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Not Your Grandparents' Intellectual Property: How Rightsholders are Using License Agreements to Avoid Exhaustion and Ensure Their Products Stay Out of the Secondary Market

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**NOT YOUR GRANDPARENTS' INTELLECTUAL PROPERTY: HOW
RIGHTSHOLDERS ARE USING LICENSE AGREEMENTS TO
AVOID EXHAUSTION AND ENSURE THEIR PRODUCTS STAY OUT
OF THE SECONDARY MARKET**

INTRODUCTION

A. *Exposé of the Issue*

I spent the better part of a Saturday morning last spring helping my grandfather assemble his new computer, as good grandchildren do.¹ We proceeded without complication before beginning the task of downloading the software. While we waited for Microsoft Office software programs to install, a digital box inquired whether “the user” agreed to the terms and conditions of Microsoft’s license agreement to use its software. As my cursor made its way toward “yes,” my grandfather asked a question that caught my attention: “Why is there a license agreement? I thought I purchased everything I needed.” Sympathetic to his confusion, I explained that he did in fact “purchase” Microsoft Office programs, which in this case really meant he paid for permission to *use* the programs, rather than outright ownership of them, such as the ability to share or re-sell.

His genuine curiosity about the means by which businesses buy and sell products in the digital age had me wondering about the extent to which the scope of intellectual property has changed in the United States since first written into the Constitution.² In the not-so distant past, it was a luxury simply to have a private phone line – literally a wire – attached to one’s house to avoid sharing phone lines with the neighbors. And so too the means for selling products covered by intellectual property were primitive: only physical, tangible products exchanged hands in sales transactions.

Clearly there have been some advancements in the way life is lived and information is shared, as evidenced by tweets, snaps, texts, pins, vlogs, blurbs, and #tbt vines. The technological landscape fast outpaces the United States’ system of lumbering jurisprudence. Where do the limitations placed on the scope of intellectual property in the physical world come into play in the digital world? Large industries that own creative content are moving toward license

1. Please do not contact the author for computer assistance.

2. U.S. CONST. art. I, § 8, cl. 8.

agreements, rather than selling their products outright.³ This system is not inherently wrong. In fact, it is rather enterprising to stretch the power of intellectual property, although this practice never fails to surprise consumers who otherwise thought they had outright ownership of products they purchase.

The future of intellectual property in the digital age looks to blur the lines between what is a sale and what is a license. The consumer must ask: “Did I really ‘buy’ anything at all, or did I merely agree to licensing terms in exchange for the right to use it?”

B. *Intellectual Property*

The existence of intellectual property⁴ itself, including its nature and scope, defines how a government justifies granting property rights in useful or creative information in exchange for the public disclosure of that information.⁵ Every modern developed country in the world has some system of limited monopolies in exchange for the public disclosure of technological and creative advancement.⁶

Generally, patents grant limited monopolies in exchange for disclosures of new and useful technologies, and copyrights provide similar monopolies in exchange for creative works in an attempt to stir the pot of culture, art, film, and music. Granting legal monopolies for any reason should require an answer to the important question of how to draw boundaries around such powerful exclusive rights. It serves neither economic nor moral interests to grant inventors and artists unfettered control over their works within the given lifespan of their patents or copyrights.⁷ Fortunately, as will be discussed within this article, there are indeed limitations on the scope of intellectual property rightsholders’

3. For example, instead of selling books by first printing onto discrete bindings of pages and distributing them for sale, companies are digitizing their content and simply granting access as a license agreement, significantly restricting rights the “buyer” would otherwise have. *See Conditions of Use*, AMAZON <https://www.amazon.com/gp/help/customer/display.html?nodeId=508088> [<https://perma.cc/W3WD-Q3GD>] (last visited May 21, 2018).

4. Intellectual property here is meant to encompass patents, copyrights, and trademarks. Trade secrets often fall within the definition of intellectual property, but will not be discussed within the scope of this article. The general doctrine of trademark exhaustion falls outside the scope of this article as well. *See generally* 3 MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 19.8 (4th ed. 2017).

5. The astute reader will wonder what effect if an economic researcher proved that patent or copyright systems actually hindered “advancements” in innovation or creative works!

6. *See* Daniel R. Cahoy, *Oasis or Mirage?: Efficient Breach as a Relief to the Burden of Contractual Recapture of Patent and Copyright Limitations*, 17 HARV. J.L. & TECH. 135, 138 (2003).

7. The standard lifespan of a U.S. patent is twenty years from the date of its initial filing. *See* 35 U.S.C. § 154(a) (2012). The lifespan of a U.S. copyright is the life of the author plus seventy years. *See* 17 U.S.C. § 302(a) (2012). Whether these lifespans themselves serve any economic interest is best left untouched by the author.

exclusive abilities to control their inventions and works once sold.⁸ How such limitations will affect the market and how intellectual property rightsholders will react to these changes is yet to be determined.

The doctrine of limitation on patented and copyrighted goods sold into the market is commonly referred to as exhaustion, or the first-sale doctrine.⁹ Variations in scope of this limitation reflect the balance of power between the artist (or inventor) and society.¹⁰ The nature of intellectual property is quid pro quo between people and government. Advancing societies often thrive off the reliable output of new technologies and art, while enterprising inventors and authors almost certainly want compensation for their efforts expended on creative endeavors.

C. *The Secondary Market*

The secondary market is a broad term that captures many concepts, but this article generally defines transactions involving products that have passed outside original intellectual property rightsholders' control.¹¹ These transactions often include other related concepts such as parallel imports and gray markets, although those transactions tend to encompass importation and international trade, specifically.¹² Limitations placed on control over products once they fall outside the scope of intellectual property protection creates such secondary markets, which may have unintended economic consequences. Further, exactly how intellectual property rightsholders will choose to transact works and inventions that fall outside the scope of intellectual property protection is yet to be seen. This article argues that such rightsholders are likely to fill the void left by international intellectual property exhaustion with license agreements.¹³

8. See *infra* p. 8. The exhaustion doctrine for trademarks is treated differently than for patents and copyrights, due to the nature of trademarks themselves.

9. These terms are interchangeable, although commonly referred to as exhaustion within patent law and the first-sale doctrine within copyright law.

10. "The [Progress] Clause itself reflects a balance between the need to encourage innovation and the avoidance of monopolies which stifle competition without any concomitant advance in the Progress of Science and useful Arts." *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 147 (1989) (noting the Progress Clause contains both a grant of power and set of limitations upon that power).

11. See R. Anthony Reese, *The First Sale Doctrine in the Era of Digital Networks*, 44 B.C. L. REV. 577, 586 (2003).

12. Chung-Lun Shen, *Intellectual Property Rights and International Free Trade: New Jurisprudence of International Exhaustion Doctrine under the Traditional Legal System*, 7 J. INT'L COM. L. & TECH. 176, 181 (2012).

13. See *infra* p. 24.

This article will analyze the Supreme Court's framework in deciding *Kirtsaeng*¹⁴ and *Lexmark*,¹⁵ anticipate the likely effects on the secondary market, and then predict how intellectual property rightsholders will likely attempt to enforce their rights moving into the future. My analysis will look into arguments both for and against intellectual property exhaustion, ranging from greater market freedom and the prevention of economic stagnation at the whim of intellectual property rightsholders, to penalizing low-income countries and destabilizing local markets.

Part I of this article will introduce a general overview of copyright and patent laws in the United States.¹⁶ Part II will describe the evolution of the first-sale doctrine within United States copyright law until the 2013 Supreme Court case, *Kirtsaeng v. John Wiley & Sons, Inc.*¹⁷ Part III will similarly describe the evolution of exhaustion within United States patent law until the 2017 Supreme Court case, *Impression Products, Inc. v. Lexmark Int'l, Inc.*¹⁸ Part IV will expand upon the general principles of economic theories related to secondary markets, and will discuss how international intellectual property exhaustion within the United States may positively — and negatively — affect these secondary markets.¹⁹ Finally, Part V will analyze the current state of how intellectual property rightsholders may actually decide to deal with international exhaustion, what steps they likely can take to protect their intellectual property, and the likelihood those steps will be successful.²⁰

I. OVERVIEW OF UNITED STATES COPYRIGHT AND PATENT LAWS

Congressional enactment of copyright and patent legislation derives from the “Progress Clause” of the Constitution, which grants to Congress express power over these areas of intellectual property.²¹ It is fairly accepted that the first term in each of the “pairings” within the Progress Clause refers to copyright law. Thus, the Progress Clause can be turned into the Copyright Clause by reading “to promote the Progress of Science²² ... by securing for limited Times to Authors ... the exclusive Right to their ... Writings.” The second term in each

14. *Kirtsaeng v. John Wiley & Sons, Inc.*, 568 U.S. 519, 554 (2013).

15. *Impression Products, Inc. v. Lexmark Int'l, Inc.*, 137 S.Ct. 1523, 1526-28 (2017). These decisions placed the United States economy under the purview of international exhaustion.

16. *See infra* pp. 5-8.

17. *Kirtsaeng*, 568 U.S. at 519; *see infra* pp. 8-13.

18. *Lexmark*, 137 S.Ct. at 1523; *see infra* pp. 13-16.

19. *See infra* pp. 17-24.

20. *See infra* pp. 24-33.

21. U.S. CONST. art. I, § 8, cl. 8: The Congress shall have power “to promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.” *See In re Bergy*, 596 F.2d 952, 958 (C.C.P.A. 1979).

22. Back in the day, “science” meant knowledge. *See generally* WILLIAM STANLEY JEVONS, *ELEMENTARY LESSONS IN LOGIC* 7 (1870).

of the “pairings” within the Progress Clause refers to patent law. Thus, with an equal touch of linguistic magic, the Progress Clause turns into the Patent Clause by reading “to promote the Progress of . . . Useful Arts,²³ by securing for limited Times to . . . Inventors the exclusive Right to their . . . Discoveries.”

Exactly how a federal patent and copyright system would fit into the Constitution was the subject of debate among the delegates to the Constitutional Convention in 1787.²⁴ The delegates certainly wanted to avoid the inter-state conflicts that were already happening among competing inventors and states.²⁵ The Patent and Copyright Acts, written into law even before other fundamental institutions of United States democracy like the Bill of Rights, serve to highlight the apparent need for uniform intellectual property protections across the states.²⁶

United States copyright law can be traced back to the British Statute of Anne, which had a heavy influence on the Copyright Act of 1790.²⁷ Striking similarity between these pieces of legislation is not surprising, given the United States’ trend of simply adopting British common law and statutory law during that era.²⁸ There was an understandable sentiment during the agrarian Colonial Era that protection of copyrighted works did not deserve high colonial priority, thus states were encouraged to enact their own legislation to protect the works of their citizens.²⁹ At the passage of the Copyright Act of 1790, authors were granted limited monopolies of fourteen years for the exclusive right to publish and vend “maps, charts and books,” being renewable for a second fourteen-year term if the author was still alive at the time of renewal.³⁰ United States copyright protection has grown substantially since 1790 and now protects a much broader range of creative works for the life of the author, plus seventy years.³¹

23. At that time, “arts” meant trade, skill, or profession. *Id.*

24. MAX FARRAND, 2 RECORDS OF THE FEDERAL CONSTITUTION 505-06 (1911).

25. Even George Washington acknowledged the importance of intellectual property protection in his State of the Union address to Congress in 1790: “The advancement of agriculture, commerce, and manufactures, by all proper means, will not, I trust, need recommendation; but I cannot forebear intimating to you the expediency of giving effectual encouragement, as well to the introduction of new and useful inventions from abroad, as to the exertions of skill and genius of producing them at home.” *Annals of Congress*, 1st Cong., 2d Sess., I, 932-33.

26. See KENNETH W. DOBYNS, *THE PATENT OFFICE PONY: A HISTORY OF THE EARLY PATENT OFFICE* 18 (1994).

27. Oren Bracha, *The Adventures of the Statute of Anne in the Land of Unlimited Possibilities: The Life of a Legal Transplant*, 25 *BERKELEY TECH. L.J.* 1427, 1428 (2010); see also, Statute of Anne, 8 ANN., c. 19 (1710) (Gr. Brit.).

28. Bracha, *supra* note 27, at 1428.

29. *Id.* at 1440.

30. PETER K. YU, *INTELLECTUAL PROPERTY AND INFORMATION WEALTH: COPYRIGHT AND RELATED RIGHTS* 143 (2007).

31. See 17 U.S.C. § 302.

The Third Act of the First Congress was the enactment of the Patent Act of 1790,³² which granted a limited monopoly of fourteen years to any inventor who “hath ... invented or discovered any useful art, manufacture, engine, machine, or device, or any improvement therein not before known or used.”³³ As the first Secretary of State, Thomas Jefferson was the driving force behind the creation of federal policies regarding a national patent system for the United States.³⁴ Even today, United States patent laws are remarkably similar to their origins, offering patent protection to “whoever invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof.”³⁵

Under modern United States law, the general power of copyright ownership is the ability to exclude all others from reproduction, distribution, public display, public performance, or otherwise copying a creative work if such work is deemed a sufficiently original work of authorship fixed in a tangible medium of expression.³⁶ Modern United States law grants patent owners similar exclusive rights to exclude all others from making, using, selling, offering to sell, or importing the patented invention once the government has deemed the invention sufficiently new, useful, and nonobvious to merit protection.³⁷ Despite these exclusive powers, there are recognized limitations on the intellectual property rightsholder’s power of exclusion over a copyrighted or patented product once it is sold. When there is an authorized sale of a copyrighted work or a patented work, such monopoly as provided by means of intellectual property protection is exhausted as to that particular sold work.³⁸

II. THE FIRST-SALE DOCTRINE IN THE UNITED STATES: BEFORE AND AFTER *KIRTSAENG*

Much of the same logical framework that applies to the copyright first-sale doctrine applies equally to the patent exhaustion doctrine.³⁹ The historical

32. *Bonito Boats*, 409 U.S. at 147.

33. 1 STAT. 109, 110 (1790).

34. 13 THE WRITINGS OF THOMAS JEFFERSON 406–08 (1904).

35. 35 U.S.C. § 101 (2012).

36. See 17 U.S.C. § 106 (2012) for the exclusive rights of the copyright owner. See also 17 U.S.C. § 102(a) (2012) for the requirements to acquire copyright protection at the time of the work’s creation.

37. See 35 U.S.C. § 271(a) (2012) for the exclusive rights of the patent owner. See also 35 U.S.C. § 101 for the utility requirement, 35 U.S.C. § 102 for the novelty requirement, and 35 U.S.C. § 103 (2012) for the nonobviousness requirement of patent law.

38. 5-16 DONALD S. CHISUM, CHISUM ON PATENTS § 16.03 (2018).

39. The first-sale doctrine under United States copyright law, while not identical to patent exhaustion, relies on similar theoretical principles. Guy A. Rub, *Rebalancing Copyright Exhaustion*, 64 EMORY L.J. 741, 754 n.53 (2015).

developments that led each one toward international exhaustion are important in their own right.

A. *The First-Sale Doctrine*

The exclusive distribution right of a copyright owner differs from his other exclusive rights in the sense that those other rights involve copying in some way.⁴⁰ It would be anomalous if the copyright owner could extend his monopoly to cover unauthorized sales of copies once they were lawfully sold.⁴¹ Once there is a lawful sale of the copyrighted work, the policy of protecting the copyright monopoly gives way to the policy of promoting free trade and commerce within a free market.⁴²

The first-sale doctrine under United States copyright law traces back to *Bobbs-Merrill Co. v. Straus*,⁴³ when the Supreme Court construed the exclusive right to vend as applicable only to the initial sale of that copyrighted good, absent any contractual provisions to the contrary.⁴⁴ The Court held the right to vend was extinguished upon lawful sale to the customer.⁴⁵ This was the first application of the first-sale doctrine within United States law,⁴⁶ and the first time the court dealt with the intersection of the competing interests between copyright, contract, and licensing.⁴⁷

Since that time, the first-sale doctrine has formally been codified into federal law.⁴⁸ The Copyright Act⁴⁹ expressly states: “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.”⁵⁰ Technical terminology more accurate than “first sale” would be “first authorized disposition by which title passes.”⁵¹ The

40. 2 MELVILLE NIMMER, NIMMER ON COPYRIGHT § 8.12 (2017).

41. *Id.*

42. *Id.* In *Sony Corp. of Am. v. Universal City Studios, Inc.*, the Supreme Court stated the purpose of protecting the exclusive rights of authors is to incentivize creativity “and to allow the public access to the products of genius after the limited period of exclusive control has expired.” 464 U.S. 417, 429 (1984). The ultimate goal of the Copyright Act is for the good of the public consumer. *Twentieth Century Music Corp. v. Aiken*, 422 U.S. 151, 151-52 (1975).

43. 210 U.S. 339, 343 (1908).

44. *Id.* at 348.

45. *Id.* at 344.

46. 4 WILLIAM PATRY, PATRY ON COPYRIGHT § 13.19 (2014).

47. *Bobbs-Merrill*, 210 U.S. at 350 (“There is no claim in this case of contract limitation, nor license agreement controlling the subsequent sales of the book.”).

48. *See* 17 U.S.C. § 109(a) (2012).

49. For a general treatment of the Copyright Act’s evolution over the years, see MARSHALL LEAFFER, UNDERSTANDING COPYRIGHT LAW (4th ed. 2005).

50. 17 U.S.C. § 109(a).

51. NIMMER, *supra* note 40.

appropriate inquiry is whether (1) the physical product was manufactured under the authorization of the copyright owner, (2) whether that particular copy of the physical copy was transferred under the authority of the copyright owner, (3) whether the defendant qualifies as the lawful owner of that particular copy, and (4) whether the defendant disposed of that copy by sale or other means, rather than make a reproduction.⁵²

In 1998, the Supreme Court heard *Quality King Distributors, Inc. v. L'anza Research Int'l, Inc.*,⁵³ where it decided the issue of whether goods manufactured within the United States, subsequently exported and sold abroad, then finally imported back into the United States and sold by another distributor, were subject to the original copyright owner's exclusive right of importation under 17 U.S.C. § 602(a),⁵⁴ or whether such goods were excluded by the first-sale doctrine under 17 U.S.C. §109(a).⁵⁵ The Court, referring back to precedent set by *Bobbs-Merrill*, held the first-sale doctrine did apply to domestically produced copyrighted works sold abroad and then imported back into the United States.⁵⁶ The Court held that because § 109 is a limitation on the exclusive rights of § 106, then it is also a limit on those importation rights within § 602(a).⁵⁷ Justice Stevens, as the author of the majority opinion, commented on the purpose of § 109, writing "the whole point of the first-sale doctrine is that once the copyright owner places a copyrighted item in the stream of commerce by selling it, he has exhausted his exclusive statutory right to control its distribution."⁵⁸ However, this holding extended only to goods manufactured within the United States, and then purchased abroad.⁵⁹ The Court did not reach the issue of whether the first-sale doctrine applied to items manufactured abroad.⁶⁰

52. *UMG Records, Inc. v. Augusto*, 558 F.Supp.2d 1055, 1059 (C.D. Cal. 2008), *affirmed*, 628 F.3d 1175 (9th Cir. 2011).

53. 523 U.S. 135 (1998).

54. "Importation into the United States, without the authority of the owner of copyright under this title, of copies ... of a work that have been acquired outside the United States is an infringement of the exclusive right to distribute copies ... under section 106." 17 U.S.C. § 602(a) (2012).

55. The owner of a particular copyrighted work may sell or otherwise dispose of such copyrighted work without the permission from the copyright owner of the original work. 17 U.S.C. § 109(a).

56. *Quality King*, 523 U.S. at 152; *see also*, David Tseng, *Bypassed: The Kirtsaeng Decision's Underwhelming Impact on Exhaustion*, 43 AIPLA Q.J. 559, 564 (2015).

57. *Quality King*, 523 U.S. at 143.

58. *Id.* at 152.

59. *Id.*

60. The Supreme Court's lack of a decision on this issue in *Quality King* left the topic open to confusion and debate within the lower courts. In 2008, the Ninth Circuit held in *Omega S.A. v. Costco Wholesale Corp.* that § 109(a) applied only to items manufactured within the United States. 541 F.3d 982, 983 (9th Cir. 2008). The Supreme Court granted certiorari, but the Ninth Circuit's ruling was upheld by the Court's 4-4 decision. *See NIMMER, supra* note 40, at § 8.13.

B. *Kirtsaeng v. John Wiley & Sons, Inc.* (2013)

The controlling case for the first-sale doctrine under United States copyright law is *Kirtsaeng v. John Wiley & Sons, Inc.*⁶¹ In anticipation of his move from Thailand to the United States to begin his studies in mathematics, Mr. Supap Kirtsaeng asked his friends and family to buy cheaper versions of his English textbooks in foreign shops, then ship those books to him once he was in the United States.⁶² When he was finished with the textbooks, he re-sold them at the higher United States market rates and kept the profit for himself.⁶³ As the copyright owner of the textbooks, John Wiley & Sons, Inc. sued Kirtsaeng, basing its lawsuit on the “unauthorized importation and re-sale of books” as an infringement of the prohibition against imports.⁶⁴ Kirtsaeng argued that his books were lawfully made and acquired, and that the § 109(a) first-sale doctrine allowed him to import and re-sell the copyrighted books without permission.⁶⁵

The Supreme Court agreed with Kirtsaeng, holding the first-sale doctrine under § 109(a) does apply to copyrighted goods sold abroad and then brought into the United States.⁶⁶ The Court said this case presented a similar issue to the one decided in *Quality King Distributors, Inc. v. L'anza Research Int'l, Inc.*,⁶⁷ where § 602(a)(1)'s reference to § 106(3)'s exclusive distribution right incorporates the first-sale doctrine of § 109(a).⁶⁸ The difference here was that the copies were manufactured abroad.

The critical words in § 109(a) that decided the legal issue here were “lawfully made under this title.”⁶⁹ The Supreme Court held there is no geographic limitation imposed on the first-sale doctrine based on § 109(a)'s language, context, and common law history of copyright law.⁷⁰ By adopting this position, the Court extended the interpretation of the first-sale doctrine to include items manufactured in foreign countries and essentially abrogated the Ninth Circuit's decision in *Omega*.⁷¹ The Court reasoned that Congress intended the Copyright Act to reach the works of citizens of treaty nations, even those manufactured abroad, and that it simply did not make sense to read a geographic

61. 568 U.S. 519 (2013).

62. *Id.* at 525.

63. *Id.*

64. *Id.* at 526.

65. 17 U.S.C. § 109(a) (The owner of a particular copyrighted work may sell or otherwise dispose of such copyrighted work without the permission from the copyright owner of the original work).

66. *Kirtsaeng*, 568 U.S. at 524-25.

67. 523 U.S. 137.

68. *Kirtsaeng*, 568 U.S. at 524.

69. *Id.*

70. *Id.* at 529.

71. 541 F.3d at 989.

limitation into the statutory language of the first-sale doctrine.⁷² A geographic limitation would unduly restrict the right to dispose of lawfully purchased property whichever way the consumer sees fit, which defied the original creation of the copyright laws for the benefit of the public good.⁷³

Acknowledging this ruling brought United States copyright law under the umbrella of international exhaustion, the *Kirtsaeng* Court, quoting Lord Coke from 1628, emphasized its belief in the importance of allowing buyers of goods the freedom to compete in the market,⁷⁴ and that the history of American law generally promotes competition and freedom of sale as advantageous to the consumer.⁷⁵ The Court also went on to express a lengthy list of all the industries that would suffer under a regime of restricted copyright exhaustion, including libraries, technology companies, retailers of foreign goods, and art museums.⁷⁶ The Court made this decision fully aware of the economic impact that an international first-sale doctrine would have on copyright owners.⁷⁷

III. THE EXHAUSTION DOCTRINE IN THE UNITED STATES: BEFORE AND AFTER *LEXMARK*

A. *The Exhaustion Doctrine*

In the 1873 case *Adams v. Burke*,⁷⁸ the Supreme Court first acknowledged the patent exhaustion doctrine by recognizing there were no territorial boundaries on the purchaser's right to use a patented invention once he had made a lawful and authorized purchase.⁷⁹ In *Adams*, the purchaser of a patented coffin lid had taken the lid for his own use outside the ten-mile radius of Boston, which was expressly forbidden by the patent owner.⁸⁰ The Supreme Court wrote: "The

72. *Kirtsaeng*, 568 U.S. at 540.

73. Alex N. Rosenblum, Comment, *Wiley's First Sale Folly: The Irrelevance of Location of Manufacture When Raising a First-Sale Defense*, 19 SW. J. INT'L LAW 231, 246 (2012).

74. *Kirtsaeng*, 568 U.S. at 539.

75. *Id.* (quoting *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877, 886 (2007)).

76. *Id.* at 544.

77. "A publisher may find it more difficult to charge different prices for the same book in different geographic markets ... we can find no basic principle of copyright law that suggests that publishers are especially entitled to such rights." *Id.* at 552. Justice Ginsburg dissented, arguing that Congress had intended to provide copyright owners with protections against imports of foreign-made copies of their copyrighted works. *Id.* at 557. Ginsburg fully adopted the philosophy that intellectual property is territorial in nature and should allow for intellectual property rightsholders to possess "parallel rights" under the laws of different nations. *Id.* at 573 (citing Vincent Chiappetta, *The Desirability of Agreeing to Disagree: The WTO, TRIPS, International IRP Exhaustion and a Few Other Things*, 21 MICH. J. INT'L L. 333, 340-41 (2000)).

78. 84 U.S. 453 (1873).

79. *Id.* at 456.

80. *Id.*

patentee ... having in the act of sale received all the royalty or consideration which he claims for the use of his invention in that particular machine or instrument, it is open to the use of the purchaser without further restriction on account of the monopoly of the patentees.”⁸¹

Then, in the 1894 case *Keeler v. Standard Folding-Bed Co.*,⁸² the Supreme Court relied on *Adams* to determine that a purchaser could re-sell a patented invention he had purchased, just as he could use such patented invention without limitation, because the lawful and authorized purchase had freed him from the patent monopoly on these rights.⁸³ The Court expressly stated that “one who buys patented articles of manufacture from one authorized to sell them. . . becomes possessed of an absolute property in such articles, unrestricted in time or place.”⁸⁴ The Supreme Court took these exhaustive concepts even further in 1942 when it decided *United States v. Univis Lens Co.*,⁸⁵ where it held the patent conferred no right for the patent owner to control the re-sale price of his invention by the subsequent purchaser’s sale.⁸⁶

In 2008, the Supreme Court heard *Quanta Computer, Inc. v. LG Electronics, Inc.*,⁸⁷ where it held that patent exhaustion applies to the sale of components of a patented system that must be combined with additional components in order to practice the patented method.⁸⁸ The court held that exhaustion does apply to method claims.⁸⁹ Once the *Quanta* decision was handed down, there was much discussion whether *Quanta* undermined the decisions of *Mallinckrodt v. Mediapart*,⁹⁰ where the Federal Circuit held there was no patent exhaustion accompanying conditional sales,⁹¹ and *Jazz Photo Corp. v. Int’l Trade Commission*,⁹² where the Federal Circuit again held there was no patent exhaustion accompanying the first sale of a patented item made outside the United States.⁹³ Despite the holding in *Quanta*, the holdings in *Mallinckrodt* and *Jazz Photo* were affirmed by the Federal Circuit case *Lexmark Int’l, Inc. v.*

81. *Id.*

82. 157 U.S. 659 (1894).

83. *Id.* at 663–64.

84. *Id.* at 659.

85. *United States v. Univis Lens Co.*, 316 U.S. 241 (1942).

86. *Id.* at 250.

87. 553 U.S. 617 (2008).

88. *Id.* at 621 (“For over 150 years this Court has applied the doctrine of patent exhaustion to limit the patent rights that survive the initial authorized sale of a patented item.”).

89. *Id.* at 630.

90. 976 F.2d 700 (Fed. Cir. 1992).

91. *Id.* at 709.

92. 264 F.3d 1094 (Fed. Cir. 2001).

93. *Id.* at 1098, 1111.

*Impression Prods., Inc.*⁹⁴ in 2016, when the Federal Circuit held that *Mallinckrodt* and *Jazz Photo* were not undermined by *Quanta*.⁹⁵

B. *Impression Prods., Inc. v. Lexmark Int'l, Inc.* (2017)

In the opinion written by Chief Justice Roberts, the Supreme Court looked at two issues at bar: whether a patented item sold under express restriction of the purchaser's right to re-use or re-sell may be enforced, and whether patent exhaustion applies to items sold outside the United States and first purchased outside the United States.⁹⁶ The Supreme Court's ruling officially abrogated the holdings of *Mallinckrodt* with respect to domestic exhaustion,⁹⁷ and *Jazz Photo* with respect to international exhaustion.⁹⁸ The Supreme Court held "a patentee's decision to sell a product exhausts all of its patent rights in that item, regardless of any restrictions the patentee purports to impose or the location of the sale."⁹⁹

The Court focused its domestic exhaustion ruling on the reasoning that the purpose of patent law has been fulfilled once the patent owner has received compensation for the sale of his patented invention.¹⁰⁰ The Court did hold that a patent owner may attempt to enforce restrictions on the use or sale of his patented invention through applicable doctrines of contract law, but that he may not do so under patent law because the sold invention has "passed outside of the patent monopoly."¹⁰¹

Next, the Court turned to the issue of whether patent exhaustion applies to inventions first purchased outside the United States, where the United States patent laws do not govern.¹⁰² The Court drew parallels to its recent 2013 decision in *Kirtsaeng*, where this issue was raised in the context of copyright law, already discussed in this article *supra*.¹⁰³ The common law doctrines that originated both patent law and copyright law did not make geographic distinctions, therefore a straightforward application of the exhaustion doctrine required the conclusion that it applied overseas as well.¹⁰⁴ In fact, the court explained the "historic kinship between patent law and copyright law" left no room for such a rift between the two regarding the issue of international exhaustion.¹⁰⁵

94. 816 F.3d 721 (Fed. Cir. 2016).

95. *Id.* at 726–27. *See also* 5-16 DONALD S. CHISUM, CHISUM ON PATENTS § 16.03 (2018).

96. *Impression Prods., Inc. v. Lexmark Int'l, Inc.*, 137 S.Ct. 1523, 1529 (2017).

97. *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700 (Fed. Cir. 1992).

98. *Jazz Photo Corp.*, 264 F.3d at 1111.

99. *Lexmark*, 137 S.Ct. at 1529.

100. *Id.* at 1532.

101. *Id.* at 1533.

102. *Id.* at 1535.

103. *Id.* at 1535–36; *see generally* *Kirtsaeng v. John Wiley & Sons, Inc.*, 133 S.Ct. 1351 (2013).

104. *Lexmark*, 137 S.Ct. at 1536; *see also* *Kirtsaeng*, 133 S.Ct. at 1363.

105. *Lexmark*, 137 S.Ct. at 1536. Justice Ginsburg dissented with respect to international patent exhaustion. She argued that patent law is territorial, and that the previous holding regarding

IV. THE EFFECTS OF INTERNATIONAL INTELLECTUAL PROPERTY EXHAUSTION ON THE SECONDARY MARKET

Exhaustion is at the crossroads between intellectual property, marketplace economics, and consumer benefits. Among the international community, the scope of the ability of an intellectual property rightsholder to control the importation of patented or copyrighted goods once those rights have been exhausted is still a controversial topic.¹⁰⁶ No international agreement was reached within the TRIPS Agreement regarding control over the importation of legitimate goods once the intellectual property rights have been exhausted.¹⁰⁷ Goods imported and sold outside the control of the original rightsholder are commonly referred to as “parallel imports” or “grey market” goods.¹⁰⁸ There is still no global consensus between different member states and countries regarding the appropriate level of intellectual property exhaustion.¹⁰⁹ Three categories of exhaustion are practiced by different countries around the world: national, regional, and international.¹¹⁰

A. *How the Rest of the World Deals with Intellectual Property Exhaustion*

What is truly different between the exhaustion doctrines among countries is the scope of what is exhausted. Two questions must be asked: (1) What transactions trigger exhaustion, and (2) which exclusive rights are then narrowed as a result of exhaustion? Some countries, such as India, apply national exhaustion, whereby only domestic sales trigger exhaustion.¹¹¹ Under national exhaustion, the intellectual property owner always retains exclusive rights regarding the importation of protected inventions or creative works that are first purchased abroad. Other countries, now including the United States after the 2013 *Kirtsaeng* ruling and the 2017 *Lexmark* ruling, follow international exhaustion, whereby sales made anywhere in the world trigger exhaustion of the

copyright exhaustion is not binding on patent exhaustion because the two “are not identical twins.” (Ginsburg, J., dissenting). *Id.* at 1538.

106. See SUSY FRANKEL & DANIEL J. GERVAIS, *ADVANCED INTRODUCTION TO INTERNATIONAL INTELLECTUAL PROPERTY* 114 (2016).

107. See Vincent Chiappetta, *The Desirability of Agreeing to Disagree: The WTO, TRIPS, International IPR Exhaustion and a Few Other Things*, 21 MICH. J. INT'L L. 333, 334–35 (2000).

108. It should be noted that parallel trade does not refer to illegal activities or the trade of counterfeit goods. See Marianne Buckley, Comment, *Looking Inward: Regional Parallel Trade as a Means of Bringing Affordable Drugs to Africa*, 41 SETON HALL L. REV. 625, 627 (2011).

109. See generally T. 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 (1999).

110. There is no global consensus on the appropriate level of intellectual property exhaustion. See Rub, *supra* note 39, at 751; see also Agreement on Trade-Related Aspects of Intellectual Property Rights art. 6, Apr. 15, 1994, 33 I.L.M. 1197, 1867 U.N.T.S. 299; Berne Convention for the Protection of Literary and Artistic Works, Sept. 28, 1979, S.Treaty Doc. No. 99-27 (1986).

111. Rub, *supra* note 39, at 751.

intellectual property rightsholder's exclusive rights.¹¹² Finally, other jurisdictions follow regional exhaustion, which is the practice followed within the European Union, whereby any sale of a protected work within any member state of the European Union then triggers exhaustion of that product with respect to any other member state within the European Union.¹¹³ To illustrate the European Union's case of regional exhaustion, a copyright owner could exercise exclusive rights of restrictions upon imports of his books first sold in the United States into Ireland, but not if those books were first sold in Spain.¹¹⁴

Disharmonization regarding the treatment of exhaustion and imports has come under increasing scrutiny in recent years.¹¹⁵ Such inconsistencies between countries result in inefficiency and make worldwide consolidation of intellectual property laws and uniformity nearly impossible to achieve.¹¹⁶

B. *What Are Secondary Markets?*

The demand for goods remains steady in a healthy economy, regardless of how much intellectual property protection may cover those goods. The secondary market includes all goods and products sold outside of the control or desire of the original intellectual property rightsholder.¹¹⁷ The secondary market is important to understand when discussing the benefits and drawbacks between regimes of intellectual property exhaustion because it does not require much imagination to appreciate the interests that are at stake on either side of the argument for or against the secondary market: the rightsholders clearly want more control over their inventions and creative works, and consumers want the cheapest prices possible for goods they wish to buy. Therefore, an awareness of how the secondary market affects regional economies is as critical as it is controversial.

In colloquial business parlance, "gray markets" and "gray businesses" are focused on selling genuine products by unauthorized means, most commonly

112. *Id.*

113. *Id.*; see also Thomas N. Bart, *Parallel Trade of Pharmaceuticals: A Review of Legal, Economic, and Political Aspects*, 11 *VALUE HEALTH* 996, 998 (2008); J.A.L. STERLING, *WORLD COPYRIGHT LAW* § 9.06 (3d ed. 2008).

114. According to the World Intellectual Property Organization's latest survey, twenty-seven countries followed national exhaustion, nineteen countries followed international exhaustion, twenty-two countries followed regional exhaustion, and another eight countries reported following a "mix" depending on the circumstances, or were uncertain which regime they followed. See WIPO Standing Committee on the Law of Patents, *Exhaustion of Patent Rights*, 3 (Oct. 6, 2014).

115. CHRISTOPHER HEATH, *PARALLEL IMPORTS AND INTERNATIONAL TRADE* 11 (1999), https://www.wipo.int/edocs/mdocs/sme/en/atrip_gva_99/atrip_gva_99_6.pdf [<https://perma.cc/Q8MA-QWWK>] (presented at the Annual Meeting of the International Association for the Advancement of Teaching and Research in Intellectual Property (ATRIP) at the headquarters of WIPO in Geneva (July 7 to 9, 1999)).

116. *Id.* at 12.

117. Reese, *supra* note 11, at 586.

through online sites.¹¹⁸ Whenever there are profits to be made, distributors that operate within the secondary market are encouraged to fight for a percentage of those profits, often offering the consumers a better deal.¹¹⁹ Depending on the market, online gray market retailers may have cornered most, if not all, of the market.¹²⁰

C. *Good and Bad Effects of the Secondary Market on the United States Economy*

International exhaustion creates several implications regarding the interaction between intellectual property rights and the secondary market.¹²¹

International exhaustion will likely strengthen competition in the United States for higher quality products at lower, or at least more reasonable, prices.¹²² The free competition of commerce has been understood historically as an important identity value within American economic philosophy and seems to be met with little opposition.¹²³ The typical consumer enjoys the ability to compare prices between different desired products before making a final buying decision.¹²⁴ In effect, a strong working secondary market forces the hand of intellectual property rightsholders to balance their prices with the competition of the secondary market, keeping prices reasonable for consumers. As a matter of common sense, international exhaustion works toward preventing market monopolies. Once the intellectual property rightsholder has established some form of market power, the market they have created for their exclusive product

118. Mike Ives, *Dealers' Online Sales Continue to Challenge Watch Brands*, N.Y. TIMES (Nov. 17, 2017), <https://www.nytimes.com/2017/11/17/style/watches-online-sales.html> [<https://perma.cc/3J98-68Y8>]. This is not to be confused with the black market or other illegal goods, although the two concepts may intersect occasionally.

119. *Id.*

120. Victoria Gomelsky, *Time to Sell Online?*, N.Y. TIMES (Mar. 23, 2017), <https://www.nytimes.com/2017/03/23/fashion/watches-internet-sales.html> [<https://perma.cc/P3EY-ASJY>]; see also Fritz Hahn, *Why D.C.'s 'Gray Market' Is a Good Thing for Beer Lovers*, WASH. POST (July 5, 2015), https://www.washingtonpost.com/lifestyle/food/why-dcs-gray-market-is-a-good-thing-for-beer-lovers/2015/07/05/95762f0e-2019-11e5-84d5-eb37ee8eaa61_story.html?utm_term=.924c63871998 [<https://perma.cc/9CHL-8BPQ>].

121. Chung-Lun Shen, *supra* note 12, at 176 (“The international exhaustion doctrine is the optimal legal model for the harmonization goal through examining the theoretical arguments and observing legal experience in the global community.”).

122. Vincent Chiappetta, *Patent Exhaustion: What's It Good For?*, 51 SANTA CLARA L. REV. 1087, 1136 (2011) (arguing that empirical evidence shows a healthy secondary market will result in increased product quality and reduced prices).

123. Harvey E. Bale, Jr., *The Conflicts Between Parallel Trade and Product Access and Innovation: The Case of Pharmaceutical*, 1 J. INT'L ECON. L. 637 (1998).

124. Frederick M. Abbott, *First Report to the Committee on International Trade Law of the International Law Association on the Subject of Parallel Importation*, 1 J. INT'L ECON. L. 607, 612 (1998).

will approach monopolization.¹²⁵ With this power, prices are decided by the intellectual property rightsholder, opening the possibility for potentially exorbitant prices going well beyond ensuring compensation for creativity and innovation. International exhaustion may lead to lower prices in the secondary markets outside the control of the intellectual property rightsholder once those products are first sold, allowing for competition. At the very least, such secondary markets will eliminate the artificial monopoly created by the intellectual property rightsholder, which helps to resolve the abuse of market power.

However, an analysis of international exhaustion must also deal with potential harmful effects on the economy as well. Efficient international marketing and business often involves altering prices based on the economic status and income levels of local populations.¹²⁶ Such schemes typically charge higher prices in developed markets and lower prices in developing markets.¹²⁷ This practice of price discrimination makes sense as a means to take advantage of higher profits to compensate for possible losses in selling to low-income markets. However, in order to deal with international exhaustion where the producer can no longer control the exact pricing scheme in particular markets, sellers will likely follow a more uniform price, thus raising prices in low-income markets.¹²⁸ It is easy to see the higher financial burden placed on low-income markets under this scheme. Regarding the pharmaceutical industry, many economists predict that companies will refuse to sell drugs at lower prices to low-income markets because those companies anticipate arbitrage and undercutting in those markets.¹²⁹ Taken to the extreme, this would clearly spell disaster for vulnerable populations that desperately need medications, yet simply cannot afford the prices.

An especially important point of consumer protection is that promotion of secondary markets often increases the uncertainty of product quality after initial sales. It is highly unlikely that products sold through secondary markets will come equipped with warranties or quality assurance contracts.¹³⁰ Consumers will simply assume the risk of purchasing goods manufactured in foreign

125. SETH E. LIPNER, *THE LEGAL AND ECONOMIC ASPECTS OF GRAY MARKET GOODS* 79-80 (1990).

126. Carsten Fink, *Entering the Jungle – The Exhaustion of Intellectual Property Rights and Parallel Imports*, in *COMPETITIVE STRATEGIES FOR THE PROTECTION OF INTELLECTUAL PROPERTY* 178 (Carsten Fink & Keith E. Maskus eds., 1999).

127. J.S. Chard & C.J. Mellor, *Intellectual Property and Parallel Imports*, 12 *THE WORLD ECON.* 69, 76 (1989).

128. David A. Malueg & Marius Schwartz, *Parallel Imports, Demand Dispersion, and International Price Discrimination*, 37 *J. INT'L ECON.* 167, 190 (1994).

129. Jennifer L. Graber, *Excessive Pricing of Off-Patent Pharmaceuticals: Hatch It or Ratchet?*, 92 *N.Y.U. L. REV.* 1146, 1164 n.88 (2017).

130. Chard & Mellor, *supra* note 127, at 73.

markets with little familiarity with the quality of products made in those regions. Downstream distributors of patented or copyrighted products can easily take advantage of the goodwill or reputation built up by the original manufacturer's investment in research and development, marketing, product testing, improvements, and advertising.¹³¹ This leads to market inefficiency when product creators know their investment will not yield the desired results. Some economists argue these effects of strong secondary markets will actually increase prices, thus hurting consumers, because manufacturers will be forced to make all their profits on the front end, at the initial purchase.¹³²

D. Why Stronger Secondary Markets are Beneficial to Consumers

International exhaustion is more beneficial to the United States economy than it is harmful. Generally, territoriality as it relates to intellectual property exhaustion is an obstacle to free commerce.¹³³ Territoriality has enjoyed powerful consideration historically but will face increasing obsolescence as innovation and technology drive consumers online.¹³⁴ Online rights and online transactions are transforming economic interactions, where consideration of territoriality loses priority. The first-sale doctrine is slowly being applied to digital goods as well.¹³⁵ The Court of Justice for the European Union has already held the first-sale doctrine applies to digital copies as well as physical copies.¹³⁶ Many copyright owners are digitizing and licensing their works online in response to online demand and as an alternate method to control their works.¹³⁷

131. Robert J. Staaf, *The Law and Economics of the International Gray Market: Quality Assurance, Free-Riding and Passing Off*, 4 I.P.J. 191, 207-11 (1989).

132. Greg Dolin, *Supreme Court's Lexmark Patent Decision Will Harm Consumers*, THE HILL (June 12, 2017), <https://thehill.com/blogs/pundits-blog/the-judiciary/337491-supreme-courts-lexmark-patent-decision-will-harm-consumers> [<https://perma.cc/T3J5-TUXK>].

133. BERNT HUGENHOLTZ ET AL., *THE RECASTING OF COPYRIGHT & RELATED RIGHTS FOR THE KNOWLEDGE ECONOMY* 218 (2006) (arguing the territorial nature of European intellectual property economic rights is an obstacle to creativity and allows for the compartmentalization of internal markets along geographic boundaries).

134. Physical location with respect to intellectual property exhaustion will become a matter of semantics in the digital age, where the country of origin will decrease in importance in otherwise entirely virtual transactions.

135. See John Villasenor, *Rethinking a Digital First-Sale Doctrine in a Post-Kirtsaeng World: The Case for Caution*, 2 COMPETITION POL'Y INT'L ANTITRUST CHRON., May 2013 at 1-4.

136. See Case C-128/11, *UsedSoft GmbH v. Oracle Int'l Corp.*, 2012 E.C.R. I-0000; see also Alice J. Won, *Exhausted? Video Game Companies and the Battle Against Allowing the Resale of Software Licenses*, 33 J. NAT'L ASS'N ADMIN. L. JUDICIARY 388, 393 (2013).

137. Brittany Greger, Comment, *Consumer Rights Need a Reboot: The Supreme Court's Decision in Kirtsaeng v. John Wiley & Sons, Inc. May Have Unintended Consequences for the First-Sale Doctrine and Consumers*, 47 TEX. TECH L. REV. 275, 278 (2015).

Further, international exhaustion and the secondary market serve to protect consumers.¹³⁸ This notion can be observed by exceptions to intellectual property rightsholders' exclusive rights when countries can show necessity to protect human health and life, or to protect industrial or commercial property.¹³⁹ The free competition of goods sold in the market should be ensured, even in areas where internal markets are favored.¹⁴⁰ Globalization has created a smaller world wherein consumers want products from all over the world. National markets have become international ones, and by natural extension, this means national transport of goods has become international transport of goods.¹⁴¹

The decisions in *Kirtsaeng* and *Lexmark* to limit the control that intellectual property rightsholders have over their products after initial sales serves as an indirect endorsement of the secondary market.¹⁴² Support of the secondary market benefits consumers within such markets.¹⁴³ As will be discussed in the next section of this article, private contract provisions and licensing may still be viable means for intellectual property rightsholders to restrict trade of their goods.¹⁴⁴

V. PRACTICAL WAYS INTELLECTUAL PROPERTY RIGHTSHOLDERS WILL ATTEMPT TO PROTECT THEIR INTELLECTUAL PROPERTY FROM EXHAUSTION

The United States economy operating within international exhaustion raises several questions about how intellectual property rightsholders will attempt to assert control over their intellectual property. There are no binding statutes or case law that have squarely decided whether an intellectual property rightsholder

138. See Clark D. Asay, *Kirtsaeng and the First-Sale Doctrine's Digital Problem*, 66 STAN. L. REV. 17, 22 (2013) (noting that copyright owners found ways to make money after the advent of the VCR, despite their initial arguments that such technology would impair their ability to generate revenue).

139. COMMISSION COMMUNICATIONS ON PARALLEL IMPORTS OF PROPRIETARY MEDICINAL PRODUCTS – FREQUENTLY ASKED QUESTIONS, Press Release, EUR. COMM'N, MEMO/04/7 (Jan. 19, 2004), europa.eu/rapid/press-release_MEMO-04-7_en.pdf.

140. See, e.g., Case C-44/01, *Pippig Augenoptik v. Hartlauer Handelsgesellschaft*, 2003 E.C.R. I-3095 (“Parallel imports play an important role in preventing the compartmentalisation of national markets.”).

141. See Shubha Ghosh, *Pills, Patents, and Power: State Creation of Gray Markets as a Limit on Patent Rights*, 53 FLA. L. REV. 789, 814 (2001).

142. See Nina Totenberg, *Supreme Court OKs Discounted Resale of 'Gray Market' Goods*, NPR (Mar. 19, 2013, 3:28 PM), <https://www.npr.org/sections/thetwo-way/2013/03/19/174757355/supreme-court-oks-discounted-resale-of-gray-market-goods> [<https://perma.cc/5VS6-LUSN>].

143. See Gary Shapiro, *Supreme Court Gives American Consumers Victory over Copyright Owners in Kirtsaeng v. John Wiley & Sons*, FORBES (Mar. 20, 2013), <https://www.forbes.com/sites/garyshapiro/2013/03/20/supreme-court-gives-american-consumers-victory-over-copyright-owners-in-kirtsaeng-vs-john-wiley-sons/#4d2dbff662b9> [<https://perma.cc/7GQG-AGXW>].

144. Claude E. Barfield & Mark A. Groombridge, *Parallel Trade in the Pharmaceutical Industry: Implications for Innovation, Consumer Welfare, and Health Policy*, 10 FORDHAM INTEL. PROP. MEDIA & ENT. L.J. 185, 196 (1999).

may use a license agreement to maneuver around intellectual property limitations that would have gone into effect had there been a sale.¹⁴⁵ This uncertainty in the law has not slowed the rapid pace by which companies have employed the use of license agreements, especially after the Supreme Court decided the issue of international exhaustion.

It is this article's argument that, unless and until the Supreme Court rules otherwise, intellectual property rightsholders will continue to use license agreements to keep products outside the secondary market.¹⁴⁶ Further, this article will explain which steps intellectual property rightsholders may take to maximize the probability their license agreements will be enforced,¹⁴⁷ and what effect this enforcement may have on damages.¹⁴⁸

A. *How Common Are License Agreements?*

The practice of covering digital content with license agreements already pervades the marketplace.¹⁴⁹ For example, Amazon licenses its digital content, and does not sell it.¹⁵⁰ When a user downloads a book from Amazon, he has agreed to licensing agreements that do not allow for lending or re-sale.¹⁵¹ The current market continues to see an increase in demand for "streaming" and digital products, such as provided by YouTube, Spotify, iTunes, and Netflix.¹⁵² Libraries are entering into more licensing agreements as books and content become digital.¹⁵³ Shrinking budgets often mean libraries are forced to decide between maintaining payment of license fees for access to e-books, and offering

145. John P. Uetz, Note, *The Same Song and Dance: F.B.T. Productions, LLC v. Aftermath Records and the Role of Licenses in the Digital Age of Copyright Law*, 57 VILL. L. REV. 177, 191 (2012).

146. See *infra* Section V.A.

147. See *infra* Section V.B.

148. See *infra* Section V.C.

149. Uetz, *supra* note 145, at 190.

150. See B.J. Ard, *Confidentiality and the Problem of Third Parties: Protecting Reader Privacy in the Age of Intermediaries*, 16 YALE J.L. & TECH. 1, 42 (2013); see also *Kindle License Agreement and Terms of Use*, AMAZON, <https://www.amazon.com/gp/kindle/kcp/install.html?ie=UTF8&mobile=1&tou=1> [<https://perma.cc/8NZW-GUJK>] (last updated Oct. 7, 2017) ("Unless otherwise specified, Digital Content is licensed, not sold, to you by the Content Provider.").

151. Amazon secured a patent on the re-sale of its digital content. U.S. Patent No. 8,364,595 (filed May 5, 2009) (issued Jan. 29, 2013).

152. Rub, *supra* note 39, at 782.

153. See Rachel Ann Geist, Comment, *A "License to Read": The Effect of E-Books on Publishers, Libraries, and the First Sale Doctrine*, 52 IDEA 63, 92 (2012) (arguing that under licensing regimes, libraries are stripped from owning their own content and are subject to publishers' contractual restrictions and changing fees).

many of their other programs.¹⁵⁴ Therefore, the practice of major companies in the mainstream marketplace is to move toward license agreements.

B. Are License Agreements over Intellectual Property Actually Sales?

Whether an intellectual property rightsholder can restrict a sale in some manner as to retain ownership rights remains an issue which is highly fact-sensitive.¹⁵⁵ After all, there must be a *sale* for there to be any “first sale” doctrine to apply in the first place. Savvy and enterprising intellectual property rightsholders, as they should, are going to look for ways to retain as many rights and as much control as possible. In the digital age, the leading way to avoid copyright and patent exhaustion is the license agreement.¹⁵⁶ It is this article’s argument that intellectual property rightsholders will use licenses to their advantage, especially in the digital age, to avoid “sales” that would otherwise exhaust their intellectual property rights.

The Supreme Court left open potential doors for patent and copyright owners to retain control over their intellectual property, including contract laws structuring license agreements to restrict re-sale.¹⁵⁷ Even so, there has not been enough case law to determine an answer to the question of how an intellectual property rightsholder can ensure that a license *de jure* does not turn into a sale *de facto*. And equally important to ask, how can the intellectual property rightsholder ensure such contracts or post-sale restrictions remain enforceable?

With respect to the patent laws, *Lexmark* is clear: once there is a sale, patent infringement suits are no longer available for subsequent sales.¹⁵⁸ However, licensing has become extremely common regarding software and digital content

154. Tim Spalding, *E-Book Economics: Are Libraries Screwed?*, LIBRARYTHING BLOG (Oct. 7, 2009), <http://www.librarything.com/blogs/thingology/2009/10/ebook-economics-are-libraries-screwed/> [https://perma.cc/N2P5-6RHM].

155. Dorothy R. Auth & Howard Wizenfeld, *Avoiding Patent Exhaustion: Structuring Agreements in View of the Latest Jurisprudence*, *The National Law Review* (Jan. 5, 2018.), <https://www.lexology.com/library/detail.aspx?g=f4faaaa5-3e25-4539-b0f1-e746b1449945> [https://perma.cc/2W7E-6Q82].

156. Uetz, *supra* note 145, at 179.

157. “The single-use / no-resale restrictions in [plaintiff’s] contracts with customers may have been clear and enforceable under contract law ... Because the patentee is exchanging rights, not goods, it is free to relinquish only a portion of its bundle of patent protections ... The purchasers might not comply with the restriction, but the only recourse for the licensee is through contract law, just as if the patentee itself sold the item with a restriction.” *Impression Products, Inc. v. Lexmark Int’l, Inc.*, 137 S.Ct. 1523, 1531-35 (2017); *see also* D. Brian Kacedon & Kevin D. Rodkey, *The Aftermath of Impression Products v. Lexmark*, *LAW 360* (Nov. 13, 2017), <https://www.law360.com/articles/970183/the-aftermath-of-impression-products-v-lexmark> [https://perma.cc/V72K-MC6C].

158. This rule is notwithstanding purchasers attempting to make their own copies of the patented item. *Lexmark*, 137 S.Ct. at 1529.

agreements.¹⁵⁹ Whether these transactions are actually licenses rather than sales is frequently the subject of copyright litigation.¹⁶⁰ The same principles in this copyright litigation can easily be transferred over to patent litigation. Some circuit courts have already addressed the issue of licensing intellectual property with various legal tests.¹⁶¹

The Ninth Circuit, Second Circuit, and Federal Circuit have crafted tests to determine whether a license agreement regarding intellectual property should instead function as a sale.¹⁶² The Ninth Circuit applies three main factors: whether the owner (1) specifies that the user is granted a license; (2) significantly restricts the user's ability to transfer the software; and (3) imposes notable use restrictions.¹⁶³ In contrast, the Second Circuit shows more deference to the buyer's expectations based on the actions of the parties, using an "economic realities" test to determine whether it is more sensible to define the transaction as a sale or as a license.¹⁶⁴ Finally, the Federal Circuit focuses its attention on the restrictions placed upon the user's rights, rather than any formal title of the agreement.¹⁶⁵

Enterprising companies and intellectual property rightsholders are going to structure transactional agreements within these rulings to maximize the probability that courts define the transaction as a license rather than as a sale.¹⁶⁶ The Ninth Circuit test gives intellectual property rightsholders "magic words"

159. *Id.*

160. *Id.* at 1534-35.

161. Tests to determine licensing include "whether the copyright owner specifies that the user is granted a license, significantly restricts the user's ability to transfer the software, and imposes notable use restrictions." *Vernor v. Autodesk, Inc.*, 621 F.3d 1102, 1111 (9th Cir. 2010). The Federal Circuit places less importance on formal title of the agreement and more importance on the restrictions on the consumer's rights. *DSC Comm. Corp. v. Pulse Comm., Inc.*, 170 F.3d 1354, 1360-61 (Fed. Cir. 1999). The Second Circuit inquires into whether "the party exercises sufficient incidents of ownership over a copy of the program to be sensibly considered the owner of the copy." *Krause v. Titleserv, Inc.*, 402 F.3d 119, 124 (2nd Cir. 2005).

162. *See Vernor*, 621 F.3d 1102; *Krause*, 402 F.3d at 124; and *DSC Comm. Corp.*, 170 F.3d at 1362.

163. *Vernor*, 621 F.3d at 1111-12 (holding that both the original customer and the subsequent re-seller of software had violated the terms of the license agreement which recited that Autodesk retained all rights of ownership and the customer had only a non-exclusive and non-transferrable license).

164. *Krause*, 402 F.3d at 124 (holding that an employer did not violate an employee's license agreement not to modify software code when the code was created for the employer's sole benefit and the employer was allowed to use the code "forever").

165. *DSC Comm. Corp.*, 170 F.3d at 1361-62 (rejecting the argument that all licensees are automatically non-owners and instead looking at which particular rights are restricted).

166. Of course, more sophisticated buyers and licensees (or anyone situated in a position to negotiate the terms of a potential license) can learn from these cases as well. License agreements that give buyers more control over rights that resemble ownership, such as transferability and indefinite possession, are more likely to be deemed sales than licenses. *See id.*

to contract around restrictions on the scope of their control. Intellectual property rightsholders will certainly tuck such language into their transaction agreements, safely hidden away from the attention span of the average consumer. If the license is more aggressive on the front end of restricting transfer and use, the Ninth Circuit test will likely be satisfied. To appease the Second Circuit and the Federal Circuit as well, the intellectual property rightsholder should focus more attention on the actions of the parties rather than on the terms of the license agreement itself. The owner must do more than call the agreement a license: he or she must enforce such restrictions so that a reasonable person would believe the intellectual property rightsholder still retained ownership rights.¹⁶⁷

There is also debate over the efficiency and use of “click-wrap” licenses, and such enforcement is frequently litigated.¹⁶⁸ There must be proper notice of the license agreement and must otherwise fall into proper fairness.¹⁶⁹ The enforceability of contracting around the core doctrines of intellectual property law is still unclear under current law, but such contracts have typically been enforced.¹⁷⁰

While there is still debate over the extent to which intellectual property rightsholders can license around intellectual property restrictions, the language of these Supreme Court cases¹⁷¹ and other circuit cases makes clear that intellectual property rightsholders will have the ability to license, instead of sell, their digital goods.¹⁷² All of these combined factors mean that companies and intellectual property rightsholders will move toward licensing their digitized copies to control their works. Intellectual property rightsholders will have to consider the impact of licenses if they sell abroad as well.¹⁷³

Therefore, based on these cases, sellers of patented or copyrighted products and digital content must ask themselves: “Are we going to ‘sell’ this product, or are we going to license? If this is a license, what rights will be granted? What are the economics of selling the patented product abroad now that international exhaustion comes into play?” These are important questions, and often depend very heavily on the context of the industry within which the product is sold.

167. Despite how companies may draft license agreements in practice, the author would argue toward more courts adopting the Second Circuit and Federal Circuit tests, as a matter of fairness to consumers.

168. Among these cases, *see generally* ProCD, Inc. v. Zeidenberg, 86 F.3d 1447, 1448-49 (7th Cir. 1996); and SCO Group, Inc. v. Novell, Inc., 578 F.3d 1201, 1206 (10th Cir. 2009). For an example of the prototypical software license agreement, *see* Cahoy, *supra* note 6, at 153.

169. Brower v. Gateway 2000, Inc., 246 A.D.2d 246, 251, 253 (N.Y. App. Div. 1998).

170. Rub, *supra* note 39, at 809. *See generally* Ritchie v. Williams, 395 F.3d 283, 287-89 (6th Cir. 2005) (holding that provisions restricting the future transfer of copyrighted goods are enforceable under contract law).

171. *See* Kirtsaeng v. John Wiley & Sons, 133 S.Ct. 1351 (2013); Impression Products, Inc. v. Lexmark Int’l, Inc., 137 S.Ct. 1523 (2017).

172. Greger, *supra* note 137, at 300.

173. Auth & Wizenfeld, *supra* note 155.

C. *Which Damages Will Apply: Breach of Contract, or Intellectual Property Infringement?*

What is the effect of a consumer purchasing a product covered by intellectual property law, then additionally agreeing by contract to more restrictions than would have been allowed by either copyright law or patent law? Can breach of contract cover remedies and damages that copyright and patent infringement cannot?¹⁷⁴

Intellectual Property rightsholders will have to consider their access to remedies when the consumer decides to violate the terms of the license agreement. If the damages are low enough, the consumer may calculate the risk that it is worth re-selling or otherwise violating the terms of the license agreement, regardless of contractual restrictions.¹⁷⁵ Does failure to follow the license constitute breach of contract, or infringement of intellectual property? This inquiry is highly fact-sensitive and slight variations in facts may cause wildly different damage calculations.¹⁷⁶ For a finding of breach of contract, the intellectual property rightsholder will typically receive expectation damages.¹⁷⁷ On the other hand, a finding of infringement will cause copyright or patent infringement damages to control.¹⁷⁸ For patent infringement, the intellectual property rightsholder can receive “damages adequate to compensate for the infringement, but in no event less than a reasonable royalty.”¹⁷⁹ Otherwise, the patent holder can forgo actual damages and elect to receive the expected value of a hypothetical license. In a similar vein, a copyright owner can elect to receive either disgorgement of the infringer’s actual profit, or statutory damages.¹⁸⁰ The

174. After the *ProCD* decision, scholars worried that contract law would “kill” copyright law. Guy A. Rub, *Copyright Survives: Rethinking the Copyright-Contract Conflict*, 103 VA. L. REV. 1141 (2017) (arguing the effect of contract law on the public domain and copyright law in general has remained minimal).

175. This idea of contract parties performing a cost-benefit analysis whether to honor their contract or pursue more favorable options is commonly referred to as “Efficient Breach Theory.” See generally Cahoy, *supra* note 6, at 136-37.

176. Some intellectual property rightsholders may not particularly care which kind of damages they are entitled to, as long as they are compensated; however, they should at least be aware that this determination will likely require many expensive hours of an attorney’s time and may even require litigation in its own right.

177. See Roger D. Blair & Thomas F. Cotter, *An Economic Analysis of Damages Rules in Intellectual Property Law*, 39 WM. & MARY L. REV. 1585, 1587-88 (1998).

178. Patent infringement damages are controlled by 35 U.S.C. § 284. Copyright infringement damages are controlled by 17 U.S.C. § 504(b) (2010) (“The copyright owner is entitled to recover ... any profits of the infringer that are attributable to the infringement and are not taken into account in computing the actual damages.”).

179. 35 U.S.C. § 284 (2012).

180. 17 U.S.C. § 504(c)(1) (2010) (“The copyright owner may elect ... to recover, instead of actual damages and profits, an award of statutory damages ... in a sum of not less than \$750 or more than \$30,000 as the court considers just.”).

harder question is determining which calculation of damages to choose when either breach of contract or intellectual property infringement could be applied.¹⁸¹

First, if the license is exclusive, the only remedy available to the intellectual property rightsholder is breach of contract.¹⁸² Damages in this case will be limited to contract expectation damages.¹⁸³ Further, the absence of contractual privity of any subsequent buyers and sellers means the original intellectual property rightsholder will be limited to notoriously difficult claims such as tortious interference with contract.¹⁸⁴ Possible contractual breaches like this may become less of a concern as technology advances to place greater restrictions on physical copies and re-sale, but the rightsholders should be aware that damages will be limited to breach of contract instead of intellectual property infringement and limited causes of action against third parties who purchase downstream.¹⁸⁵

If the license is non-exclusive, different courts may determine the exact same violation constitutes either breach of contract or intellectual property infringement, depending on the jurisdiction.¹⁸⁶ Courts apply a variety of tests to determine whether the complaint arises under contract law or federal infringement laws, again increasing the uncertainty of enforceability.¹⁸⁷ The

181. See Melville B. Nimmer and David Nimmer, 3 *Nimmer on Copyright* § 12.01[A] (2010) (The distinction between breach of contract damages and infringement damages is a difficult line to draw and “among the knottiest” in intellectual property). Other procedural issues outside the scope of this article should still be taken into account, such as awards of attorneys’ fees and variations in the statute of limitations. See generally Robert P. Merges, *A Transactional View of Property Rights*, 20 BERKELEY TECH. L.J. 1477, 1505 (2005).

182. Omri Ben-Shahar, *Damages for Unlicensed Use*, 78 U. CHI. L. REV. 7, 10 (2011).

183. Under the contract common law, the remedy of expectation damages would serve to ensure the non-breaching party is placed in the same position that party would have been if the breach had not occurred and the contract had been performed as agreed. When dealing with intellectual property license agreements, the damage is likely to be the difference between the original market value of outright sale and the price reduction in consideration of the restriction being placed on the intellectual property. See Cahoy, *supra* note 6, at 165.

184. *Id.*

185. Daniel Hemel, *Trade and Tradeoffs: The Case of International Patent Exhaustion*, 116 COLUM. L. REV. 17, 19 n.8 (2016) (noting that neither of the parties that argued *Lexmark* before the Federal Circuit argued that violations of contractual restrictions placed on licensed patented goods would be entitled to anything more than contract remedies rather than patent remedies, and that such contracts could not be enforced against third parties).

186. Ben-Shahar, *supra* note 182 at 10-11.

187. For treatment on this issue, see James M. McCarthy, Comment, *Federal Subject Matter Jurisdiction: When Does a Case Involving the Breach of a Copyright Licensing Contract “Arise Under” the Copyright Act?*, 19 U. DAYTON L. REV. 165, 175-84 (1993). Some tests include whether the dispute is “informed by the substantive law of copyright,” within “the subject matter of copyright,” or whether there is “more than an aroma of copyright.” Ben-Shahar, *supra* note 182 at 12.

fuzzy boundaries created by contracting around intellectual property cause difficulty for courts to apply uniform standards.¹⁸⁸

To maximize potential damages and to ensure buyers do not choose efficient breach, intellectual property rightsholders will likely incorporate express language in the license agreement that will automatically rescind the license upon material breach, such as nonpayment. This will allow the intellectual property rightsholder to rescind the license and hold the licensee liable for infringement for uses thereafter. This method also allows the rightsholder a clear path towards arguing for infringement damages, because with no license, damages are only recoverable for infringement.¹⁸⁹

Issuing a license and then pulling out the rug from underneath the infringer allows the intellectual property rightsholder to have its proverbial cake and eat it too. Not only does the license agreement help the rightsholder avoid exhaustion; it also keeps open the doors to both breach of contract and intellectual property infringement causes of action. There is no doubt that intellectual property rightsholders will structure their agreements to allow for the maximum damages and other remedies available to them through this schema.

D. Do Consumers Care?

As explored in previous sections, intellectual property rightsholders can avoid the pitfalls of “sales” by attempting to enter license agreements. This article predicts that an increasing number of companies will attempt license agreements until the courts begin to come down with more affirmative rulings on the issue. As demand for digital content continues to grow, will consumers care that their rights are restricted? Restrictions need to be placed on the rights of consumers for the courts to view license agreements as licenses rather than sales, which may lead to unhappy consumers. Even if licenses are legally viable, companies may think twice before possibly alienating a sizeable portion of their market.

Further, licensees and downstream buyers will certainly not be happy dealing with the uncertainties in this area of law.¹⁹⁰ When there is a sale, licensees and downstream purchasers know precisely when they are free to use re-sale patented inventions and copyrighted works. It may chill the economic marketplace when businesses and downstream sellers are unable to predict what damages they may face if they are found in either breach of contract or

188. McCarthy, *supra* note 187 at 183-84.

189. For general tips on how to structure a license agreement to maximize enforceability and potential damages, see Auth & Wizenfeld, *supra* note 155.

190. Lorelei Ritchie, *Re-evaluating Declaratory Judgment Jurisdiction in Intellectual Property Disputes*, 83 IND. L.J. 957, 975 (2008).

intellectual property infringement.¹⁹¹ Intellectual property rightsholders and consumers generally benefit from the certainty of knowing how to structure license agreements most advantageously toward either party.¹⁹² Sellers will certainly want to ensure the maximum extent of protection will be enforced, and buyers will certainly want to know whether the license agreement they are signing can actually be enforced.¹⁹³ Sellers of intellectual property must take care not to alienate a potential customer base by placing onerous restrictions on the property rights of their buyers.

CONCLUSION

The Supreme Court's decisions in *Kirtsaeng* and *Lexmark* mean that intellectual property rightsholders will have to look for alternate methods of keeping their products outside of the secondary market. Online transactions are becoming more commonplace, increasing the rate at which consumers buy goods on the secondary market.¹⁹⁴ Some businesses are built entirely on the premise of facilitating all transactions exclusively on secondary marketplace goods.¹⁹⁵ Because of the secondary market's rise in prominence and the Supreme Court's rulings to adopt international exhaustion, intellectual property rightsholders will also have to look for alternative methods of retaining control over intellectual property. Based on current practices, intellectual property rightsholders are attempting to retain control through license agreements.¹⁹⁶ There still remains a lack of uniformity regarding how courts interpret contractual license provisions that attempt to maneuver around intellectual property limitations, so intellectual property rightsholders will have to take care to see how courts rule on this issue going forward.¹⁹⁷

191. Javier M. Leija, *The Patent Exhaustion Doctrine: Patent Holders' Rights Versus the Public's Interest in Using the Invention*, 2 PHOENIX L. REV. 163, 186 (2009).

192. *Id.*

193. Chiappetta, *supra* note 122, at 1116, 1120 (arguing that intellectual property owners will have to offset their prices based on what buyers are willing to pay after their rights are contractually restricted).

194. Lynda J. Oswald, *Statutory and Judicial Approaches to Gray Market Goods: The "Material Differences" Standard*, 95 KY. L.J. 107, 107-08 (2006-2007).

195. Victoria Gomelsky, *Watch Brands Confront a Risky Business: The Secondhand Market*, N.Y. TIMES (Jan. 15, 2018), <https://www.nytimes.com/2018/01/15/fashion/watches-resale-maximilian-busser.html> [<https://perma.cc/N4K6-TZ34>] (arguing that secondary markets frequently change the dynamics of the gray market).

196. "[W]ith increasing alacrity, people agree to terms by clicking away at electronic standard forms on websites and while installing software ('clickwrap' contracts)." Robert A. Hillman & Jeffrey J. Rachlinski, *Standard Form Contracting in the Electronic Age*, 77 N.Y.U. L. REV. 429, 431 (2002) (noting also that consumers often have no interest in reading or understanding the license agreements).

197. Carlyle C. Ring, Jr., *Uniform Rules for Internet Information Transactions: An Overview of Proposed UCITA*, 38 DUQ. L. REV. 319, 321-23 (2000).

Regardless, it appears the demand for doing business digitally is here to stay. As an executive said about doing business exclusively on the secondary market: “The younger generation ... they’re not looking to shop the same way their grandparents did.”¹⁹⁸

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198. Gomelsky, *supra* note 195.

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