textbook Publishers Lose Revenue Because of Reimportation*

Reimportation causes textbook publishers to lose profits.<sup>83</sup> While students who reimport textbooks for personal use will cut into discriminatory pricing profits, this loss in profits will be limited

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growth in textbook prices has been slowed, increasing by 5 percent in 2003–2004.”); MERIAH FAIRCHILD, *RIPOFF 101: HOW THE CURRENT PRACTICES OF THE TEXTBOOK INDUSTRY DRIVE UP THE COST OF COLLEGE TEXTBOOKS* 7 (2004), available at <http://calpirg.org/reports/textbookripoff.pdf>.

U.S. Senator Charles E. Schumer (NY) released a study showing that undergraduates at New York colleges and universities are confronting skyrocketing costs for textbooks. The Schumer study found that the average New York freshman or sophomore paid \$922 for textbooks this year—an increase of approximately 41 percent since 1998.

*Id.*

The average price of a new textbook is \$52.36, and the average price of a used textbook is \$40.01 according to the *2005 College Store Industry Financial Report* by the National Association of College Stores [NACS]. The College Board has reported that the cost of books and supplies for the 2004-05 academic year ranged from \$770 to \$870 depending upon the type of institution a student attended.

*FAQ on College Textbooks*, *supra* note 7.

<sup>80</sup> See, e.g., GAO REPORT, *supra* note 8, at 16–17; FAIRCHILD, *supra* note 79, at 9. When textbook publishers bundle textbooks with additional instructional material, often the textbooks are not offered separately. Rarely do professors use the materials that are bundled with the textbooks. However, because the textbooks are not sold unbundled, students have no choice of purchasing only the textbook and are forced to purchase the more expensive bundled materials, whereas purchasing the textbook alone would be cheaper. “Of the books surveyed, only one textbook was available for purchase both bundled and unbundled. The bundled version was \$130, more than double the unbundled price of \$60.” FAIRCHILD, *supra* note 79, at 9–10.

<sup>81</sup> When new textbook editions are published, the number of available used books decreases, as the only used books available are older editions. FAIRCHILD, *supra* note 79, at 14.

<sup>82</sup> *Hearing*, *supra* note 3, at 16.

<sup>83</sup> An effect of gray marketing is a reduction or cannibalization of sales for manufacturers in countries where the prices are higher. Myers, *supra* note 68, at 105. These sales are being lost to arbitrageurs.

by the small scale at which such reimportation occurs. The prohibitive transaction costs faced by a single purchaser (as opposed to those faced by an arbitrageur), as well as agency problems, prevent student reimportation from occurring at a larger scale. However, textbook publishers will experience a greater loss of profit due to large scale reimportation and arbitrage. Continued reimportation decreases the profitability of discriminatory pricing. The existence of arbitrage, in particular, violates one of the conditions necessary for price discrimination to be profitable.<sup>84</sup>

### 1. *Reimportation for Personal Use*

When an individual who would have purchased a textbook, for his own personal use, in the United States at the U.S. price purchases it from overseas at the overseas price, the publishing company loses the difference between these prices. One sale at the U.S. price is replaced by one sale at the foreign price, and the surplus is reallocated from the publishing company to the individual student. Such reimportation for personal use is limited, however, by transaction costs and agency problems.

Because of the transaction costs involved, individuals have less of an incentive to purchase textbooks from overseas. One student searching for one particular textbook may not find it worthwhile to find out what books are required for particular courses, search foreign bookstore websites, purchase the books, wait for them to be shipped from overseas (likely arriving after the start of classes), and then, possibly, deal with the hassle of returning the books. Because one student incurs all of the transaction costs in an attempt to save money on one textbook, transaction costs act as a limiting factor to reimportation for personal use. While the money saved will likely outweigh the transaction costs, the existence of the transaction costs may be enough to dissuade individuals from making overseas purchases, especially when the “[c]ollege stores continue to have the natural advantage of proximity to the students and the willingness to accept returns when the student drops the class or decides not to use the book.”<sup>85</sup>

Another factor that may limit the spread of reimportation for personal use is the agency problem.<sup>86</sup> While students are physically

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<sup>84</sup> See *supra* note 36 and accompanying text.

<sup>85</sup> *Hearing, supra* note 3, at 16.

<sup>86</sup> Cabolis et al., *supra* note 38, at 17.

purchasing the textbooks, their parents are often paying for them, making the students less sensitive to price.<sup>87</sup> The student is less likely to feel the need to search for cheaper textbooks in places other than the college bookstore. Therefore, although publishing companies will lose revenue when individual students reimport for personal use, this is unlikely to be a major problem for them. This type of reimportation will occur only on a small scale due to the limiting factors of transaction costs incurred by one person and the agency issue.

## 2. *Reimportation by Arbitrageurs*

Textbook publishers have more cause for concern when textbooks are reimported in bulk by arbitrageurs, e.g., college bookstores and student groups, and then resold to individual students. A single arbitrageur reimports a greater number of textbooks than a single student might reimport for his own use. Also, bulk reimportation by arbitrageurs may elevate individual student demand for reimported textbooks; when purchasing from the arbitrageur, the student is not incurring any additional costs, but only saving money. This increased individual student demand will therefore promote arbitraging behavior. Finally, the fact that an arbitrageur's transaction costs are spread among multiple copies of multiple textbooks further encourages arbitraging behavior.

The amount of revenue lost by textbook publishers is multiplied by the greater number of textbooks being reimported by each individual arbitrageur.<sup>88</sup> The surplus is transferred from the publishers to the arbitrageurs (e.g., bookstores and student groups), who sell at a price between the overseas and U.S. price, and to the individual student who is purchasing at a lower price.

Additionally, the individual student demand for cheaper textbooks from overseas will increase as it becomes easier for students to obtain them; the college bookstores and student groups are incurring the transaction costs, not the students. The arbitrageurs are the ones searching for the cheaper textbooks and shipping them to the United States. Individual students do not incur any additional transaction costs because the reimported textbook is al-

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<sup>87</sup> *Id.*

<sup>88</sup> Compare to the situation in which an individual reimports one textbook for individual use. The loss for the textbook company was the price differential between the U.S. price and the foreign price. The loss to the textbook company when arbitrageurs reimport in bulk is the price differential multiplied by the number of textbooks reimported.

ready located at their college bookstore or at a table set up by a student group. Increased demand by individual students will increase the arbitrating behavior of bookstores, student groups, and business-savvy individual students, creating even more of a problem for textbook publishers.

In addition, the transaction cost is less of an issue for arbitrageurs. While shipping costs might increase with the number of textbooks being purchased from overseas, the search costs of finding a particular textbook is spread across all of the copies of that textbook that are being published. Also, shipping costs are unlikely to increase by equal intervals with every additional textbook being shipped. To a certain extent, the role of U.S. customs may allay the concerns of textbook publishers over lost profits. U.S. customs allows textbooks to enter the U.S. duty free, but only for orders under \$2000.<sup>89</sup> This limits the quantity of textbooks that can be ordered from overseas at a single time, thus increasing transaction costs. The cost of ordering additional shipments once an initial order has been made is minimal, however; the first order is the only one which involves the most difficult feat, finding the cheapest textbooks.

#### IV. ACTIONS TEXTBOOK PUBLISHERS CAN TAKE TO PREVENT LOSS IN REVENUE DUE TO REIMPORTATION

Textbook companies' efforts to prevent and limit reimportation indicate that the loss in revenue due to reimportation is problematic, not negligible.<sup>90</sup> Although some exogenous factors, e.g., customs limits,<sup>91</sup> restrict the ease with which textbooks can be reimported into the United States, textbook publishers seek to curb, if not cease, the popularity of reimportation. If they cannot,

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<sup>89</sup> See Clay & Choon, *supra* note 55, at 5 ("United States Customs permits textbooks (and all other bound printed books) to enter the country duty-free. To expedite the process and reduce the applicable paperwork, Customs suggests that orders be below \$2000, so they will be subject to informal entry. So unless a student is ordering a huge quantity of textbooks, customs duties (or delays) will not be a significant issue."). The role of customs in preventing reimportation is limited to this, as "[c]ustoms can prevent copyright violations only if they are piratical, but not if they are lawfully made copies." Tait R. Swanson, *Combating Gray Market Goods in a Global Market: Comparative Analysis of Intellectual Property Laws and Recommended Strategies*, 22 HOUS. J. INT'L L. 327, 328 (2000).

<sup>90</sup> See GAO REPORT, *supra* note 8, at 24 (stating that publishers are concerned about the large-scale reimportation of textbooks and thus "have taken recent steps to limit the reimportation of textbooks in large quantities.").

<sup>91</sup> See *supra* note 89.

they will have to rework the business model upon which they have relied for years.<sup>92</sup> Publishers will no longer be able to charge higher prices, reflective of development costs, in the United States, while charging lower prices, reflective of the marginal costs of producing more copies,<sup>93</sup> in overseas countries. Dual pricing will no longer be profitable if, as expected, the occurrence of reimportation becomes even more widespread.<sup>94</sup>

The actions that textbook publishers can take in order to continue discriminatorily pricing were first expounded by Robert W. Clarida in *Fighting the Gray Market: How to Stop Parallel Imports Despite Quality King Ruling*.<sup>95</sup> They can be separated into two categories. The first category consists of actions that prevent reimportation, allowing publishers to continue practicing price discrimination at the current level.<sup>96</sup> The second category includes actions that decrease the incentives to reimport by making reimportation and arbitrage less profitable.<sup>97</sup> While some of these suggestions in the second category allow for the continuation of discriminatory pricing at the current level,<sup>98</sup> others allow for discriminatory pricing to continue but at a less extreme level.<sup>99</sup> However, if textbook publishers can neither prevent reimportation nor decrease the incentive to reimport, they must resort to the most extreme solution: ending all sales in foreign markets.<sup>100</sup> Loss of revenue due to lost sales of reimported goods cannot occur if there are no goods to reimport.

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<sup>92</sup> *Hearing*, *supra* note 3, at 16.

<sup>93</sup> GAO REPORT, *supra* note 8, at 21.

Publishers typically incur substantial costs in order to develop textbooks, but once these development costs are undertaken, the additional cost of producing more copies is quite low. As a result, a publisher may be able to profitably sell textbooks in one country at prices that are close to actual costs of printing and distributing additional copies while charging higher prices in the United States that reflect the substantial development costs undertaken.

*Id.* The substantial investments made by publishers before a single textbook is sold “include the cost of author advances, the development of content for the textbooks and supplements, copyrights and permissions for illustrations and photographs, along with the cost of typesetting and printing enough copies to provide sample copies and cover expected sales.” *Id.* at 12.

<sup>94</sup> *See supra* note 67.

<sup>95</sup> Clarida, *supra* note 21, at 1.

<sup>96</sup> *See infra* Part IV.A.

<sup>97</sup> *See infra* Part IV.B.

<sup>98</sup> *See infra* Part IV.B.2.

<sup>99</sup> *See infra* Part IV.B.1.

<sup>100</sup> *See infra* Part IV.B.3.

*A. Actions that Prevent Reimportation*

If reimportation could be prevented, there would be a return to the pre-internet era in which locating cheaper textbooks overseas and purchasing them for personal use or to sell to others was practically nonexistent. Absent reimportation, market segmentation would exist again, with the reinstatement of the barrier created by oceans, and arbitrage would be prevented.<sup>101</sup> Textbook publishers, however, lack a federal copyright cause of action, which would be a powerful weapon against those involved in the chain of the reimportation, sale, and purchase of textbooks from overseas.

*1. Quality King and the Weakening of the Federal Copyright Cause of Action*

“The first sale doctrine authorizes a buyer to dispose of the purchased copy of a work by resale . . . . The link between the first sale doctrine and arbitrage is obvious. If favored buyers can purchase a work and then sell . . . it to disfavored buyers then price discrimination is defeated.”<sup>102</sup> Since the Supreme Court decision of *Quality King*, publishers cannot bring a federal copyright action against the overseas distributor who makes U.S. sales, or against the U.S. distributor who purchases from the overseas distributor and then makes U.S. sales.<sup>103</sup> This is because the first sale doctrine in 17 U.S.C. § 109 is applicable to imported copies.<sup>104</sup> 17 U.S.C. § 109(a) states that an owner of a copy of a copyrighted item lawfully made under the title, “is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy . . . .”<sup>105</sup> Because § 109(a) applies to the situation in the textbook industry, publishers must resort to other measures to prevent reimportation.

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<sup>101</sup> “Historically, the geographic separation of countries served as a natural barrier preventing such trade from occurring.” GAO REPORT, *supra* note 8, at 24.

<sup>102</sup> Meurer, *supra* note 8, at 83. In the textbook industry situation, favored buyers are those located in overseas markets where prices are lower, whereas disfavored buyers are those located in the U.S. market where prices are higher.

<sup>103</sup> *Quality King Distrib. v. Lanza Research Int'l*, 523 U.S. 135 (1998).

<sup>104</sup> *Id.*

<sup>105</sup> 17 U.S.C. § 109(a) (2005) (“Notwithstanding the provisions of section 106(3), the 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.”).

Plaintiff L'anza sold hair care products to which copyrighted labels were affixed.<sup>106</sup> L'anza sold the products to U.S. distributors at a price that included the costs L'anza incurred from advertising and brand promotion.<sup>107</sup> L'anza also sold the products to foreign distributors, but at a lower price, because it did not promote its brand in foreign markets.<sup>108</sup> The Court assumed that the goods in question traveled the following route: L'anza manufactured the goods and sold them to a foreign distributor; the foreign distributor sold the goods to Defendant Quality King Distributors (a U.S. distributor); Quality King Distributors resold the goods to retailers who ultimately sold the goods to consumers.<sup>109</sup> L'anza brought suit against the foreign distributor, Quality King, and the retailers, alleging "that the importation and subsequent distribution of those products bearing copyrighted labels violated L'anza's "exclusive rights under 17 U.S.C. §§ 106, 501 and 602 to reproduce and distribute the copyrighted material in the United States."<sup>110</sup> A default judgment was entered against the foreign distributor who failed to appear, and the retailers settled. Therefore, Quality King Distributors remained as the sole defendant in the action.<sup>111</sup> While the district court and Ninth Circuit both rejected Quality King's defense based on 17 U.S.C. § 109's first sale doctrine,<sup>112</sup> the Supreme Court accepted it in finding Quality King not liable for copyright infringement.<sup>113</sup>

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<sup>106</sup> *Quality King*, 523 U.S. at 138.

<sup>107</sup> *Id.* at 138–9.

<sup>108</sup> *Id.*

<sup>109</sup> *Id.* at 139.

<sup>110</sup> *Id.* at 139–140. The following statutes were used in the Court's analysis:

Exclusive rights in copyrighted works: Subject to sections 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 (2005);

Infringing importation of copies or phonorecords. (a) 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 . . .

17 U.S.C. § 602 (2005).

<sup>111</sup> *Quality King*, 523 U.S. at 140.

<sup>112</sup> 17 U.S.C. § 109(a) (2005).

<sup>113</sup> *Quality King*, 523 U.S. at 140.

Though § 602(a) states that importation into the United States without authorization of the copyright owner is an actionable offense of infringement of the exclusive right to distribute copies,<sup>114</sup> the exclusive right to distribute is a *limited* right, and the terms of § 109(a) provide one of those limitations.<sup>115</sup> The Supreme Court found that the first sale doctrine of § 109(a) expressly permits the owner of a lawfully made copy to sell that copy “[n]otwithstanding the provisions of § 106(3).”<sup>116</sup> “After the first sale of a copyrighted item ‘lawfully made under this title,’ any subsequent purchaser, whether a domestic or foreign reseller, is obviously an ‘owner’ of that item,” authorized by § 109(a) to sell that item.<sup>117</sup> Quality King subsequently purchased the goods from a foreign reseller (the foreign distributor to whom L’anza sold the products originally) and was therefore the owner of the goods, authorized to sell them under § 109(a).

The Supreme Court also found § 602(a) inapplicable.<sup>118</sup> Section 602(a) states that “[i]mportation into the United States, without the authority of the owner of copyright under this title, of copies . . . of a work that have been acquired outside the United States is an infringement of the exclusive right to distribute copies . . . under § 106, actionable under § 501.”<sup>119</sup> However, “[s]ince § 602(a) merely provides that *unauthorized* importation is an infringement of an exclusive right ‘under § 106,’ and . . . that limited right does not encompass resales by lawful owners,” which include “both domestic and foreign owners of L’anza’s products who decide to import them and resell them in the United States.”<sup>120</sup> Section 106 limits the rights of distribution to the copyright owner but says nothing about resale of a good by the good’s owner. Therefore, Quality King, the domestic distributor who reimported goods originally sold to a foreign distributor at a lower price than would have been available to Quality King if it had purchased directly from L’anza, was not found liable for copyright infringement.

In the wake of *Quality King*, textbook publishers do not have a copyright cause of action against those who purchase textbooks

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<sup>114</sup> 17 U.S.C. § 602 (2005).

<sup>115</sup> *Quality King*, 523 U.S. at 142.

<sup>116</sup> *Id.*

<sup>117</sup> *Id.* at 145.

<sup>118</sup> *Id.*

<sup>119</sup> 17 U.S.C. § 602(a) (2005).

<sup>120</sup> *Quality King*, 523 U.S. at 145 (emphasis added).

from an overseas vendor and then resell them. Publishing companies cannot bring suits for copyright infringement against those parties in the role of Quality King Distributors, e.g., the campus bookstores, student groups, or individual students who purchase in bulk from overseas and resell to earn arbitrage profits. Publishers do not have a copyright cause of action against individuals who purchase for personal use or against the ultimate, individual consumers because these individuals are not reselling the textbooks and therefore do not fall under the copyright regime. A default judgment was found against the original foreign distributor in *Quality King* who failed to appear in court, but the Court's reasoning also applies to foreign distributors. As "owners" of the textbooks, they are entitled to sell them, and it does not matter whether they sell them to students in the countries in which they are located or to people, groups, or stores in the United States that plan to resell them. Therefore, textbook publishers must resort to other means to prevent foreign distributors from selling to U.S. distributors.

## 2. *Manufacture Textbooks Both Domestically and Abroad*

After the *Quality King* decision, textbook publishers may have a copyright cause of action against foreign and domestic distributors who sell and purchase goods that are manufactured abroad.<sup>121</sup> The majority opinion explicitly states that "the owner of goods lawfully made under the Act is entitled to the protection of the first sale doctrine in an action in a United States court *even if the first sale occurred abroad.*"<sup>122</sup> It can be argued that the majority would allow a copyright action to be brought when the goods are manufactured abroad and the first sale occurs abroad.<sup>123</sup> However, *Quality King* also "implies that distributors of copyrighted goods, which are manufactured abroad and then imported into the United States, may not be entitled to the first sale defense against copyright infringement due to the fact that said defense only applies to copies that were 'lawfully made' in the United States."<sup>124</sup> "Lawfully made" refers to goods "lawfully made" under the United States Copyright Act.<sup>125</sup> Justice Ginsburg's concurring opinion rec-

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<sup>121</sup> Clarida, *supra* note 21, at 1.

<sup>122</sup> *Quality King*, 523 U.S. at 145 n.14 (emphasis added).

<sup>123</sup> Clarida, *supra* note 21, at 1.

<sup>124</sup> Stanley, *supra* note 14, at 877. See also Clarida, *supra* note 21, at 1.

<sup>125</sup> Stanley, *supra* note 14, at 878 n.42.

ognized that the Court's opinion was not applicable to cases "in which the allegedly infringing imports were manufactured abroad."<sup>126</sup> Since *Quality King*, lower courts' decisions involving goods manufactured abroad have emphasized the fact that the goods in *Quality King* were manufactured in the United States.<sup>127</sup> The Supreme Court has yet to rule on this issue. Therefore, if the goods are manufactured abroad and then imported into the United States, a copyright cause of action may still exist.

Manufacturing abroad is not a viable solution, however. If textbook publishers found it profitable to manufacture abroad, they could take advantage of recent district court decisions<sup>128</sup> when deciding where to file suit and resort to a copyright action to prevent reimportation into the United States. However, textbook publishers are unlikely to find manufacturing abroad profitable and thus cannot prevent the reimportation of cheaper textbooks from overseas.<sup>129</sup> Because of local market conditions, textbooks must be priced lower in the overseas markets than in the United States for any overseas sales to be made.<sup>130</sup> Publishers can profitably sell textbooks overseas at lower prices because the U.S. sales recoup the production and development costs, and because the cost of publishing extra textbooks in the United States for overseas sales is low.<sup>131</sup> Manufacturing textbooks to be sold overseas within the foreign market would not be profitable, though, because of the increased costs of building new plants and employing more workers in order to produce only a small amount of textbooks for the international market. The publishing companies would have to in-

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<sup>126</sup> *Quality King*, 523 U.S. at 153.

<sup>127</sup> See, e.g., *U2 Home Entm't, Inc. v. Lai Ying Music & Video Trading, Inc.*, 2005 U.S. Dist. LEXIS 9853, at \*16 (S.D.N.Y. Sept. 12, 2005) ("The importation of copies into the United States of a work manufactured in a foreign country can form the basis for a copyright infringement claim by an exclusive licensed U.S. distributor without regard to the first sale doctrine."); *UMG Recordings v. Norwalk Distrib.*, 2003 U.S. Dist. LEXIS 26302, at \*11 (C.D. Cal. June 12, 2003) ("The critical distinction, however, between the present case and *Quality King* is that the phonorecords in this case were produced in a foreign country, whereas the products considered in *Quality King* were manufactured in the United States and reimported into the United States.").

<sup>128</sup> See *supra* note 127.

<sup>129</sup> Compare Dugan, *supra* note 14, at 406 ("While this loophole may prove to be a solution for the large manufacturers intent on controlling the sale of their goods in the United States, it will not work for many small copyright holders. Companies without the means to move their production abroad must look for other ways of protecting their interests.").

<sup>130</sup> See *supra* note 61.

<sup>131</sup> GAO REPORT, *supra* note 8, at 21.

crease the price charged for textbooks in the international market to recoup their costs, but doing so would drastically decrease, if not eliminate, demand, thus decreasing international sales.

The key reason textbook publishers sell to foreign distributors is that they can meet the local market conditions and charge lower prices because the additional cost of producing the textbooks for the foreign market within the U.S. plants is low. Manufacturing textbooks abroad for the international market increases the costs of producing textbooks for that market, making it difficult, if not impossible, to charge prices suitable to local market conditions, and is, thus, not profitable. Therefore, manufacturing abroad so that copyright infringement suits may be brought is not a feasible solution for textbook publishers, post-*Quality King*.

### 3. *Restrict Distribution by Contract*

Another possible way for textbook publishers to prevent the reimportation of textbooks manufactured in the United States and then sold to foreign distributors is by restricting distribution by contract.<sup>132</sup> Through contract law, a “seller can monitor the distribution chain and punish distributors who cooperate with gray market arbitrageurs.”<sup>133</sup> Such contractual remedies exist in the computer software and hardware market.<sup>134</sup> In order to take advantage of educational discounts offered on computer software and hardware, students and professors must contractually “agree not to resell for some period of time.”<sup>135</sup> The success of such contractual restrictions is low, “given the frequent advertisements in student newspapers offering to resell such equipment.”<sup>136</sup> Though mostly ineffective in the computer software and hardware market, contractual restrictions are the most effective solution for the reimportation problem in the textbook industry, as long as publishing companies take care to clearly set out the terms in their contracts with foreign distributors and continuously enforce the terms of these contracts.

The use of contractual restrictions in the pharmaceutical industry presents guidelines that textbook publishers can follow to prevent reimportation. Contractual restrictions have been used in

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<sup>132</sup> Clarida, *supra* note 21, at 1. See also Stanley, *supra* note 14, at 878–79.

<sup>133</sup> Meurer, *supra* note 8, at 146.

<sup>134</sup> CHURCH & WARE, *supra* note 28, at 161.

<sup>135</sup> *Id.*

<sup>136</sup> *Id.*

the pharmaceutical industry to prevent reimportation from Canada. The retail prices of the most widely prescribed prescription drugs are on average 20 to 30 percent lower in Canada than they are in the United States.<sup>137</sup> The price differential exists because of the price controls imposed in Canada by the Patented Medicine Prices Review Board.<sup>138</sup> Drugs are reimported into the United States because of the price differential. Because of this reimportation, pharmaceutical companies have implemented contractual restrictions and made sure that the parties, such as pharmacies, that are selling drugs to people in the United States are subject to these contractual restrictions.<sup>139</sup> For example, to deal with the problem of Canadian pharmacies selling cheaper prescription drugs over the Internet, Pfizer informed forty-six pharmacies that they were required to purchase drugs directly from Pfizer instead of from wholesalers.<sup>140</sup> By purchasing directly from Pfizer, the pharmacies are subject to Pfizer's "standard contract terms that bar its customers from exporting the medicines."<sup>141</sup> Previously, only the wholesalers Pfizer contracted with were subject to these terms, and the pharmacies, as third parties, were not. Pfizer can therefore sue pharmacies for breach of contract and cut off their supplies if sales terms are not respected.<sup>142</sup> In addition, GlaxoSmithKline PLC prohibits Canadian pharmacies and wholesalers from exporting drugs by contract.<sup>143</sup> The existence of the contract terms alone seems to have prevented some reimportation; when asked to certify that they were adhering to the contract terms, most pharmacies and wholesalers complied.<sup>144</sup> The relative success of contractual restrictions demonstrates that textbook publishers can take similar steps.

By restricting the terms of contracts with distributors to limit to whom sales can be made, textbook publishers have a breach of contract action against the foreign distributors if the foreign dis-

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<sup>137</sup> Simon R. Rabinovitch, *On the Legitimacy of Cross-Border Pharmacy*, 43 ALBERTA L. REV. 327, 330 (2005).

<sup>138</sup> *Id.* at 332.

<sup>139</sup> *See id.* at 359 ("Admittedly, a disadvantage of such contracts is that they are enforceable only against the contracting parties, complicating firms' ability to intercept drugs that go outside authorized distribution channels.").

<sup>140</sup> Scott Hensley & Anna Wilde Mathews, *Pfizer Warning May Curb Drug Exports from Canada*, WALL ST. J., Aug. 7, 2003, at A2.

<sup>141</sup> *Id.*

<sup>142</sup> *Id.*

<sup>143</sup> *Id.*

<sup>144</sup> *Id.*

tributors sell to prohibited buyers,<sup>145</sup> for example, U.S. distributors such as college bookstores and student groups. Some publishers have already “strengthened their agreements with foreign wholesalers to prevent the large-scale sale of U.S. textbooks back to the United States.”<sup>146</sup> For example, publishers can strengthen the remedies available in case of breach and may be able to collect liquidated damages.<sup>147</sup>

Foreign distributors may find that potential damages make the unauthorized sales unprofitable, and therefore these sales will cease, preventing reimportation into the United States. However, a potential hurdle in preventing reimportation through the use of restrictive contractual clauses is that publishing companies will find it difficult to convince foreign distributors to agree to restrictive terms. Furthermore, even if foreign distributors do agree to the restrictive terms, publishing companies will find it difficult to enforce them because of jurisdictional problems.

A textbook publisher must first convince the foreign distributor to agree to be subject to U.S. laws and jurisdiction if a contract breach occurs.<sup>148</sup> In addition, if a foreign distributor is a large distributor in the textbook publisher’s international market, that distributor will have leverage and argue against consenting to U.S. law and jurisdiction.<sup>149</sup> If the textbook publisher does not want to lose the foreign distributor’s business, the publisher may find it necessary to eliminate this contract clause. However, if the foreign distributor has made a large number of sales to the United States, jurisdiction may be found based on general minimum contacts. In this manner, a textbook publisher may still be able to enforce the contract against the foreign distributors it is most worried about.

Even if a publishing company succeeds in enforcing the contract and a judgment is entered against the foreign distributor, collecting damages may prove difficult, especially if the foreign distributor is insolvent, a situation that is most probable in an emerging market.<sup>150</sup> The feasibility of enforcement of a judgment

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<sup>145</sup> Clarida, *supra* note 21, at 1.

<sup>146</sup> GAO REPORT, *supra* note 8, at 24.

<sup>147</sup> Dugan, *supra* note 14, at 407.

<sup>148</sup> Stanley, *supra* note 14, at 878.

<sup>149</sup> A foreign distributor might find it unfavorable to be subject to U.S. law and jurisdiction because of unfamiliarity.

<sup>150</sup> Stanley, *supra* note 14, at 878–79. “Although enforcement efforts can be difficult in any foreign market, they become increasingly difficult in emerging markets due to the fact

depends on where the foreign distributor is located. A textbook publisher may find it easier to enforce a judgment and collect damages from a foreign distributor located in the United Kingdom, while it may be more difficult to do so when the foreign distributor is located in Malaysia. While threat of suit and imposition of damages may deter foreign distributors from contract breaches, it is questionable whether textbook publishers will have the continued incentive to bring such suits when they have difficulty collecting damages and attorneys' fees. If fewer suits are brought, foreign distributors will no longer be deterred from breaching; the threat of a breach of contract action becomes weak. Therefore, in order for foreign distributors to be deterred, it is important that textbook publishers continue to bring suits and, perhaps, stop renewing or entering into contracts with new distributors if breaches continue to happen.

One way that publishers have restricted distribution by contract is by having online retailers located outside the United States limit the number of copies of a given textbook that can be delivered to one address.<sup>151</sup> This allows for the loss of revenue from one person purchasing a book from a foreign distributor rather than a U.S. distributor, but it does not allow for the large-scale loss of revenue that would result from arbitrage behavior.

While restricting distribution by contract allows for a breach of contract action against the foreign distributor, it does not create a cause of action against a third party who can create situations in which the foreign distributor can sell to it without breaching its contract with the publisher.<sup>152</sup> If the financial incentive is great enough, a third person, not party to the contract between the publisher and the foreign distributor (for example, another foreign distributor or a U.S. distributor), may purchase the textbooks abroad and then redistribute them by selling them directly to U.S. customers or to U.S. distributors.<sup>153</sup> Thus, the third party is reimporting into the United States, and the contractually-bound foreign distributor is not. The financial incentive must be great for a the third

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that breaching parties in such countries often lack the financial resources to compensate for damages." *Id.* at 871 n.44.

<sup>151</sup> GAO REPORT, *supra* note 8, at 24.

<sup>152</sup> See Dugan, *supra* note 14, at 407 ("Products can still be acquired overseas by a third party and then imported into the United States. In that case, the importation may be contrary to the contract provisions, but there is no cause of action for breach of contract due to the importer's lack of privity with the copyright holder.").

<sup>153</sup> Stanley, *supra* note 14, at 879.

party to purchase the textbooks abroad because of the added cost of traveling abroad, time consumed, and shifting of the burden of shipping to the United States.<sup>154</sup> If the number of textbooks being purchased is small and the profit earned on each is low, an expensive plane ticket, loss of time, and the hassle of arranging shipping may decrease the likelihood of a third party traveling abroad to purchase. Therefore, if the publisher prevails in breach of contract actions and can collect damages, it will be able to prevent reimportation, as third parties are likely to find the cost of going abroad to purchase and then reimport to be cost prohibitive. However, for the restrictive contract provisions to be effective, textbook publishers must continuously enforce such provisions so that deterrence is successful. If the cost of one publishing company doing so is prohibitive, publishing companies should look into combining forces against foreign distributors, as foreign distributors are likely to be selling textbooks manufactured by various companies for reimportation.<sup>155</sup>

#### B. *Actions that Decrease the Incentive to Reimport*

In addition to preventing reimportation, textbook publishers can also seek to decrease the incentives to reimport by decreasing the possible profits available from arbitrage. Textbook publishers can continue to discriminatorily price, but the difference between the U.S. and foreign prices must be narrowed so that the incentive to reimport is decreased.<sup>156</sup> Textbook publishers can also decrease the incentive to reimport while continuing to discriminatorily price at current levels by differentiating the foreign and domestic product enough to diminish the U.S. demand for the foreign-distributed product.<sup>157</sup>

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<sup>154</sup> While cost of shipping is taken into account in the original situation, in that situation the U.S. customer/distributor pays the foreign distributor, who then has the responsibility of shipping the goods, for shipping. However, when a third party purchases abroad, the third party still bears the cost, but it now becomes the third party's responsibility to ship the goods.

<sup>155</sup> A combination of forces such as this is seen in the fashion industry when different fashion houses join in suits against distributors of counterfeit goods. See Liza Casabona, *Barbara Kolsun: Counterfeit Cop*, *WOMEN'S WEAR DAILY*, May 25, 2006, at 12B, available at <http://www.iacc.org/resources/BKarticle.pdf>.

<sup>156</sup> See *infra* Part IV.B.1.

<sup>157</sup> See *infra* Part IV.B.2.

### 1. *Eliminate the Price Differential*

By eliminating the difference between the price at which textbooks are sold to distributors (and ultimately consumers) in the United States and the price at which textbooks are sold to distributors abroad, the incentive to reimport is decreased.<sup>158</sup> Both the money saved by the student purchasing a single book from abroad, as well as distributors' arbitrage profits, are decreased, reducing the likelihood that the money saved or profits earned will outweigh the transaction costs involved. Though establishing flatter pricing would decrease reimportation, it is unlikely that the textbook industry would find such a solution profitable. The price differential can be reduced by either decreasing the prices charged for textbooks in the United States or by increasing the prices charged for textbooks in foreign markets. However, neither option is feasible.

The prices charged to foreign distributors cannot be increased. Textbook publishers have argued that they can sell textbooks in foreign markets only by pegging the price to local demand characteristics, and therefore, they must price these books lower than they would be priced in the United States.<sup>159</sup> If textbook publishers tried to increase the prices charged in international markets, sales would stop. Essentially, the result of this increase would be the extreme situation of the cessation of exports to prevent reimportation.<sup>160</sup> Narrowing the price differential by increasing the prices charged to foreign distributors would not only decrease the incentive to reimport, but, by causing a halt to exports, it would completely destroy any possibility to reimport.

The price charged in the United States cannot be decreased to narrow the price differential because any loss of revenue that is prevented from reimportation would be outweighed by the loss of revenue incurred from the sales to U.S. distributors. Sales to U.S. distributors make up to 85 to 95 percent of the textbook publisher's

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<sup>158</sup> See Clarida, *supra* note 21, at 1.

As Justice Stevens observed [in *Quality King*], it was really [the] two-tier marketing structure that the plaintiff . . . sought to protect under the Copyright Act, not the label designs per se. As reported in the opinion, the foreign shampoo prices in *Quality King* were 35 percent to 40 percent lower than L'Anza's U.S. prices. If that gap were narrowed, little incentive would remain for anyone to resell previously exported U.S. products.

*Id.* See also Stanley, *supra* note 14, at 879.

<sup>159</sup> See *supra* note 61.

<sup>160</sup> See *infra* Part IV.C.

revenue.<sup>161</sup> In some cases, the prices of books available from foreign distributors are 50 percent of that of domestic distributors.<sup>162</sup> While the “foreign sale price could still be lower than the domestic price, so long as the margin is not significant enough to make importation economically beneficial,”<sup>163</sup> the significant difference between the prices and the dominance U.S. sales have on revenue makes it unlikely that U.S. prices could be lowered enough to decrease the incentive to reimport, while remaining profitable. This is because U.S. prices are based on the need to recoup production and development costs.<sup>164</sup> Lower U.S. prices will make this more difficult. Therefore, eliminating the price differential by lowering the U.S. prices is not a feasible way to prevent reimportation because publishing companies will lose profits.

## 2. *Change the Packaging*

Another way reimportation can be made less popular is by changing the packaging of textbooks sold abroad.<sup>165</sup> It can be argued that by changing the packaging of goods, textbook publishers and manufacturers in general no longer price discriminate, because the goods are no longer the same or identical.<sup>166</sup> However, economists have held that price discrimination can also exist when different prices are charged for similar goods.<sup>167</sup> “By creating a different name or look for its export products, a manufacturer can thus take advantage of the average U.S. consumer’s aversion to the unfamiliar.”<sup>168</sup> The U.S. consumer would prefer to pay more money for the product manufactured for domestic sale in familiar packaging

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<sup>161</sup> GAO REPORT, *supra* note 8, at 23 (International sales make up 5 to 15 percent of revenues. Therefore, domestic sales make up 85 to 95 percent of revenues.).

<sup>162</sup> Lewin, *supra* note 10.

<sup>163</sup> Stanley, *supra* note 14, at 880.

<sup>164</sup> *See supra* note 93.

<sup>165</sup> *See* Stanley, *supra* note 14, at 881–82. *See also* Clarida, *supra* note 21, at 1.

<sup>166</sup> *Contra* Myers, *supra* note 68, at 5.

Intuitively, many believe that the more standardized a manufacturing product is, the better it will flow across borders for usage in a variety of conditions, and that gray markets are driven simply on price differentials or availability considerations between those markets. However, preliminary interviews indicated that adaptation of individual products for specific markets lead to substantially more cross-border demand . . . [i]f the exporter is not offering the customer exactly what he wants, and the product exists elsewhere, the environment exists for gray markets.

*Id.*

<sup>167</sup> *See supra* note 27.

<sup>168</sup> Clarida, *supra* note 21 at 1.

rather than pay less money for a product manufactured for overseas sale in less familiar packaging.<sup>169</sup> Therefore, the decrease in demand for reimported goods will lower the incentive to reimport. While changing packaging may be feasible for certain types of products such as software<sup>170</sup> and shampoo,<sup>171</sup> it has proven to be less successful for the textbook industry thus far.

While such a strategy might work for goods such as the shampoo in *Quality King*, it is unlikely to work in the textbook industry. While changing the label on a shampoo bottle may be a small cost, changing the covers on 5 to 15 percent of textbooks being exported is not. Changing covers would increase the additional cost of manufacturing the textbooks for export, so that textbook publishers would be unable to price lower to meet overseas demand. Therefore, such a drastic change in packaging would be unprofitable. In addition, if altering the packaging is to be successful in decreasing the demand for cheaper reimported textbooks, the changes must be “material.”<sup>172</sup> A more material change would involve publishing the same textbooks in completely different languages, specific to the foreign country in which they are being sold. However, such a material change would not be profitable for the textbook industry that can only meet the demand overseas by charging close to the current marginal cost.

Textbook publishers have attempted to alter the product packaging somewhat by affixing restricted-for-sale stickers that say “International Student Edition” on the textbooks manufactured for export.<sup>173</sup> However, the use of such a sticker is unlikely to trigger the student’s “aversion to the unfamiliar,”<sup>174</sup> and demand for reimported textbooks will not decrease. The changing of the packaging, however, will unlikely increase the demand for reimported textbooks, as the contrary proposition supported by Myers<sup>175</sup> that a

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<sup>169</sup> *Id.* See also Stanley, *supra* note 14, at 881 n.64.

<sup>170</sup> Meurer, *supra* note 8, at 145. Software sellers can block gray market arbitrage through product differentiation. For example, software sellers “can deny customer service and warranties to gray market software” or publish manuals in the non-English language, making the reimported good less attractive to the domestic purchaser. *Id.*

<sup>171</sup> Dugan, *supra* note 14, at 407 (suggesting that “[c]hanging the language of a shampoo bottle’s label from English to Russian . . . would make the product undesirable to U.S. consumers.”).

<sup>172</sup> Swanson, *supra* note 89, at 367.

<sup>173</sup> Lewin, *supra* note 10.

<sup>174</sup> Clarida, *supra* note 21, at 1.

<sup>175</sup> See Myers, *supra* note 68.

demand exists for the differentiated product versions is unlikely to apply in the textbook industry. No student in the United States is clamoring for a reimported textbook just because it features an “International Student Edition” sticker on the cover.

### C. *Cease All Sales to Foreign Distributors*

A very extreme way textbook publishers can prevent reimportation is by ceasing all sales to foreign distributors.<sup>176</sup> If no textbooks are sold by the publishers to foreign distributors, then no textbooks can be reimported. If no textbooks are reimported, then no sales at U.S. prices are being lost to sales at foreign prices. Such a solution would be successful in eliminating reimportation. However, the feasibility of such an action depends on whether the textbook publisher is forfeiting or is willing to “forfeit any possible benefits of exporting.”<sup>177</sup> A textbook publisher may prefer to forfeit any possible benefits of exporting if doing so will halt the reimportation trend from increasing, as “international sales make up from 5 to 15 percent of [the publishers’] total revenues.”<sup>178</sup> Therefore, the benefits from exporting are small. If the instances of large scale reimportation increase enough, the revenues that the textbook publishers make in the United States will decrease more than the small amount of revenue that can be made in the international market. Therefore, it becomes profitable for textbook publishers to cease all international sales.

Such an action is drastic, though, and it may be considered unfair to some. All students, not just those who were purchasing textbooks directly or indirectly from foreign distributors, will be hurt by the end of international sales, as textbook publishers argue that international sales, even at lower prices, decrease the prices charged in the United States.<sup>179</sup> Also, those in foreign markets in need of textbooks in particular subjects will find a decrease in the number of options available.

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<sup>176</sup> See Clarida, *supra* note 21. “[I]f no goods are exported, the manufacturer will not have to compete with the lower-priced versions of its own products brought back from abroad.” *Id.* See also Stanley, *supra* note 14, at 876.

<sup>177</sup> Stanley, *supra* note 14, at 877.

<sup>178</sup> GAO REPORT, *supra* note 8, at 23.

<sup>179</sup> See *supra* note 65.

## V. CONCLUSION

If the instances of reimportation continue to increase and the loss of revenues becomes significant enough, textbook publishers will no longer find it profitable to price discriminate. In the worst-case scenario, for both textbook publishers and students, textbook publishers will not be able to prevent or disincentivize reimportation. Because of this, textbook publishers will choose not to sell on the international market any longer, making price discrimination irrelevant. Reimportation has been driven in part by the increasing prices of textbooks in the United States. However, textbook publishers have defended their pricing decisions by arguing that the international market sales, even at lower prices than in those in the United States, lower prices of textbooks in the United States.<sup>180</sup> Therefore, the cessation of international sales will increase prices of textbooks in the United States even more. While price discrimination may be considered unfair, its end may work more as a disadvantage to students, rather than as an advantage to them.

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<sup>180</sup> See GAO Report, *supra* note 8, at 24.

