STATUTORY DOMAIN AND THE COMMERCIAL LAW OF INTELLECTUAL PROPERTY

John F. Duffy and Richard Hynes*

For more than a century, the commercial law of intellectual property has generated intense controversy with ever-growing stakes. The central fulcrum in the area—the “first sale” or “exhaustion” doctrine—has produced four recent Supreme Court cases, a host of lower court decisions, and a mountain of scholarly criticism. Scholars who otherwise agree on little unite in excoriating the doctrine as a “per se,” “ham-handed,” “sterile” rule that is “frustratingly under-theorized” and grounded in “a set of arid technicalities of no particular value.” Champions of intellectual property dislike the doctrine because they want infringement suits to enforce contractual restrictions on goods embodying intellectual property. Skeptics of intellectual property want a stronger doctrine that would sweep away all contractual restrictions and encumbrances on such goods. We argue that both camps wrongly assume that the doctrine was created through common law reasoning in pursuit of substantive policies such as fostering an unencumbered flow of goods in commerce. This Article demonstrates that, in both its historical origins and its current application, the law in this area is based on statutory interpretation and is directed toward the more nuanced goal of limiting the domain of intellectual property statutes to avoid displacing other ar-

* The authors are, respectively, the Samuel H. McCoy II Professor of Law and the Nicholas E. Chimicles Research Professor of Business Law and Regulation at the University of Virginia School of Law. For helpful comments and suggestions, we thank participants at workshops at Boston University, George Mason University, the Munich Intellectual Property Law Center and Max-Planck-Institut für Innovation und Wettbewerb, the University of Toronto, the University of Virginia, and the William & Mary Law School.
eas of law. This thesis explains why the foundational cases reject intellectual property infringement claims but are agnostic as to whether the unsuccessful plaintiffs could achieve their goals under contract or property law theories. The century-long development of law in this area also provides useful insights for statutory interpretation theory by illustrating precisely how courts limit a statute's domain so that one area of law appropriately yields to another.

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INTRODUCTION

The modern law of intellectual property ("IP") includes—or is thought to include—not only rules governing the existence and extent of rights (for example, rules about the validity and infringement of patents, copyrights, and trademarks) but also doctrines regulating the commerce in goods embodying IP rights (such as books and smartphones). Such commercial law accounts for an entire subfield in IP law, with its own casebooks, treatises, and professional organizations.¹ In recent years, the importance of the area has greatly expanded both because intellectual property has become more economically valuable and because the information revolution has allowed rightholders to create and deploy ever more nuanced licensing agreements, which are frequently accepted with the mere click of a button.² Indeed, the commercial law of IP has become so important that cases in the field are now included as part of the basic canon taught in modern property and contract law.³

The central fulcrum of the commercial law of IP is the so-called "first sale" or "exhaustion" doctrine (names used interchangeably in this Arti-


³ See E. Allan Farnsworth et al., Contracts 227–30 (8th ed. 2013) (setting forth the copyright licensing case ProCD, Inc. v. Zeidenberg, 86 F.3d 1447 (7th Cir. 1996), to explain contract formation); Thomas W. Merrill & Henry E. Smith, Property: Principles and Policies 458–64 (2d ed. 2012) (using ProCD as a principal case to show the relationship between licenses and property).
The importance of that doctrine can be easily understood in stark terms: Certain commercial transactions in goods—at least sales and perhaps other transactions too—"terminate[]" or "exhaust[ ]" IP rights in those goods. Thus, IP lawyers advising clients on commercial transactions must constantly ask whether, and to what extent, any IP rights will survive the contemplated transactions.

The practical importance of exhaustion is also demonstrated by the breadth of the case law and the controversy surrounding the doctrine. The doctrine rests on a string of U.S. Supreme Court precedents dating back to the mid-nineteenth century, but the area continues to generate litigation. Within the last decade, the Supreme Court has issued decisions on patent and copyright exhaustion in four separate cases (one of which was a deadlocked per curiam affirmation). The doctrine also continues to generate a large body of lower court cases and a virtual mountain of scholarly commentary.

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4 The doctrine is more commonly called "first sale" in the copyright area and "exhaustion" in patents, but sophisticated observers treat the labels as interchangeable. See, e.g., Kirtsaeng v. John Wiley & Sons, Inc., 133 S. Ct. 1351, 1355, 1371 (2013) (using the terms "first sale," "exhausted," and "exhaustion" to describe the doctrine in copyright); 5 Donald S. Chisum, Chisum on Patents: A Treatise on the Law of Patentability, Validity and Infringement § 16.03[2][a], at 16-362.8 (2014) (using both "first sale" and "exhaustion" to describe the patent doctrine).

5 Kirtsaeng, 133 S. Ct. at 1355 (describing the copyright doctrine as providing that, once copyright works are "lawfully sold" or "ownership otherwise lawfully transferred," the copyright owner's exclusive distribution rights are "exhausted"); Quanta Computer v. LG Elecs., 553 U.S. 617, 625 (2008) (describing the "longstanding doctrine of patent exhaustion" as providing that "the initial authorized sale of a patented item terminates all patent rights to that item").

6 In addition to Quanta Computer and Kirtsaeng, supra notes 4 and 5, the Court decided the patent exhaustion case Bowman v. Monsanto Co., 133 S. Ct. 1761 (2013), and rendered a per curiam affirmance due to an equally divided Court in the copyright exhaustion case Costco Wholesale Corp. v. Omega, 562 U.S. 40 (2010).

The doctrine also raises important theoretical issues, for it defines the relationship between IP and other areas of commercial law. Consider, for example, the seminal 1908 copyright case *Bobbs-Merrill Co. v. Straus.* The plaintiff in the case, the publisher Bobbs-Merrill Company, owned the copyright in a book entitled *The Castaway* and sold copies of it to wholesalers with a notice in each book stating: "The price of this book at retail is one dollar net. No dealer is licensed to sell it at a less price, and a sale at a less price will be treated as an infringement of the copyright." The wholesalers sold the books to the brothers Isidor and Nathan Straus, who operated the famous retail store R.H. Macy & Company. Macy's, in turn, sold the books at retail for eighty-nine cents, which Macy's knew to be contrary to the notice's purported restriction. Bobbs-Merrill sued to enforce the one-dollar retail price condition.

From the perspective of contract law, a reasonable initial instinct might be to enforce the condition. A fundamental purpose of contract law is to enforce private agreements, and while some doctrines such as unconscionability limit parties' general freedom to contract, such doctrines are at their nadir in cases involving sophisticated commercial parties. The difficulty with a contract theory is that Bobbs-Merrill had contracts only with the wholesalers, so the publisher had no contract action against Macy's.

To prevail against Macy's, Bobbs-Merrill needed a property rights theory, for property rights operate against the entire world, not merely those within contractual privity. Superficially, the copyright statute at the time seemed to provide just such a theory, for it granted copyright

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8 210 U.S. 339 (1908).

9 Id. at 341.

10 The full caption of the case is "Bobbs-Merrill v. Straus et al., doing business as R.H. Macy & Company." Id. at 339. We refer to the defendants as "Macy's." In addition to his commercial success and IP litigation, Isidor Straus is also famous for perishing with his wife, Ida, on the Titanic. She refused to leave the ship without her husband, and he declined to go while the life-boats were still being reserved for women and children. Their decision to stay together on the doomed vessel has become legendary, see June Hall McCash, A Titanic Love Story: Ida and Isidor Straus (Mercer Univ. Press 2012), even earning a scene in the 1997 film *Titanic,* see Full Cast & Crew, IMDb, http://www.imdb.com/title/tt0120338/fullcredits?ref_=tt_cl_sm#cast (last visited February 14, 2016), archived at https://perma.cc/4MMU-DSES?type=source (noting the actors cast as Ida and Isidor Straus).

holders the "sole liberty of . . . vending" their works.\textsuperscript{12} Not unreasonably, Bobbs-Merrill took the statute at its word and argued that each and every vending of a copyrighted book needed a license.\textsuperscript{13} The notice Bobbs-Merrill placed in its books conferred the necessary license for each sale in the chain of distribution, provided that the ultimate retail price was one dollar or more. Since that condition was violated, Macy's sales were unlicensed and thus infringing.

Emphasizing that "[t]here is no claim in this case of contract limitation, nor license agreement controlling the subsequent sales of the book," the Supreme Court treated the case as presenting "purely a question of statutory construction."\textsuperscript{14} Nevertheless, Bobbs-Merrill lost, with the Court reasoning that:

To add to the right of exclusive sale the authority to control all future retail sales . . . would give a right not included in the terms of the statute, and, in our view, extend its operation, by construction, beyond its meaning, when interpreted with a view to ascertaining the legislative intent in its enactment.\textsuperscript{15}

In short, the Court viewed control over "all future . . . sales" (that is, after the first sale) as being an addition or extension "beyond [the] meaning" of the statute's exclusive right to vend.

Bobbs-Merrill is widely considered to be a foundational precedent for the exhaustion doctrine, and the standard view among modern commentators is that the case—and exhaustion more generally—is based on substantive "common law" policies disfavoring "restraints on alienation, . . . servitudes in general, and servitudes on chattels in particular."\textsuperscript{16} The problem with that standard view is that such policy justifications are wholly absent in Bobbs-Merrill. While a few prior commentators have

\textsuperscript{12} Bobbs-Merrill, 210 U.S. at 348 (citing An Act to Amend Title Sixty, Chapter Three of the Revised Statutes of the United States Relating to Copyrights § 4952, 26 Stat. 1106, 1107 (1891) (repealed 1909)).

\textsuperscript{13} Id. at 349.

\textsuperscript{14} Id. at 350.

\textsuperscript{15} Id. at 351.

\textsuperscript{16} Katz, supra note 7, at 64; see also Hovenkamp, supra note 7, at 493 (asserting "[t]he first sale doctrine grew out of the common law's strong policy against restraints on alienation"); Reese, supra note 7, at 580 (similar); Rothchild, supra note 7, at 13 (similar); Rub, supra note 7, at 754 (similar).
noted the puzzling absence of such policy justifications,\textsuperscript{17} so accepted is the standard view that some commentators noting the problem have gone so far as to assert that the Supreme Court must have been dissembling—or at least not telling the whole truth—when, in cases like \textit{Bobbs-Merrill}, it claimed to be engaged in statutory interpretation.\textsuperscript{18}

Our thesis is that the Court was telling the truth and that the modern commentators are wrong. The legal doctrine in the area pursues not common law policies disfavoring encumbrances or restraints on alienation, but instead the more nuanced goal of limiting the scope or domain of IP statutes to avoid displacing the law in other fields, such as general contract, property, and antitrust law. Such domain limitations on a statute's scope are now well known in the statutory interpretation literature,\textsuperscript{19} and \textit{Bobbs-Merrill} fits the pattern perfectly. The \textit{Bobbs-Merrill} Court stated that it was engaged solely in statutory interpretation; it characterized the issue in the case as concerning "the extent of the protection . . . given by the copyright statutes";\textsuperscript{20} it continued that spatial metaphor in holding that courts should not "extend [the statute's] operation, by construction, beyond its meaning"\textsuperscript{21} and it remained agnostic as to any possible remedies the plaintiff might have outside of copyright law.

As we show in Part I below, \textit{Bobbs-Merrill} is not unique. It follows a pattern repeated in many other foundational exhaustion cases, which (1) claim to be engaged in statutory interpretation; (2) rely on spatial meta-

\textsuperscript{17} See Robinson, supra note 7, at 1470 (noting that, although modern commentary associates the first sale doctrine "with the public policy against restraints on alienation and with antitrust policy against restraints of trade . . . neither rationale appears in \textit{Bobbs-Merrill}").

\textsuperscript{18} See, e.g., Perzanowski & Schultz, supra note 7, at 929–30 (asserting that "[d]espite the \textit{Bobbs-Merrill} Court’s claim that it acted merely as a faithful interpreter of the terms of the Copyright Act,” the Court must have been “engaged in judicial weighing of competing interests and policies” to formulate “a common law defense to infringement” that was “nowhere to be found within [the text of the Copyright Act]”); Rub, supra note 7, at 753–54 (asserting that “[w]hile \textit{Bobbs-Merrill} is a statutory interpretation case, the decision cannot be fully understood without appreciating” the then-existing “extreme hostility to vertical restraints along the chain of distribution and the common law rule that prohibited servitudes on chattels and restraints on alienation”); Van Heuveling, supra note 7, at 911 (asserting that even though it does not cite “cases addressing chattel servitudes,” \textit{Bobbs-Merrill} must be grounded in “hostility toward running restrictions on chattels”).

\textsuperscript{19} See infra notes 34–36 and accompanying text.

\textsuperscript{20} \textit{Bobbs-Merrill}, 210 U.S. at 346 (emphasis added).

\textsuperscript{21} Id. at 351.

\textsuperscript{22} Id. at 350 (recognizing the case presented no claim based on a contract or licensing agreement).
phors in holding certain matters to be "outside," "beyond," or "not within" the relevant IP statute; and (3) almost invariably, disclaim any attempt to adjudicate the relief plaintiffs might obtain outside of IP law. That pattern is not even limited to the case law. When Congress codified the exhaustion doctrine in copyright law, the codification limited the scope of rights under the copyright statute, but showed no intent to control the results that might be reached through other bodies of law. Thus, the overarching theme in the doctrinal area (both in case law and in statutory codifications) is that IP statutes will be interpreted to avoid displacing generally applicable commercial law including contract, property, and antitrust law. In effect, the doctrine functions like a choice-of-law rule or a jurisdictional limit: It divides areas of law without necessarily dictating ultimate substantive results.

This view explains why the doctrine disappoints both champions and skeptics of broad IP rights, for each side seeks to have IP law do too much. For example, Professor Richard Epstein—generally an advocate of strong IP rights and a critic of the exhaustion doctrine—has argued that copyright's first sale doctrine "undermines freedom of contract by invalidating consensual restrictions of any further sale or disposition." Yet the first sale doctrine does no such thing. It invalidates nothing. It merely requires contractual agreements to be enforced through contract claims, not through IP infringement actions. Professor Epstein rejects reliance on contract alone because contract claims would "not give rise to a federal cause of action" and would be "subject to any standard defenses that could be raised in ordinary contract actions." But in our view, limiting contracting parties to contractual remedies does not undermine freedom of contract but merely keeps IP statutes from displacing more general law where the statutes themselves include little or no indication that such law should be displaced.

The skeptics of broad IP property rights make the same kind of error. They support the exhaustion doctrine but want it to do much more: They want the IP cases recognizing the doctrine to be interpreted broadly "to

23 See infra notes 81–84 and accompanying text.
24 Epstein, supra note 7, at 503; see also F. Scott Kieff, *Quanta v. LG Electronics: Frustrating Patent Deals by Taking Contracting Options off the Table?*, 2008 Cato Sup. Ct. Rev. 315, 329–30 (arguing that the Supreme Court's exhaustion doctrine "do[es] violence to the expressed intent of even commercially sophisticated contracting parties").
25 Epstein, supra note 7, at 508.
reject the chattel servitude logic"\textsuperscript{26} and to "promot[e] free alienability"\textsuperscript{27} of goods embodying intellectual property. Yet again, the doctrine does not do that. It cuts off IP rights and thus frees the purchasers of goods from liability \textit{under IP statutes}. But it leaves those purchasers subject to the nuanced rules and carefully balanced policies of general commercial law. The doctrine's goal is to preserve, not to preempt.

Thus, because of the exhaustion doctrine, general commercial law applies much the same whether the underlying goods embody IP or not. Stated another way, for transactions in goods embodying IP (which today includes everything from books and DVDs to automobiles and dishwashers), routine commercial law issues—such as whether sales contracts can restrict purchasers' rights in using or reselling the goods, or whether the goods can be encumbered to bind downstream owners—are governed by the rules and remedies found in commercial law generally (that is, in the Uniform Commercial Code ("UCC"); state contract and property law; federal and state antitrust law; etc.), with that law neither supplemented nor supplanted by statutory IP law.

This Article proceeds as follows. After Part I demonstrates that the foundational exhaustion precedents are best viewed as establishing a statutory domain limit, Part II examines one important theoretical implication: Such domain limitations may be justifiably formalistic. Prior commentators from every perspective have noted exhaustion's formalism and have decried it—calling the doctrine a "sterile,"\textsuperscript{28} "ham-handed,"\textsuperscript{29} "per se rule"\textsuperscript{30} that is "frustratingly under-theorized"\textsuperscript{31} and grounded in little more than "a set of arid technicalities of no particular value."\textsuperscript{32} Yet, under our theory, that formalism is a strength, not a weakness. Formalism is not surprising in a domain limitation. As we discuss in Part II, exhaustion is analogous not so much to a common law decision about whether to allow or forbid a particular transaction, but to a

\textsuperscript{26} Van Houweling, supra note 7, at 914.
\textsuperscript{27} Rothchild, supra note 7, at 4.
\textsuperscript{29} See Herbert Hovenkamp, Response: Markets in IP and Antitrust, 100 Geo. L.J. 2133, 2155 (2012).
\textsuperscript{30} Id. at 2154.
\textsuperscript{32} See Epstein, supra note 7, at 509.
There, the Court held that the FDA lacked statutory authority to regulate cigarettes under the Food, Drug & Cosmetics Act even though the goal pursued by the agency—limiting minors' access to cigarettes—was very much consistent with public policy. As in that case, so too in exhaustion: Limits on statutory scope are enforced without a judicial assessment of good public policy in each case. We show specific examples and discuss the theoretical implications of that approach.

Part III of the Article distinguishes between, and explains, arbitrary and meaningful variations in the doctrine. Precisely because exhaustion is a formalistic domain limitation, a degree of arbitrariness exists as to where, precisely, the formal line is drawn. Such arbitrariness can in fact be seen in the doctrine. Indeed, though prior commentators have devoted little attention to this point, the precise trigger for exhaustion has varied across time and across fields of IP. Our thesis accounts for this variation and suggests that finding the optimal line is less important than maintaining a stable and clear line. Yet not all variations are arbitrary. Because exhaustion is based ultimately on statutory interpretation, the doctrine should be responsive to the particulars of the relevant IP statute. Again, we find the actual doctrine bears this out, and that some otherwise puzzling variations between patent and copyright exhaustion (for example, on the issue of so-called international exhaustion) arise from the different structures of rights under the patent and copyright statutes.

Part IV addresses the issues whether, and to what extent, IP rightholders can circumvent the exhaustion doctrine. Such issues have been much litigated in the courts and much discussed in the academic commentary. The split in views is predictable. IP owners want complete freedom to contract around exhaustion, while many IP commentators want the courts to forbid any circumvention. Once again, our thesis explains why the doctrine partially disappoints each side.

Before turning to the main parts of this Article, we note one additional point. In referring to statutory “domain,” we follow terminology originating in then-Professor Frank Easterbrook’s classic article Statutes’ Domains. While subsequent scholars have acknowledged that article’s

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34 Frank H. Easterbrook, Statutes’ Domains, 50 U. Chi. L. Rev. 533 (1983); see Caleb Nelson, Statutory Interpretation 863 (2011) (describing the article as “a classic” and noting that “the notion that statutes do have limited domains” is now generally accepted); see also Wil-
influence, the literature has so far lacked a good case study of statutory domain. As an example in his article, Easterbrook posited that, for a hypothetical statute requiring the leashing of dogs, the issue of whether cats needed to be leashed was beyond the statute’s domain. That simple example, however, was obviously overdetermined, for as Easterbrook himself noted, the hypothetical statute’s text was “too plain for argument.”

The case law on exhaustion supplies what the statutory interpretation literature has been missing—a clear example in which the Supreme Court has restricted statutory domain in a manner that illustrates many of the features articulated in Judge Easterbrook’s original article, including both (1) judicial judgments that a statute was simply “inapplicable” to the issue, and (2) rulings that leave the parties “remitted to whatever other sources of law might be applicable.” The doctrine in this area should interest not only IP scholars but also statutory interpretation theorists, for the century-long development of the law in this area provides insights into precisely how courts limit statutory scope or domain so that one area of law appropriately yields to another.

I. LIMITING THE DOMAIN OF INTELLECTUAL PROPERTY: ORIGINS

As discussed in the Introduction, we believe modern commentators are wrong in asserting that the exhaustion doctrine evolved from common law decisionmaking in which courts were pursuing substantive policies disfavoring personal property encumbrances and restraints on alienation. Instead, we think that the Supreme Court was being candid when, in Bobbs-Merrill and other cases, it claimed to be engaged in statutory interpretation. True, the Court was not parsing the meaning of a particular statutory word, phrase, or sentence; it was instead engaged in the broader interpretive exercise of defining the scope—or domain—of the statute as a whole. That process is, however, still recognizable as


35 See Easterbrook, supra note 34, at 535.
36 Id. at 533, 544.
37 See supra text accompanying notes 16–22.
statutory interpretation and is fundamentally different from a process of common law decisionmaking.

Our view is based on three recurring themes in the case law. First, the Court repeatedly claimed to be engaged in statutory interpretation, not merely in one isolated case, but in multiple cases. The Court was interested not in substantive commercial policies but instead in defining the appropriate scope of IP statutes, with the appropriateness judged by metrics familiar to statutory interpretation—namely, legislative meaning, intent, and purpose. Perhaps most tellingly, the Court found cases difficult where specific statutory provisions arguably suggested contrary results.

Second, in cases where the statutory rights were held to be exhausted, the Court repeatedly relied on spatial metaphors in describing its holdings—it concluded that the rights asserted by IP owners were "beyond" or "outside" the scope of the relevant statute. Such descriptions are consistent with the exhaustion doctrine being a domain limitation.

Third and finally, the Court often stated that it was agnostic about whether the IP owner might be able to achieve the same goal through other legal mechanisms, such as contract or property causes of action. Such agnosticism about ultimate results would be difficult to explain if the Court were engaged in pure policymaking directed toward substantive goals (such as forbidding IP owners from imposing alienation restrictions or encumbrances on the goods being sold).

A. Nineteenth-Century Patent Cases: The Evolution of a Domain Limit

The doctrinal development of the patent exhaustion doctrine during the nineteenth century can be divided into two periods: (1) 1846 to 1853; and (2) 1873 to 1895. In each of these periods, the Court addressed whether specific statutory provisions authorized the assertion of patent rights against parties to whom a patentee had transferred ownership of patented goods. In the first period, the Court considered rights under statutes authorizing extensions of patent terms. In the second, the focus was on a statute authorizing territorial division of patent rights. This organization both reinforces our theme that the case law was focused on statutory interpretation and faithfully reflects the issues as the Supreme Court perceived them.
The two earliest cases providing the foundation of patent law’s exhaustion doctrine involved patent term extensions. These cases plainly show that the doctrine originated in statutory interpretation, not common law decisionmaking to advance substantive policies.

*Wilson v. Rousseau*\(^{38}\) was an important first step in formulating the doctrine. Under the law at that time, patents lasted for fourteen years but could be extended for an additional seven. The patentee in *Wilson* received such an extension on a patent for a wood planing machine, and one issue in the case was whether owners of machines purchased during the original term needed new licenses to continue using their machines during the extended term. The Court held that they did not because of an enigmatic statutory savings clause protecting “assignees and grantees of the right to use the thing patented, to the extent of their respective interests therein.”\(^{39}\) That clause protected the “right to use”—not the complete set of statutory patent rights (to make, use, and sell)—with respect to “the thing patented,” which the Court interpreted to mean each physical copy of the patented machine.\(^{40}\) And it protected that right only to the “extent of [the grantees’] interests therein,” which the Court construed to mean the interests of an “owner” in continuing to use particular physical machines “purchased from the patentee.”\(^{41}\) The result was that owners of the patented machines were free to continue using their machines during the seven-year extended term.

In addition to parsing the language of the savings clause, *Wilson* gave a much more general reason for its result. The Court recognized that, once purchased from patentees, patented articles “go[] into common use” throughout the commercial world, and that if the savings clause were not interpreted to provide protection, extended patent terms would lead to “the common use [being] arrested.”\(^{42}\) Such a construction was an “unmixed evil” and “never contemplated by Congress.”\(^{43}\) Here, the Court recognized the potential for patent law to displace ordinary commercial practices, and it rejected such displacement based on considerations of statutory interpretation.

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\(^{38}\) 45 U.S. (4 How.) 646 (1846).

\(^{39}\) Id. at 680 (quoting Patent Act of 1836, § 18, 5 Stat. 117, 125).

\(^{40}\) Id. at 683.

\(^{41}\) Id. at 683–84.

\(^{42}\) Id. at 684.

\(^{43}\) Id.
Perhaps because the *Wilson* opinion is so obviously grounded in statutory interpretation, and thus tends to contradict the current narrative that exhaustion is a common law doctrine, modern commentators typically ignore or downplay *Wilson*'s importance. Yet *Bloomer v. McQuewan*, the more famous of the two early cases, directly relied on *Wilson*. *Bloomer* involved the very same patent at issue in *Wilson*, but that one patent had then been extended for *another* seven years by a special statute enacted by Congress. While that special statute did not have a savings clause like the general extension statute at issue in *Wilson*, the Supreme Court held that the two statutes should be construed "in pari materia" so that the special statutory extension was subject to all the conditions articulated in *Wilson*.

*Bloomer*'s in pari materia holding was sufficient to resolve the case, but the Court did not stop there. Instead, it explained more clearly the theoretical basis for *Wilson* by invoking a spatial metaphor. "[W]hen the machine passes to the hands of the purchaser," the Court reasoned, "it is no longer within the limits of the monopoly. It passes outside of it, and is no longer under the protection of the act of Congress." And once it passes "outside of" the patent laws, the machine becomes the purchaser's "private, individual property, not protected by the laws of the United States, but by the laws of the State in which it is situated." For clarity, the Court emphasized that, after the machine has passed outside of patent law, "[c]ontracts in relation to it are regulated by the laws of the State."

*Bloomer*'s spatial metaphor quickly became the Court's canonical way of describing the doctrine. For our purposes, the key point is that

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45 *Bloomer*, 55 U.S. at 549.

46 Id. at 548; see also id. at 550 (construing the special statute as "ingrafted on the general law" and thus subject to the conditions articulated in *Wilson*).

47 Id. at 549.

48 Id. at 550.

49 Id.

50 See, e.g., Chaffee v. Bos. Belting Co., 63 U.S. (22 How.) 217, 223 (1859) (stating that a machine sold by a patentee "is no longer within the limits of the monopoly" and "is no long-
this spatial analogy was grounded purely on statutory interpretation. The Court was quite obviously deploying standard tools of statutory construction in both *Wilson* and *Bloomer* (for example, *Bloomer*'s use of the *in pari materia* canon). Moreover, the Court relied on reasoning undergirding statutory domain limitations—namely, that the courts should hesitate to construe a statute as displacing large swaths of general law where statutory text and structure give little indication that such matters were considered and resolved in the legislative process.\(^{51}\) It is true, of course, that a very sophisticated view of statutory interpretation is essential to appreciating *Wilson* and *Bloomer*, and that modern patent exhaustion doctrine has developed to a point where these early cases are almost completely forgotten. Yet these foundational cases are nonetheless pure statutory interpretation, and if that aspect of the history is ignored, the doctrine cannot be properly understood.

2. 1873–1895: Territorial Divisions

To a modern lawyer, *Adams v. Burke*\(^{52}\) and *Keeler v. Standard Folding Bed*\(^{53}\) seem like easy cases. In both, the defendants purchased patented goods in sales that were both authorized by the patentees and not subject to any contractual restriction on use or resale. Nevertheless, the defendants were sued on the theory that their uses and resales constituted patent infringement. While ruling in favor of the defendants, the Court divided 6-3 in both cases. The puzzle for a modern lawyer is this: Why were these cases at all difficult? The answer underscores our fundamental point—that the exhaustion doctrine has always been about statutory interpretation. The difficult issue in each case is that a specific provision in the Patent Act has long authorized patentees to subdivide their patent rights into different territories,\(^{54}\) and in *Adams* and *Keeler*,

\(^{51}\) See *Bloomer*, 55 U.S. at 554 (concluding that the extension statute “was not intended to interfere with rights of property before acquired; but that it leaves them as they stood during the extension under the general law”); *Wilson*, 45 U.S. at 684 (reasoning that Congress “never contemplated” a construction that would “arrest[]” common use).

\(^{52}\) 84 U.S. (17 Wall.) 453 (1873).

\(^{53}\) 157 U.S. 659 (1895).

the patentees exercised that statutory right by conferring exclusive geographic territories to "local assignee[s]." Both cases thus involved the issue of whether, given the statute, purchasers from local assignees should be geographically constrained in their rights.\textsuperscript{55}

In Adams, the defendant (an undertaker) purchased patented coffin lids within the territory of one local assignee, carried the lids outside that territory, and used them in the territory of another assignee.\textsuperscript{56} In Keeler, the defendant bought a railroad car full of patented beds from one local assignee, shipped them to the territory of another assignee, and resold them there.\textsuperscript{57} In both cases, the local assignees in the second territory sued on the theory that the unlicensed using (in Adams) or selling (in Keeler) within their territory constituted patent infringement. In rejecting those infringement claims, the Court relied on Bloomer's spatial analogy to hold that, after the authorized sale, the patented goods "passe[d] without the limit of the monopoly"\textsuperscript{58} and were "no longer under the peculiar protection granted to patented rights."\textsuperscript{59}

Adams and Keeler were not easy cases, and thus drew substantial dissents, but not because the Justices were engaged in difficult common law policymaking about the desirability of territorial encumbrances on personal property. The cases were hard because they presented a difficult issue of statutory interpretation: whether Bloomer's presumptive domain limitation (that sales move goods "outside" of patent law) should be limited by the express statutory right to grant exclusive territorial assignments. The dissenters had a point: Patentees' specific statutory right to subdivide their patent rights into territories would be undermined—at least to some degree—if purchased goods could move freely from one territory to another. If there is a reason why the dissenters lost, it is that they were overstating the degree that statutory right was being undermined. But as discussed in Section III.B of this Article, the Court does tailor the exhaustion doctrine in light of other provisions in the pa-

\textsuperscript{55} See Keeler, 157 U.S. at 662 (noting that "as is often the case, the patentee [in the case] has divided the territory of the United States into twenty or more 'specified parts'" and granted exclusive rights to make and sell the patented article to a "local assignee").

\textsuperscript{56} Keeler, 157 U.S. at 661–62; Adams, 84 U.S. at 456–57.

\textsuperscript{57} Adams, 84 U.S. at 454–55.

\textsuperscript{58} Keeler, 157 U.S. at 660.

\textsuperscript{59} Adams, 84 U.S. at 456; see also Keeler, 157 U.S. at 661 (the goods "passed outside of the monopoly").

\textsuperscript{60} Keeler, 157 U.S. at 661.
tent and copyright statute, which is precisely what should happen if the doctrine is based on statutory interpretation.

One final point deserves attention: Near the end of its opinion, the Keeler majority explicitly stated that it was not deciding "[w]hether a patentee may protect himself and his assignees brought home to the purchasers." The Court commented that it was "obvious that such a question would arise as a question of contract, and not as one under the inherent meaning and effect of the patent laws." Here, the Court was spelling out the logical implication of the Bloomer’s domain limitation: Patentees may be able to protect themselves through contract law—the Court was plainly agnostic—but whether they can poses an issue of contract, not patent, law.

B. The Origins of the Doctrine in Copyright

Three events are foundational in the development of copyright’s first sale doctrine: (1) the 1908 Bobbs-Merrill decision; (2) the doctrine’s codification in 1909; and (3) its recodification in 1976. Each of these events supports the view that the doctrine is merely a limit on what qualifies as copyright infringement (that is, a limit on the domain of the copyright statute), not a substantive restriction on permissible commercial arrangements.

This Article’s Introduction provided a brief summary of Bobbs-Merrill; here, we focus on three additional details of the case. First, even though the Supreme Court’s patent decisions already supported the view that, once purchased, goods embodying intellectual property pass “outside” of the limits of federal statutory protection, the Bobbs-Merrill Court approached the issue “as a new one” because it recognized that “there are differences between the patent and copyright statutes in the extent of the protection granted by them.” Such reasoning underscores that the Court was not evaluating the desirability of restraints on alienation as a matter of general common law. It was instead treating the case as one of statutory construction about the “extent” of the Copyright Act’s protections. The Court’s ultimate conclusion—that the right to control subsequent sales was “not included in” the statute and would
“extend its operation... beyond its meaning”—continued the Court’s pattern of relying on spatial metaphors to state its statutory holding.64

A second significant detail (one oddly missing from most scholarly descriptions of the case) is the reason why the publisher Bobbs-Merrill chose to litigate the case at the Supreme Court solely as an action under the Copyright Act. Bobbs-Merrill’s attempt to prevent books from being sold at less than $1.00 retail was undertaken collusively as part of a horizontal price-fixing agreement with other publishers who, collectively, controlled ninety-five percent of the U.S. market.65 At the time of the Bobbs-Merrill litigation, the New York Court of Appeals had already held that the publishers’ joint price-fixing agreement violated state antitrust law with respect to uncopyrighted books but was protected by federal copyright law with respect to copyrighted books.66 Thus, Bobbs-Merrill desperately needed to establish that the right to fix retail prices was within the scope of federal copyright law, because only the perceived scope of copyright law was protecting Bobbs-Merrill and its fellow publishers from antitrust liability.67

The third important point about the Bobbs-Merrill litigation concerns whether the publisher could have imposed restrictions on the resale of its books outside of copyright law (putting to one side, of course, the antitrust problem). In the lower courts, Bobbs-Merrill did litigate both a claim sounding in tort (tortious interference with contract) and one sounding in property (a theory that the books were encumbered by an “ambulatory covenant”).68 With respect to both claims, the U.S. Court of Appeals for the Second Circuit noted that substantial precedent support-

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64 Id. at 351.
65 See Straus v. Am. Publishers’ Ass’n, 83 N.Y.S. 271, 274 (N.Y. App. Div. 1903) (describing the price-fixing agreement of the publishers’ association). That collusive agreement was the publishers’ response to the rise of department stores—such as Macy’s—that were offering significant discounts on books. The business history here parallels the more recent rise of the Kindle e-reader, which also offered significant discounts and also scared publishers into an ill-fated attempt to raise retail prices on e-books through an illegal horizontal agreement organized by Apple. See United States v. Apple Inc., 791 F.3d 290, 314–329 (2d Cir. 2015) (holding the agreement on e-books to be a per se antitrust violation).
67 After the Supreme Court’s decision in Bobbs-Merrill, the Court ruled—not surprisingly—that federal copyright law offered no antitrust protection for the collusive agreement of the publishers. See Straus v. Am. Publishers’ Ass’n, 231 U.S. 222, 234–36 (1913).
68 Bobbs-Merrill v. Straus, 147 F. 15, 17–18, 24 (2d Cir. 1906). Bobbs-Merrill did not bring a breach of contract claim because it was undisputed that Macy’s, having purchased its supply of books from wholesalers, had no contract with Bobbs-Merrill.
Bobbs-Merrill’s legal theories. Thus, Bobbs-Merrill did not lose on its non-copyright claims because the common law of New York was inalterably hostile to restraints on alienation or encumbrances on personal property. Rather, it lost because both non-copyright claims depended upon the $1.00 retail price restriction being part of a contract, but Bobbs-Merrill failed to prove “that any purchaser assented to the terms of the notice” placed in the books. In other words, Bobbs-Merrill’s claims failed because it could not prove its $1.00 retail price floor was part of any contract.

Bobbs-Merrill did not litigate its non-copyright claims at the Supreme Court, thus the Court remained agnostic about such theories, noting only that the case contained “no claim . . . of contract limitation, nor license agreement controlling the subsequent sales of the book.” Parallel litigation brought against Macy’s by another of the colluding publishers—Charles Scribner’s Sons—reveals a severe practical problem faced by the publishers in asserting their contract-based theories: They did not want to play hardball with their own customers. Many book wholesalers would not agree to the retail price condition, but the publishers continued to sell to them anyway. Thus, third parties like Macy’s could obtain books without inducing anyone to violate their contracts.

Yet not every copyright owner of this era lost on its non-copyright claims. In the 1906 case Authors & Newspapers Ass’n v. O’Gorman Co., the plaintiff distributed books through agents who were contractually authorized to sell only to purchasers who agreed not to resell the books before August 1, 1907. A notice on each book’s inside cover informed purchasers of that contractual limit and stated that purchasers agree to that condition “by the acceptance of [a] copy [of the book].” The plaintiff sought to enforce the restriction against a defendant that bought sev-

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69 The court found that Bobbs-Merrill’s tortious interference theory was supported by the Supreme Court in Angle v. Chicago, St. Paul, Minneapolis & Omaha Railway Co., 151 U.S. 1 (1894). Bobbs-Merrill, 147 F. at 25. On the property-based “ambulatory covenant” theory, the court noted that “there is some conflict in the decisions,” but all of the New York state decisions cited by the court supported enforcement. See id. at 25–26.
70 Id. at 27. The court described the resale price condition as “a notice, not a contract.” Id.
71 Bobbs-Merrill, 210 U.S. at 350.
72 Scribner v. Straus, 147 F. 28, 32 (2d Cir. 1906).
73 Scribner v. Straus, 210 U.S. 352, 355 (1908) (affirming the Second Circuit’s determination that “there was no satisfactory proof that [Straus] did thus induce any person to break his agreement with [Scribner’s]”).
74 147 F. 616, 617 (C.C.D.R.I. 1906).
75 Id.
eral dozen books and was reselling early. The court dismissed the plaintiff’s copyright claims and treated the case as “involving ordinary principles of contract.” Still, the plaintiff prevailed. While the court rejected the plaintiff’s argument that the notice alone bound purchasers, it nonetheless enjoined the reselling because the defendant had actual knowledge of the notice’s contractual limit. The court specifically rejected the argument that “this restraint on alienation is contrary to public policy.”

We mention *O’Gorman* not only to demonstrate that, at the time of *Bobbs-Merrill*, copyright holders could impose binding contractual restrictions in some circumstances, but also to show a weakness in modern scholarship. So pervasive is the view that *Bobbs-Merrill* is based on some preexisting common law hostility to restraints on alienation that one of the leading treatise writers and commentators on copyright—Professor David Nimmer—has cited *O’Gorman* as a case in which a copyright owner was “attempt[ing] to magnify its rights via contract” and the court “refused to enforce use restrictions placed on the inside cover of a book.” That is, of course, flatly wrong—the court issued an injunction enforcing the restrictions.

While *Bobbs-Merrill* was not based on common law hostility to restraints on alienation, the decision is still justifiable—indeed, especially so—because IP rightholders do have alternative legal avenues by which they *may* be able to accomplish their goals. We use the word “may” advisedly, because those alternative avenues have legal complexities and impose requirements (like contractual agreement) that the IP owners might have trouble satisfying. By restricting the scope of copyright infringement, *Bobbs-Merrill* prevented the copyright statute from displacing those other areas of law with their complexities.

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76 Id. at 619. The court relied on the Second Circuit’s decision in *Bobbs-Merrill v. Straus*, which would eventually be affirmed by the Supreme Court. Id. at 618–19; see *Bobbs-Merrill*, 210 U.S. at 351.

77 *Bobbs-Merrill*, 147 F. at 619–21.

78 Id. at 620.

79 See Nimmer et al., supra note 7, at 44–45 & n.116. Professor Lemley has cited *O’Gorman* for the proposition that “merely including ‘license’ terms on the inside cover of a book did not create a contract on those terms.” Mark A. Lemley, Beyond Preemption: The Law and Policy of Intellectual Property Licensing, 87 Calif. L. Rev. 111, 120 n.19 (1999). That is technically true but perhaps a bit misleading. The court held that while the terms were unenforceable if they were merely printed inside the book, they were enforceable if the purchaser had actual knowledge of them. *O’Gorman*, 147 F. at 619–21.

80 See *O’Gorman*, 147 F. at 621.
This understanding of Bobbs-Merrill also accounts for how Congress codified the doctrine one year later. The final clause of Section 41 of the Copyright Act of 1909 provides that "nothing in this Act shall be deemed to forbid, prevent, or restrict the transfer of any copy of a copyrighted work the possession of which has been lawfully obtained." That statutory language states what the Copyright Act does not do. The clause circumscribes the domain of the statute but takes no position on whether, and to what extent, other areas of law can be used to restrict the transfer of copyrighted works.

The modern re-codification of copyright’s exhaustion principle (written in 1976) now provides that:

> Notwithstanding the [statutory provision granting copyright owners the exclusive right to control distribution of copies], the owner of a particular copy or phonorecord lawfully made under this title . . . is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord.

That text, while less obviously encoding a domain limitation, nonetheless contains several indications that it is merely limiting the scope of copyright law. First, the introductory clause indicates that the statute is designed merely to limit one specific right—the exclusive distribution right—elsewhere conferred in the Copyright Act. Second, the provision gives no indication that it preempts otherwise applicable state property or contract law. Third and finally, the widely-cited House Report on the 1976 Copyright Revision Act stated that the provision “does not mean that conditions on future disposition of copies or phonorecords, imposed by a contract . . . would be unenforceable between the parties as a breach of contract, but it does mean that they could not be enforced by an action for infringement of copyright.” That legislative history accurately summarizes what the exhaustion doctrine does—it limits the reach of IP rights, leaving intact preexisting law.

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83 Copyright law does have a provision governing preemption, which we discuss in Section IV.C.

After deciding *Bobbs-Merrill* in 1908, the Supreme Court confronted the issue whether the statutory right to control the *use* of a patented invention extends to uses after a sale of a physical copy of the invention. So difficult was this question that, in five cases within six years, the Court decided it first one way and then the other. The crucial point for our purposes is that the issue was difficult for statutory reasons—the structure of the Patent Act differed from the Copyright Act. All the Justices treated the issue as one of statutory interpretation, not as common law policymaking about property encumbrances and restraints on alienation. Moreover, when the Court finally resolved the issue, it followed a familiar pattern. It relied on spatial metaphors, expressly recognizing that the enforceability of post-sale restrictions was a matter outside of patent law, to be governed by general law.

The first case in the sequence, decided 4-3 by a short-handed Court, was *Henry v. A.B. Dick Co.* A.B. Dick sold a patented mimeograph subject to “the license restriction” that the machine could be used only with ink sold by Dick. The purchaser proceeded to buy ink from Sydney Henry, who knew that the ink would be used with the patented mimeograph in violation of the license. Dick did not sue its own customer but instead pursued Henry for contributory patent infringement. The Court sustained Dick’s infringement claim.

*Henry* distinguished *Bobbs-Merrill* on pure statutory grounds. *Bobbs-Merrill* itself, the *Henry* majority noted, had cited the “differences between the patent and copyright statutes” and expressly limited its holding to copyright. Emphasizing the Patent Act’s grant of an exclusive right to *use*, the Court tied its holding directly to that right, ruling that “[s]uch a sale”—that is, a sale with a restriction on use—“while transferring the property right in the machine, carries with it only the right to use it for practicing the invention according to the terms of the li-

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85 224 U.S. 1 (1912). At the time *Henry* was argued, one seat on the Court was vacant due to the death of Justice Harlan, and one member of the Court—Justice Day—was on a leave of absence tending to his terminally ill wife. See id. at 1 n.1 (noting the vacancy on the Court and Justice Day’s absence); Statement of the Chief Justice Concerning Mrs. Day, 222 U.S. xxix (1912) (explaining the cause of Justice Day’s absence).

86 Id. at 43–44 (quoting *Bobbs-Merrill*, 210 U.S. at 345).

87 Id. at 46 (quoting the Patent Act, tit. LX, ch. 1, § 4884, 18 Stat. 953, 953 (1870), and italicizing for emphasis the word “use” in the grant of exclusive rights).
As for the apparent limit on patentee’s rights articulated in Bloomer, the Henry majority interpreted that limit as merely a presumption: “If sold unreservedly the right to the entire use of the invention passes, because that is the implied intent.” That presumption could, however, be overcome by the explicit terms of any license so that the “property right to a patented machine may pass to a purchaser with no right of use, or with only the right to use in a specified way, or at a specified place, or for a specified purpose.” If the purchaser engaged in a use “prohibited by the license,” then neither the sale nor the license would prevent the patentee from suing for patent infringement.

The three dissenting Justices—whose views would become law in five years—based their objections not on common law policies against property encumbrances or restraints on alienation. Rather, their dissent focused on the degree that the majority’s broad interpretation of patent law’s “use” right would displace other law. As the opening paragraph in the dissent noted, the decision would require parties’ rights and obligations to be tested “not by the general law of the land, . . . but by the provisions of the patent law, even although the subjects considered may not be within the embrace of that law.” Indeed, the dissenters quoted in italics—the only full sentence so emphasized in the entire dissent—Keeler’s statement that, if contractual restrictions are imposed as part of a sale, the enforcement of those restrictions “would arise as a question of contract, and not as one under the inherent meaning and effect of the patent laws.” Thus, the fight between the Henry majority and dissent was primarily about the scope or domain of the patent statute, not about common law policies.

The short-handed opinion in Henry would be short-lived. The precedent’s formal demise began the next year, when the four-Justice Henry majority became a four-Justice dissent in Bauer & Cie v. O’Donnell.

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89 Id. at 26.
90 Id. at 24 (emphasis added).
91 Id.
92 Id.
93 Id. at 50 (White, C.J., dissenting).
94 Id. at 60 (quoting Keeler, 157 U.S. at 666).
95 Indeed, within one week of the decision, Henry was almost certainly not supported by a majority of the Court. Justice Pitney took his seat on the Court on March 18, 1912, exactly one week after Henry was decided, and Justice Day had returned from his leave of absence by then. Both Justices would eventually vote to overrule Henry. Justices of the Supreme Court, 222 U.S. ii nn.2–3 (1911).
96 229 U.S. 1 (1913).
The facts in the case were strikingly similar to those in *Bobbs-Merrill*, with even the same $1.00 retail price floor. The plaintiff Bauer marketed a patented nutritional supplement with a notice stating that each package “is licensed by us for sale and use at a price not less than one dollar ($1.00)” and warning that “[a]ny sale in violation of this condition, or use when so sold, will constitute an infringement of our patent.” Bauer sued for patent infringement after the defendant drug store bought packages at wholesale and sold them for less than $1.00. The Bauer majority followed *Bobbs-Merrill*, holding that “the right to vend secured in the patent statute is not distinguishable from the right of vending given in the copyright act.”

Applying *Bobbs-Merrill* did not, however, resolve the case entirely, because the notice in *Bauer* purported to make the “use” of the product contingent on paying the $1.00 retail price. That aspect of the notice attempted to exploit what even the Bauer Court acknowledged to be the “principal difference” between the copyright and patent statutes—“the presence of the word ‘use’ in the patent statute and its absence in the copyright law.” Although *Henry* held that violating an express limitation on “use” did constitute patent infringement, the Bauer Court distinguished *Henry* on the grounds that, in trying to frame the $1.00 retail price condition into a restriction on use, Bauer’s artfully worded notice was “a mere play upon words”—“a perversion of terms.” Because the condition was not actually about use, it was not enforceable under patent law, and the sale “placed the [purchased] article beyond the limits of the monopoly secured by the patent act.” The four Justices from the Henry majority dissented without bothering to write an opinion.

*Bauer* did not overrule *Henry*, but the combination of the two decisions put the Court in a nearly impossible position. To maintain both precedents, the Court would have to continue distinguishing between genuine conditions on use and cleverly disguised conditions on sale. Such an approach would require evaluating ever more creatively worded

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97 Id. at 8 (emphases added).
98 Id. at 17. *Bauer* was the first Supreme Court case to describe the doctrine with a variant of the word “exhaustion.” Id. at 12 (describing *Bobbs-Merrill* as holding that, upon sale, the statutory right to vend “was thereby exhausted”).
99 Id. at 13–14. While the defendant retailer may not have directly violated this condition on use, his customers would have. He was thus potentially liable for inducing their infringement—much like the ink seller in *Henry*.
100 Id. at 16.
101 Id. at 17.
conditions blending together price and use restrictions. Yet, as with other jurisdictional rules, a statutory domain limit loses much of its value if it is open to endless litigation about how and where to draw the line. One decision really had to go, and *Henry* seemed the more likely candidate given that a majority of the full Court had never supported it.

*Henry* was overruled in the Court’s 1917 decision *Motion Picture Patents Co. v. Universal Film Manufacturing Co.* The facts were highly similar to *Henry*. The plaintiff, one of Thomas Edison’s companies, held the patent rights on a movie projector that was sold subject to the supposed licensing condition that the machine be used only with films licensed by the plaintiff. The purchaser transferred the projector to one of the defendants, a theater, which began using the projector with unlicensed movies of the other defendant, Universal Film. As in *Henry*, the patentee sued the supplier (here Universal) for inducing infringement; it also sued the theater for direct infringement.

As it had consistently done through the evolution of the doctrine, the Court treated the issue as one of pure statutory interpretation. The Court quoted the statute granting exclusive rights to patentees; stated that it was “concerned only with the right to ‘use,’ authorized to be granted by this statute”; and emphasized that the case turned on “the meaning of Congress.” The Court ultimately concluded that the “statutory authority to grant the exclusive right to ‘use’ a patented machine is not greater, indeed it is precisely the same, as the authority to grant the exclusive right to ‘vend.’” As the Court expressly acknowledged, equating those two rights meant the end of *Henry* because *Bauer* had already held that the Bobbs-Merrill exhaustion principle applied to the patent right to vend. As in *Bobbs-Merrill*, however, the Court was merely restricting the scope of the patent right. As in prior decisions, the Court reverted to a spatial metaphor to emphasize that the ability of a patentee to restrict by contract a purchaser’s use of a patented machine was “a question outside the patent law and with it we are not here concerned.”

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102 243 U.S. 502 (1917).
103 Id. at 506–08.
104 Id. at 509–10.
105 Id. at 516.
106 Id. at 518 (stating that *Henry* was overruled).
107 Id. at 509. The vote in *Motion Picture Patents* was 6–3, with the dissent containing the three remaining Justices from the original four-Justice majority in *Henry*. Every Justice who either returned from a leave of absence or joined the Court after *Henry* voted against sustaining the decision. See id. at 519; *Henry v. A.B. Sick Co.*, 224 U.S. 1, 1 (1916).
While *Motion Picture Patents* established the fundamental boundary between patent law and more general commercial law, two other contemporaneous decisions provide additional insight into the basis for, and the implications of, that boundary. *Straus v. Victor Talking Machine Co.* was an infringement suit against Macy's which, as in *Bobbs-Merrill*, was selling merchandise (here phonographs) at prices below the minimum retail price set in a purported license. *Bauer* had already established that, once goods were sold at wholesale, patentees could not rely on patent law to control the price at which the goods would be resold at retail. To evade *Bauer*, Victor tried to avoid making any sales—it purported to retain title to its machines throughout the chain of commerce (wholesalers to retailers to customers). Each possessor of the machine (in Victor's view, not even end consumers were owners) was given notice that its license to use the machine was contingent on a minimum $200 "royalty" being paid to the retail dealer.109

Victor lost its infringement claim because the Court viewed the retention-of-title scheme as a "disguised attempt" to do exactly what *Bauer* held infringement actions could not do—"to control the prices of [patented goods] after they had been sold."110 Among the reasons for that conclusion, the Court noted that Victor made no filings of "a qualified title in any public office."111 The reference to "public" filings of "qualified title" refers to state statutory systems for recording property encumbrances (nowadays regulated under the UCC). The Court's focus on such filing requirements is precisely correct. The central justification for inferring domain limits on IP statutes is not to prevent all property encumbrances, but to prevent the displacement of other highly complex areas of law with little or no indication that Congress wanted to meddle in the area.

While *Victor Talking Machine* provides insight into the basis for the doctrine in the area, *Boston Store of Chicago v. American Graphophone Co.* shows an important implication of the doctrine. *Boston Store* presented once again the issue whether a patentee (here, American Graphophone) could use an infringement action to enforce a resale price maintenance condition against a discounting retailer. When the case

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109 Id. at 494–96.
110 Id. at 498, 501.
111 Id. at 498.
112 246 U.S. 8 (1918).
reached the Court in 1918, that issue was “no longer open to dispute.” The Court’s opinion is nonetheless noteworthy for expressly recognizing that the case presented not one issue but two: “[1] whether the right to make the price maintenance stipulation . . . and the right to enforce it were secured by the patent law, and if not, [2] whether [the price maintenance clause] was valid under the general law.” That is precisely the right way to delineate and separate the issues, for it distinguishes between issues within the patent domain from those governed by “the general law” (including both state common law and all other applicable law such as federal antitrust law).

Boston Store’s separation of the issues undermines, we believe, Professor Hovenkamp’s assertion that an “effective merger of the first sale rule and antitrust policy” occurred in the Court’s decisions of this era. To the contrary, the Court’s decisions separate areas of law. That separation decreases legal complexity, for it allows IP law to remain stable even as other areas change. Boston Store provides a good example. In 1918, the “general law” outside of patent law included the then-recent decision in Dr. Miles Medical Co. v. Park & Sons Co., which held resale price maintenance conditions per se illegal under antitrust law. In 2007, Dr. Miles was overruled by Leegin Creative Leather Products, Inc. v. PSKS, Inc., which subjects such price restrictions to rule-of-reason analysis. That change in antitrust law allows some price restrictions to be enforceable as a matter of contract law, but it does not cast doubt, again as Professor Hovenkamp has argued, on the Court’s continuing “strict application of the first sale rule.” Rather, the “strict”—we would say, “formalist”—application of patent exhaustion continues to make sense because the patent statute is neither hostile to nor tolerant of resale price maintenance agreements. It is indifferent to them; their legality is a matter outside of patent law.

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113 Id. at 20–21.
114 Id. at 20.
115 See Hovenkamp, supra note 7, at 508.
116 220 U.S. 373, 408–09 (1911).
118 See Hovenkamp, supra note 7, at 492; see also id. at 546–47 (describing patent exhaustion as a “draconian” and “per se” rule that is in tension with more flexible, modern antitrust rules); Rub, supra note 7, at 757 (asserting “the inflexible nature of [the exhaustion] doctrine seems inconsistent with [Leegin’s] sophisticated modern understanding of the economic forces” at issue with post-sale contractual restrictions).
II. NOT COMMON LAW: BASIS AND IMPLICATIONS OF LIMITED STATUTORY DOMAIN

The courts that created the exhaustion doctrine justified their holdings as grounded in statutory interpretation, not in a free ranging power to create federal common law. The puzzle is how courts using standard tools of statutory construction could transform the relevant statutory text into the doctrine. In other words, how could the Court in Bobbs-Merrill Co. v. Straus transform a right to vend into a right to vend for the first time?

One possible answer to that question—indeed, perhaps this is the assumption of the modern academic literature—is that the courts of old were engaged in a form of statutory interpretation utterly unlike the text-centered approaches championed by a majority of today’s Supreme Court. This view has two possible versions. First, the courts responsible for creating the exhaustion doctrine may have been more willing than today’s courts to blend together statutory interpretation with judicial common law reasoning. That thesis is not implausible. The exhaustion doctrine grew up prior to Erie Railroad Co. v. Tompkins, in the era of Swift v. Tyson. In that time, the distinction between common law and federal statutory law may not have been as sharp because the Supreme Court did not view the common law as controlled solely by state authority.

Yet the problem with that explanation is that, in creating the exhaustion doctrine, the Supreme Court did sharply distinguish statutory issues under federal IP laws from common law issues concerning contract and property. Indeed, the Court remained agnostic about whether IP owners could achieve similar results through contractual agreements or encumbrances on property. The overall case law tends to confirm that the Court was following the approach articulated in Bobbs-Merrill: The Court was treating what today we would call the exhaustion issue as a question of pure statutory interpretation.

A second possible view about the origins of the exhaustion doctrine is that the Court in the era was following a much more purposivist theory

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119 See, e.g., Perzanowski & Schultz, supra note 7, at 929–30 (claiming that the Bobbs-Merrill Court, though it claimed to be “a faithful interpreter of the terms of the Copyright Act,” must have been “engag[ing] in judicial weighing of competing interests and policies” to create “a common law defense to infringement”).
120 304 U.S. 64 (1938).
121 41 U.S. (16 Pet.) 1 (1842).
of statutory interpretation and thus was much more willing than the modern Court to limit the meaning of even relatively clear statutory text. Bobbs-Merrill was, after all, decided by the Court of Chief Justice Fuller, which is also famous (or infamous) for its anti-textualist decision in Church of the Holy Trinity v. United States.\(^{122}\) This thesis may contain some truth, and might in particular explain why some Justices in that era may have been untroubled in rejecting the textualist arguments advanced by IP holders who wanted to impose conditions on future sales and uses of goods embodying their intellectual property.

The real weakness of that theory is, however, not so much with the past but with the present. Even if the theory explains why some past Justices were comfortable in first creating the exhaustion doctrine, it does not explain why the current Court is willing to maintain the doctrine—and indeed vigorously and unanimously apply it—even in the area of patent law where the doctrine remains unsupported by any statutory text.

Limited statutory scope or domain provides a more persuasive theory for both the origins and persistence of the doctrine. Under this view, the foundational exhaustion cases are less like cases involving common law decision making or purposivist statutory interpretation, and more like a case such as *FDA v. Brown & Williamson Tobacco Corp.*,\(^ {123}\) a modern decision limiting apparently broad statutory text in order to prevent the statute from displacing other areas of law. Section II.A below explains this point in more detail. Section II.B discusses some important implications.

**A. The Basis for Limited Statutory Domain**

Like the early exhaustion cases, Brown & Williamson presented what seemed, from one perspective, as an easy application of clear statutory text. The FDA was seeking to regulate cigarettes using its statutory authority to regulate “drugs” and drug delivery “devices.”\(^ {124}\) Based on the text of the statute, the agency appeared to have strong arguments for asserting its authority. Nicotine is after all a “drug”; indeed, the FDA had long regulated the nicotine included in anti-smoking products, such as

\(^{122}\) 143 U.S. 457 (1892).

\(^{123}\) 529 U.S. 120 (2000).

\(^{124}\) Id. at 126–27 (quoting 21 U.S.C. § 321(g)-(h) (2012)).
nicotine patches and gums.\textsuperscript{125} So too cigarettes seemed to fit within the literal definition of drug delivery "devices." Not only do cigarettes deliver a drug (nicotine) to smokers, but the agency had a great deal of evidence that cigarette manufacturers were intentionally designing cigarettes to deliver certain amounts of nicotine to their customers.\textsuperscript{126} Moreover, the FDA had the benefit of the 800-pound gorilla in modern statutory interpretation—the Chevron doctrine,\textsuperscript{127} which dictates that the courts must sustain any reasonable agency construction of ambiguous statutory text, provided that the agency has authority to speak with the force of law (which the FDA clearly had).

Despite all of this, the Court held that the FDA lacked statutory authority to regulate cigarettes. The Court’s holding seems to present a challenging puzzle to the champions of textualism in statutory interpretation: Why should the FDA’s jurisdiction extend to any drug delivery device except cigarettes? That puzzle is made all the more difficult because the five Justices in the majority included Justices who most often claimed to be champions of textualism (including Justices Scalia, Kennedy, and Thomas).

The puzzle presented by \textit{Brown & Williamson} is similar to the apparent conundrum presented by the foundational exhaustion cases. Why should a copyright owner’s exclusive right to “vend” be limited to an exclusive right to vend \textit{only once}? Why should a patentee’s exclusive right to control “use” of a technology be limited to an exclusive right to control use \textit{only prior to sale}? The answer to those IP law questions is quite similar to the answer given by the Court in \textit{Brown & Williamson}. Statutes do not exist “in isolation.”\textsuperscript{128} In determining the scope of a statute, courts—even (and perhaps especially) textualist courts—must look not only to the text of one statute but also to other relevant legal texts. Even the most committed textualist recognizes that a single statute can-

\textsuperscript{125} See Analysis Regarding the Food and Drug Administration’s Jurisdiction over Nicotine-Containing Cigarettes and Smokeless Tobacco Products, 60 Fed. Reg. 41,453, 41,482 & n.5 (Aug. 11, 1995) (noting that the FDA had regulated such products since 1980); see also \textit{Brown & Williamson Tobacco Corp. v. FDA}, 153 F.3d 155, 165 n.13 (4th Cir. 1998) (accepting that the FDA could regulate nicotine patches and gums).

\textsuperscript{126} See 60 Fed. Reg. at 41,491–41,520. The statutory definition of “device” required that the product be "intended" to affect the function of the human body, and the Court assumed that cigarettes literally fit within that definition. See \textit{Brown & Williamson}, 529 U.S. at 131–32.


\textsuperscript{128} \textit{Brown & Williamson}, 529 U.S. at 123.
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not be interpreted without considering how that statute fits within the entirety of the corpus juris, for the rest of the law is also authoritative text. Thus, in *Brown & Williamson*, the Court held that the proper interpretation of the FDA’s statutory authority could not be assessed without considering the vast set of federal (and even state) laws governing the sale and distribution of cigarettes, and the Court relied on that body of law in restricting the apparent textual scope of the FDA’s statute.

Thus, in *Brown & Williamson*, the Court held that the proper interpretation of the FDA’s statutory authority could not be assessed without considering the vast set of federal (and even state) laws governing the sale and distribution of cigarettes, and the Court relied on that body of law in restricting the apparent textual scope of the FDA’s statute.

Just as with the foundational cases on exhaustion, *Brown & Williamson* was not based on judicial assessments of substantive policy. After all, the FDA’s attempted regulation was directed primarily toward keeping cigarettes out of the hands of minors. The Supreme Court’s restrictive interpretation of the FDA’s authority was not justified on a policy that kids should have free access to cigarettes. To the contrary, the Court noted that federal statutory law at the time already encouraged states to restrict minors’ access to cigarettes. Yet the very existence of that other body of regulatory law provided part of the justification for inferring a limit to the scope of the FDA’s statute because the matter is regulated elsewhere in the corpus juris. That reasoning holds without regard to the desirability of the FDA’s policy goals.

*Brown & Williamson* and exhaustion cases such as *Bobbs-Merrill* can also be viewed as manifestations of the folksy principle that legislatures do not “hide elephants in mouseholes.” Thus, the literal breadth of the words “drug” and “device” should not be read so that the FDA’s statute displaces a vast body of federal and state law specifically regulating cigarettes. The literal breadth of the word “vend” should not be interpreted so that copyright law disrupts a large and complex body of commercial law.

Beneath that evocative imagery of elephants in mouseholes lies a solid foundation, for even under quite different theories of the legislative process, courts should try to ensure that the legislature has actually legislated—that is, considered and enacted a substantive policy—on the relevant issue. Judge Easterbrook originally proposed that statutory domain

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129 Branch v. Smith, 538 U.S. 254, 281 (2003) (Scalia, J.) ("[C]ourts do not interpret statutes in isolation, but in the context of the corpus juris of which they are a part . . . .").

130 *Brown & Williamson*, 529 U.S. at 137 (noting that Congress had enacted many federal statutes regulating cigarettes and other tobacco products); id. at 155 (noting that Congress had provided financial incentives for states to prohibit the sale of tobacco products to minors).

131 Id. at 155.

should be restricted to matters "anticipated . . . and expressly resolved in the legislative process." He viewed legislation as a "bargain" between competing groups—a theory later (and uncharitably) described as a "rather depressing interpretive paradigm[] . . . heavily influenced by the public choice literature."

Yet even a quite different approach to statutory interpretation—one that emphasizes matching interpretative practices to "our democratic governance structure"—reaches the similar conclusion that statutes should be interpreted to "reflect the aims, goals, and compromises that drove the legislative process."

That shared theoretical goal has particular importance along the frontiers between complex areas of law, such as IP and commercial law. With modern legislatures like our Congress (and, indeed, almost all modern legislatures in other countries), statutes on complex, specialized areas such as IP are highly likely to have been drafted by specialized committees or subcommittees with expertise in the area. And even in earlier times, such legislation would attract the expertise of IP lawyers and scholars, but perhaps not commercial lawyers with expertise in other areas. In light of such legislative specialization—indeed in the modern era, in light of the legislative committees with their own jurisdictional boundaries—limiting the domain of statutes is theoretically justifiable under any interpretive theory that seeks to avoid imposing substantive policies not resolved through the structured, democratic process that is the legislature. It is true of course, as David Strauss notes, that drawing such domain limitations involves some degree of judgment and thus may aggrandize judicial "prerogatives." But interpretation of any sort involves judgment, and the degree of judicial discretion can be minimized if the courts seek boundary lines that reflect the specialization already extant in the legislation itself and the legislative process more generally.

133 Easterbrook, supra note 34, at 544 (emphasis added).
134 Id. at 540–41.
135 Jerry Mashaw, As If Republican Interpretation, 97 Yale L.J. 1685, 1688 (1988).
138 See Strauss, supra note 34, at 1262.
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B. Implications of Limited Domain: Formalism Justified

In many exhaustion cases, the potential for IP law to displace commercial law is not obvious because the encumbrances sought to be imposed on the physical goods are not those commonly seen in other commercial contexts. An exception is *Tessera Inc. v. International Trade Commission*, a lower court decision in which that potential is evident.

Tessera licensed its patents on semiconductor chips to manufacturers that agreed to pay Tessera royalties on each patented chip manufactured and sold. The royalties, however, were to be paid *after* the chips were sold (at the end of a contractual "reporting period" lasting several months). The manufacturers produced and sold the chips but did not pay the royalties. Tessera could have pursued (and apparently did pursue) breach of contract actions against the manufacturers, but it also wanted more remedies. Seeking to enforce its IP rights against a downstream purchaser, Tessera brought an action in the International Trade Commission ("ITC"), which has power to grant patentees certain remedies concerning products that infringe U.S. patents.

Before the ITC, the purchaser of the chips relied on the exhaustion doctrine, arguing that Tessera had authorized the manufacturers' sales. Tessera's rejoinder was that its licenses had been contingent on the eventual payment of royalties. Because the manufacturers had paid no royalties, the sales were unauthorized and thus could not trigger exhaustion. Ruling in favor of the downstream purchaser, the Federal Circuit held that Tessera's patent rights were exhausted, but was that the right result?

Before analyzing this case under the exhaustion doctrine, it is useful to understand that Tessera was trying to do something that is very standard in commercial settings: It was trying to maintain property rights in goods in order to secure payments due under a contract. In other words, Tessera wanted to use patent law to synthesize something analogous to a security interest—a property-based encumbrance on goods that can provide rights even against subsequent purchasers.

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139 646 F.3d 1357 (Fed. Cir. 2011).

140 In its subsequent certiorari petition, Tessera revealed that it ultimately recovered royalties from the manufacturers, although it argued that such recovery was irrelevant to the exhaustion issue. See Petition for Writ of Certiorari at 6 n.3, *Tessera*, 646 F.3d 1357 (No. 11-903).

141 *Tessera*, 646 F.3d at 1360–63.
The analogy is clear. If a party had provided manufacturers with financial capital to produce goods, law and public policy would clearly permit the financier to encumber the goods with a security interest to protect the financier’s interest in being paid the agreed-upon return on its investment. Tessera had provided its licensed manufacturers with intellectual capital to produce the chips, and it sought merely to maintain property rights in the goods to protect its interest in being paid the agreed-upon royalties. In such circumstances, why should the courts be unreceptive to enforcing Tessera’s IP rights?

Under standard views of exhaustion, the answer to that question is not clear. The Federal Circuit reasoned that, if a licensee’s sales could become unauthorized after the “licensee somehow defaulted on a subsequently due royalty payment,” the result would be both (1) “absurd,” because there would be “a cloud of uncertainty over every sale,” and (2) “wholly inconsistent with the fundamental purpose of patent exhaustion—to prohibit postsale restrictions on the use of a patented article.”142 Neither reason is satisfactory. Let us take the second reason first. Tessera never tried to impose any restrictions on the “use” of the patented chips. It was merely trying to get paid its proper royalties. Moreover, as Tessera argued, some statements of the Supreme Court seemed to imply that exhaustion applied only after payment of “the full price which the patentee demanded,”143 or, similarly, “when the patentee has received his reward.”144 Tessera was merely trying to use the patent laws to secure the “full price” for the sale.

As for the court’s first point—that Tessera’s arguments, if successful, would impose “a cloud of uncertainty over every sale”—the honest reply is that this is true, but it is also true even under the outcome reached by the court. The Federal Circuit’s position is that patent rights are exhausted not after every sale, but after every “authorized sale.”145 For example, if Tessera’s licenses had required royalties to be paid before the manufacturers sold the chips, then the sales would have been unauthorized and the downstream purchaser would have lost. Thus, a purchaser will have uncertainty about its immunity from patent infringement unless it has perfect information about its seller’s compliance with the license under which the sale was made. The result sought by Tessera would

142 Id. at 1370.
143 Bloomer v. McQuewan, 55 U.S. 539, 552 (1852).
145 Tessera, 646 F.3d at 1369–70.
have expanded the degree of uncertainty to include subsequent events, such as the proper payment of royalties. Yet if the exhaustion doctrine were itself directly concerned with the propriety of imposing clouds—or encumbrances—on the title to purchased goods, then the real question should have been whether imposing the particular encumbrance sought by Tessera is consistent or inconsistent with public policy. The answer to that question is, as discussed above, quite easy. The law does allow parties to encumber goods to secure payments due to them. Indeed, an entire Article of the UCC—Article 9 on secured transactions—assists parties in accomplishing just that goal.146

Under our thesis, however, the result in Tessera makes perfect sense. Indeed, the case highlights what we see as the central purpose of the doctrine in this area, which is to limit the domain of IP law so that it does not displace other generally applicable principles of commercial law. Precisely because the encumbrance sought by the patentee is permissible under another area of law, exhaustion’s role as a domain limit is more apparent. The goal of exhaustion is not to prevent the patent owner from encumbering the property; it is to prevent the patent owner from relying on patent law to encumber goods.

That thesis also explains the doctrine’s formalism—that is, the doctrine’s insensitivity to the public policies that might support particular encumbrances. One example of this formalism was discussed at the end of Part I: Modern commentators have puzzled over the continued inflexibility of exhaustion even though judicial hostility to restraints on alienation has abated in modern antitrust law.147 Tessera shows the doctrine’s formalism even more clearly, because public policy plainly favors allowing property encumbrances in the circumstances of the case. Our chief insight here is that such policy insensitivity is not so troubling for a domain limit, which dictates not substantive outcomes but merely which body of law will govern substantive outcomes. A good analogy is the boundary between two states, which often is a formalistic line. When Virginia refuses to punish a crime that occurred ten feet south of its border with North Carolina, it is not because Virginia’s policy favors crime in North Carolina. It is because Virginia recognizes that crime just south

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146 See U.C.C. § 9-201(a) (2014) (authorizing security agreements to be effective not only “between the parties,” but also “against purchasers of the collateral” and “creditors”). As discussed below, however, the UCC contains notice requirements that may be difficult for the party to satisfy. See infra notes 245–48 and accompanying text.

147 See supra notes 115–18 and accompanying text.
of the Virginia-North Carolina border is properly governed by North Carolina law. That formalistic outcome does not vary even if the crime is especially heinous. So too courts applying the exhaustion doctrine need not consider whether an IP rightholder has especially compelling reasons for encumbering property because exhaustion merely recognizes that another body of law governs that issue.

III. DOCTRINAL IMPLICATIONS: ARBITRARY AND MEANINGFUL VARIATIONS

Two doctrinal implications follow from our thesis that the exhaustion doctrine is best understood as a domain limitation on the scope of IP statutes. First, formalist boundary lines are inherently arbitrary, and our theory predicts that the boundary separating IP law from more general law could be set at various locations. As shown in Section III.A, this prediction holds true, for the location of the exhaustion boundary has varied across time and across different branches of IP law. Not all variations are arbitrary, however. As discussed in Section III.B, the exhaustion doctrine should be sensitive to the particular text and structure of the underlying statute, including the statutory structure of rights. Again, this prediction holds true.

A. Arbitrary Variations in the Boundary Line

Our theory predicts that the underlying goal of the exhaustion doctrine could be served by multiple possible rules. For example, IP rights could presumptively terminate (i) when the intellectual property becomes lawfully embodied in goods; (ii) when the goods embodying the IP come into the lawful possession of another party; (iii) when those goods are lawfully owned by another party; or (iv) when the goods are first lawfully sold. The first of these four possible rules is hypothetical, but the other three have been embraced, at one time or another, by the courts or by Congress in either copyright or patent law.

All of these possible lines are reasonable. There is no platonic ideal defining the reach of IP statutes, just as there is no platonic ideal defining the border between Virginia and North Carolina; the border was set

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148 A lawful embodiment rule of exhaustion has not, so far as we can tell, been followed at any time in any IP field, although dicta in one Supreme Court decision does describe copyright exhaustion in this way. See infra note 165.
arbitrarily by royal fiat. Furthermore, the consequences of the line’s location are not so dramatic. Just as moving the Virginia-North Carolina border a few miles south would not deprive anyone of legal protections against theft (Virginia’s law would merely take over), moving the exhaustion rule does not deprive intellectual property owners of legal protections—they merely have to rely on a different body of law. For example, the hypothetical lawful embodiment rule articulated above might seem to be an excessively “early” termination of IP rights. Nevertheless, exhausting IP rights upon lawful embodiment in goods would not leave IP rightholders without protection. No one could produce, or produce and sell, goods embodying the intellectual property without the rightholder’s permission. Once goods were produced lawfully (that is, with the rightholder’s permission), the IP rightholder would have to rely on the general law of property and contract to protect its interests, but there is no necessary reason to believe that general law would be inadequate.

While the lawful embodiment rule is hypothetical, the other three possible rules—lawful possession, lawful ownership, and lawful sale—are not. The history of each approach is discussed below.

1. Unjustified Judicial Hostility to the Lawful Possession Rule

From 1909, when Congress first codified copyright’s exhaustion doctrine, until 1976, the text of the Copyright Act embraced a “lawful possession” rule. It stated that “nothing in [the Copyright Act] shall be deemed to forbid . . . the transfer of any copy of a copyrighted work the possession of which has been lawfully obtained.” Unfortunately, some lower courts ignored the text of the statute and used copyright law to resolve disputes that should have been left to more general commercial law.

149 William K. Boyd, Introduction to William Byrd’s Histories of the Dividing Line Between Virginia and North Carolina, at xvii (1929). Indeed, not only is the Virginia-North Carolina border an arbitrary line, it also has arbitrary variations due to historical practices and even historical mistakes. See, e.g., id. at xxiii (noting that, as the boundary line was being surveyed from the east to the west, a compromise led to the half-mile southerly deviation of the border line at the mouth of the Nottoway River—a deviation that remains to this day).

One of the most egregious examples was Judge Friendly’s opinion in *Platt & Munk Co. v. Republic Graphics, Inc.* The plaintiff Platt & Munk contracted with Republic Graphics to have some of its copyrighted educational books and puzzles manufactured. After Republic produced the goods, Platt & Munk refused to take delivery on the grounds that the goods were improperly manufactured. The dispute was thus over whether the contract was breached by Republic (for improperly manufacturing the goods) or by Platt & Munk (for not accepting and paying for them).

Not surprisingly, New York had law governing such garden-variety contract disputes, and that law gave Republic a specific self-help remedy: the right to resell the goods prior to adjudication of which party breached. Republic began selling the books and puzzles to third parties, who in turn were distributing the goods to the public. In addition to suing Republic for breach of contract, Platt & Munk sued the third-party distributors for copyright infringement. The district court enjoined all the defendants from making any further sales.

On appeal, the defendants argued that the codified exhaustion rule protected their sales because their “possession” of the copies had been “lawfully obtained”—the copyright holder licensed the manufacture of the copies, and the resulting possessions of the goods were lawful under all applicable federal and state laws. Rejecting that argument, Judge Friendly reasoned that “a literal reading” of the statute was “unacceptable” because “[i]f lawful possession by another sufficed .....

“More reasonable results,” Judge Friendly wrote, “are reached if the [statute] is construed .. with the aid of the” 1909 House Committee Report on the statute, which suggested that the Committee thought copyright holders should not be able to exercise control over copies after “the first sale.” But Judge Friendly rejected a “first sale” rule too because

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151 315 F.2d 847 (2d Cir. 1963).
152 Id. at 849.
153 Id. at 851.
154 Id.
155 Id. at 849, 851–52 (internal citations omitted). The Committee Report is not inconsistent with the statute’s text because a “lawful possession” rule will accomplish the result desired in the report, which was to exhaust rights after the copyright holder has made a first sale. The statutory rules exhaust rights in other situations too, but the report nowhere stated that Congress wanted exhaustion *only* in the case of sales.
that rule would render copyrighted goods immune to commercial remedies, including judicial sales, designed to protect commercial parties such as Republic. In the end, he crafted a rule that allowed a party holding copyrighted goods to invoke a resale remedy if it first obtained a court order or if the copyright holder failed to assert a good faith justification for nonpayment.\footnote{\textit{United States v. Wise}\textsuperscript{158} shows the full consequences of judicial surgery on the statutory rule. In the mid-twentieth century, movie studios
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\item\textsuperscript{156} Thus, Judge Friendly embraced a rule that exhausts rights upon a first sale or a court-ordered transfer or the copyright owner’s failure to offer a good faith justification for its nonpayment.
\item\textsuperscript{157} Judge Friendly was, of course, a notable champion of fashioning federal common law to supplement, or even supplant, federal statutory law,\footnote{\textsuperscript{157} Henry J. Friendly, In Praise of \textit{Erie}—and of the New Federal Common Law, 39 N.Y.U. L. Rev. 383, 413–19 (1964) (asserting that federal judges should be “ready, even eager” to fashion federal common law from “only the smallest bit of legislating” or “a bit of legislative history”).} so perhaps he was not troubled by the strange blending of federal copyright law and state commercial law. Yet one overarching benefit of a formalistic exhaustion doctrine is that it keeps different areas of law distinct. The alternative leads to unnecessary confusion and complexity.

\textit{United States v. Wise}\textsuperscript{158} shows the full consequences of judicial surgery on the statutory rule. In the mid-twentieth century, movie studios
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(which owned the IP rights to, and physical copies of, films) typically did not sell copies of their films but instead licensed copies to theaters, with the copies returned at the end of the license. The defendant Wise was selling copies of films such as The Sting and American Graffiti and was prosecuted for interstate transportation of stolen goods and criminal copyright infringement. He was acquitted on the interstate transportation charges.  

On the copyright charges, the Ninth Circuit sustained convictions for four films proven never to have been sold by the studios. The studios had, however, transferred lawful possession, as the films were widely distributed to theaters. Thus, Wise tried to rely on Congress’s 1909 codification of a lawful possession rule for exhaustion. Citing Platt & Munk, the Ninth Circuit ruled that “[a]lthough the statute speaks in terms of a transfer of possession, the judicial gloss on the statute requires a transfer of title before a ‘first sale’ can occur,” and that “[t]he judicial gloss” provided “clear notice” of the statute’s application. As a basis for criminal penalties, that reasoning seems hard to justify under almost any theory of statutory interpretation.

2. Lawful Ownership Versus Lawful Sale: Modern Variations

Though exhaustion is commonly called the “first sale” doctrine in copyright, sophisticated commentators recognize that the Copyright Act’s current statutory codification requires no sale. In fact, “first sale” is a bit more accurate in patent law, where the doctrine is not codified and case law generally requires a lawful sale or some other authorized transfer of title. In this Subsection, we make two modest points.

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159 Id. at 1183 n.1, 1190.
160 Id. at 1194–95.
161 Id. at 1187.
162 See, e.g., Nimmer et al., supra note 7, at 26 n.25 (noting that the modern codified rule is “imprecisely labeled the ‘first sale’ doctrine”). As the leading copyright treatise notes, “the more accurate terminology [for the doctrine] would not be ‘first sale’ but rather ‘first authorized disposition by which title passes.’” 2 Melville B. Nimmer & David Nimmer, Nimmer on Copyright § 8.12[B](1)[a] (rev. ed. 2009). Despite the greater precision, the catchy moniker “first-authorized-disposition-by-which-title-passes doctrine” has failed to take hold in the parlance of IP lawyers. Moreover, as discussed in the text, even that lengthy label would not be entirely accurate because the copyright rule does not require a transfer or passing of title. If a copy of a book is lawfully made (that is, pursuant to a license from the copyright owner), the very first owner of that book (that is, the book manufacturer) is protected by the codified version of copyright’s first sale or exhaustion doctrine.
First, we examine the difference between the modern copyright and patent rules and suggest that, under our theory, either rule is reasonable. Second, we discuss one rarely noted oddity in the modern copyright statute and suggest how best to resolve that oddity.

The facts of *General Talking Pictures Corp. v. Western Electric Co.*\(^{163}\) can be used to show the difference between the patent and copyright exhaustion rules. The patent owners in the case sued General Talking Pictures for the unlicensed use of patented vacuum-tube amplifiers. General Talking Pictures defended on the grounds that it had purchased the amplifiers from a licensed manufacturer. That manufacturer’s license, however, was expressly limited to the manufacture and sale of amplifiers for *private radio reception* and conferred “no right to sell the amplifiers for use in theaters as a part of talking picture equipment.”\(^{164}\) Because the manufacturer “knew that the amplifiers it sold to [General Talking Pictures] were to be used in the motion picture industry,” the sales were unauthorized, and thus patent exhaustion did not protect against infringement liability.\(^{165}\) As the Supreme Court has since made clear, *General Talking Pictures* does not mean that so-called field-of-use restrictions—requirements that patented products be used only in a particular field such as private radio reception—are enforceable on all downstream users without regard to exhaustion.\(^{166}\) Rather, it means that patent exhaustion operates only if the sale is authorized under the seller’s license.

In contrast to patent law, the modern copyright rule does not require a lawful sale—it can operate earlier in the chain of production and distribution. Under Section 109(a) of the Copyright Act, exhaustion protects the “owner” of any “lawfully made” copy.\(^{167}\) If a manufacturer produces copies under a valid license and thereby becomes the owner of those copies, subsequent sales do not constitute infringement even if the sales breached the manufacturer’s contract with the copyright owner. Thus, in a chain of distribution comprising the steps of (1) lawful production

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\(^{163}\) 304 U.S. 175 (1938), adhered to on reh’g, 305 U.S. 124, 126–27 (1938). *General Talking Pictures* is unusual because it generated two authoritative opinions from the Supreme Court.

\(^{164}\) Id. at 180.

\(^{165}\) Id. at 180–82.

\(^{166}\) Quanta Computer v. LG Elecs., 553 U.S. 617, 636 (2008) (confirming that exhaustion is triggered by “a sale authorized by the patent holder” and clarifying that no exhaustion occurred in *General Talking Pictures* because the sales were outside the licensing terms).

and ownership by a manufacturer; and (2) lawful sale by the manufacturer, modern copyright draws its exhaustion line at step one while patent law exhaustion requires step two.

Which line is better? Our theory suggests both are reasonable. Where the two bodies of law differ—where a manufacturer lawfully produces and owns goods but then decides to sell them unlawfully—the patentee has an infringement action, while the copyright holder does not. Yet the copyright holder is not remediless; it still has a breach of contract action for the unauthorized sales. The limited stakes explain both why slightly different exhaustion rules can endure in the two fields and why finding the optimal line is less important than maintaining a clear line.

A second and final point concerns a possible oddity in copyright’s codified exhaustion rule, which protects only “owner[s]” from infringement liability. Even after a copyright holder has sold a copy, a thief who steals and resells that copy might be liable for copyright infringement to the copyright holder.168 Sophisticated commentary views that possibility as “very strange,”169 and our thesis explains why: If the codified rule works that way, it would no longer be a true domain limit. The copyright holder’s transfer of a copy would not permanently carry the copy outside of copyright’s distribution right. Thieves, and perhaps more importantly all distributors downstream from a thief, would be liable for infringement.

We think, however, that the codified rule can and should be interpreted to eliminate this oddity. Under the common law’s simple possession rule, even “a wrongful taker” in possession of property “has title against all but the true owner.”170 Thus, even a thief and distributors downstream from the thief can be viewed as “owners” as against a copyright holder who no longer has any claim to ownership of that copy. Read this way, the codified rule would terminate a copyright holder’s distribution rights over each copy once the copyright holder has transferred ownership of that copy. Any thefts thereafter would be remedied in the same way as thefts of other personal property.

168 Nimmer & Nimmer, supra note 162, § 8.12[B][5].
170 See Oliver Wendell Holmes, Jr., The Common Law 243 (50th prtg. 1923).
B. Meaningful Variations Due to Statutory Specificity and Structure

One important corollary of our thesis is that, because the first sale or exhaustion doctrine is based on statutory interpretation, the doctrine should be sensitive to different structures of different IP statutes. Sometimes the statute obviously limits the doctrine. For example, copyright's codification of the doctrine explicitly states that even owners of copies of software or music cannot rent their copies without the copyright owner's permission. Other limits are less obvious. In particular, if a statute delineates a very specific IP right, that right is unlikely to be curtailed by the first sale or exhaustion principle.

To some extent, we have already seen this point. Subsection I.A.2 of this Article noted that the nineteenth-century patent cases on territorial restrictions were difficult because the Patent Act contained a specific provision authorizing patentees to subdivide their rights into territories. Similarly, Section I.C demonstrated that, in the early twentieth century, the Supreme Court had much more difficulty with exhaustion in patent law than in copyright because the patent statute included not just the exclusive right to vend but also the additional right to control use. In this Section, we detail three additional examples in which statutory structure affects the precise contours of the exhaustion doctrine.

1. The Public Performance Right

In Buck v. Jewell-LaSalle Realty Co., the Supreme Court considered whether exhaustion principles limit the Copyright Act's grant of an exclusive right to control public performances. The facts of the case are straightforward. The defendant hotel owner (1) received radio broadcasts containing the plaintiffs' copyrighted music and then (2) retransmitted the music through speakers so that it could be enjoyed by hotel guests. The plaintiffs' suit claimed that the hotel's retransmission of the music to hotel guests infringed the plaintiffs' exclusive rights over public performances. As a defense, the hotel owner raised the exhaustion doctrine and argued that, because the copyright owner had "duly licensed" the radio station to provide public performances of the music,

174 Id. at 196 (quoting the then-existing statutory grant of an exclusive right over public performances).
175 Id. at 195.
“the initial radio rendition exhausts the monopolies conferred” under the public performance right. As the Court noted, the hotel’s exhaustion argument relied on an “analogy” to Bobbs-Merrill, which the Court described broadly as being that “an author who permits copies of his writings to be made cannot, by virtue of his copyright, prevent or restrict the transfer of such copies.” The Court, however, unanimously rejected the hotel’s analogy to Bobbs-Merrill with a single sentence, noting that “[i]t is true that control of the sale of copies is not permitted by the Act, but a monopoly is expressly granted of all public performances for profit.”

That result holds to this day. A restauranteur who lawfully purchases a music CD would be wrong to think that all of the copyright owner’s rights over that copy are exhausted. While the restauranteur could use the CD for private entertainment, sell it, or transfer it, she would infringe the copyright if she played the CD to entertain her guests without a license. Thus, even after the exhaustion doctrine applies to a particular copy, that copy remains encumbered with a prohibition against any unlicensed use for a public performance, and each public performance requires a separate grant of permission by the copyright owner. Indeed, as the hotel owner in Buck discovered—and as the now-defunct Aereo company discovered in the more recent American Broadcasting Cos. v. Aereo, Inc.—even a re-broadcast or re-transmission of an over-the-air radio or television signal constitutes an act of infringement even though the copyright holder has licensed the initial transmission for public performance. Exhaustion generally does not operate on the public performance right.

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175 Id. at 195–97.
176 Id. at 197. Interestingly, the Court’s articulation—that merely permitting copies “to be made” terminates control over transfers of those copies—points toward a lawful embodiment rule for exhaustion discussed as a theoretical possibility in Section III.A.
177 Id.
179 134 S. Ct. 2498 (2014).
180 The one exception is found in 17 U.S.C. § 109(e) (2012), which allows the owner of a copy of “an electronic audiovisual game intended for use in coin-operated equipment” to publicly perform the work. The idea behind such an exception is that such “coin-operated equipment” would normally be used in public videogame arcades, and thus without this ex-
Yet while the law on this point is clear, the rationale of the Buck Court is not satisfying. While Buck is correct that, under the Copyright Act, "a monopoly is expressly granted of all public performances for profit," the same can be said of the exclusive right to "vend" at issue in Bobbs-Merrill. The Buck Court provided no reason why it chose to limit one of the exclusive rights "expressly granted" under the Copyright Act but not another.

Nonetheless, the result in Buck is justifiable. In determining the appropriate domain of statutes, courts must consider not only that one statute, but also the relationship or "fit" between that statute and the rest of the corpus juris. If Bobbs-Merrill did not limit copyright's domain by reading the right to vend narrowly—that is, if the Court had ruled that the copyright owner's exclusive right to vend extended to each and every vending down the chain of distribution—that result would have displaced a vast body of commercial law concerning sales of goods even though that law is only tangentially relevant to IP. It is unnecessary to decide whether the commercial law governing sales favors or disfavors post-sale restraints on alienation or encumbrances on personal property (or even whether, as we think demonstrably true, commercial law has much more intricate rules about such matters). It is enough that bodies of law regulate such restraints and encumbrances. Restricting the domain of IP law (by interpreting the right to vend narrowly) is then a sensible approach to prevent displacing that body of law with little statutory indication that such a displacement was meant.

By contrast, Buck's refusal to restrict the scope of the public performance right displaces little because other areas of law simply are not directed to the regulation of public performances. Moreover, if sales of copies did exhaust the public performance right (so that the purchaser of a single copy of a movie could give vast public showings of the movie using that one copy), the copyright owner would have to refrain from selling copies in order to retain effective control over the public performance right. In other words, if exhaustion operated on the public performance right, that right would not as a practical matter be separate from the right to vend. Such a result would seem contrary to the Copyright Act's specification of two distinct rights.

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181 Buck, 283 U.S. at 197.
182 See infra Subsection IV.B.2.
2. The Right to Make Self-Replicating Technologies

*Bowman v. Monsanto Co.*\(^{\text{183}}\) shows a similar principle at work in the patent context. A farmer named Bowman bought patented soybeans from a grain elevator and planted them to grow a new crop of soybeans. Monsanto, the patentee, sued Bowman for infringement on the theory that, by growing a new crop, Bowman had infringed Monsanto’s exclusive right to “make” new copies of the patented soybeans.\(^{\text{184}}\) Both Bowman and Monsanto agreed that Monsanto authorized the sales from the grain elevator. Relying on *Motion Picture Patents* and subsequent cases, Bowman argued that, because the sales were authorized, Monsanto could not control Bowman’s subsequent “use” of the soybeans—and one standard use of soybeans is to plant them to grow a new crop.\(^{\text{185}}\) Monsanto argued, inter alia, that the exhaustion doctrine had never been applied to limit the patentee’s exclusive right to “make” new copies of the patented invention, and Bowman’s farming made new copies of the patented soybeans.\(^{\text{186}}\)

In sum, Bowman argued that his farming was merely “using” his soybeans; Monsanto argued that it was “making” new soybeans. A neutral observer would candidly admit that Bowman’s farming was both because when the seeds are used in farming, they self-replicate (make new copies of themselves). The issue for the Court was whether the exhaustion of the “use” right also extends to exhaust the right to “make” for so-called “self-replicating technologies.”

The Court unanimously refused to extend exhaustion to apply against the right to “make” even though that ruling means that, in the context of self-replicating technologies, some uses of the technology will remain under the exclusive control of the patentee even after a sale.\(^{\text{187}}\) The Court

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\(^{\text{183}}\) 133 S. Ct. 1761 (2013).

\(^{\text{184}}\) Id. at 1765.


\(^{\text{187}}\) The Court left open the possibility that a self-replicating use might be exhausted where the self-replication “occur[s] outside the purchaser’s control” or is “a necessary but incidental step in using the item for another purpose.” *Bowman*, 133 S. Ct. at 1769. The Court also noted that, in copyright, Congress enacted a special statute to give owners of computer programs the right to make certain copies that are incidental to use and ownership. See id. That statute, discussed in Subsection IV.B.2, was necessary precisely because canonical exhaustion doctrine does not qualify the right to make new copies.
explained that exhaustion had never been applied to the separate “right to ‘make’ a new product” because, “if simple copying were a protected use, a patent would plummet in value after the first sale of the first item containing the invention.” The result would create “less incentive for innovation than Congress wanted” for the “undiluted patent monopoly . . . would extend not for 20 years (as the Patent Act promises), but for only one transaction.”

Like Buck, Bowman shows that, where statutory law grants a separate right, such as the right to make a new copy, that distinct articulation of a separate right will usually be interpreted as authorizing the exercise of that right separate from the right to control sales, and so the authorization of a sale will not qualify or exhaust the distinct right. The exception is, of course, patent law’s right to “use,” which was held to be exhausted upon sale of a copy in the Court’s 1917 Motion Picture Patents decision. The exceptional nature of that case serves only to re-emphasize why the issue was so difficult, and why a closely divided Court first ruled the other way in Henry.

Yet our key point here is that, in all of these cases, the Court is not engaged in formulation of common law, but is instead engaged in statutory analysis as it tries to discern the proper domain of IP statutes. Maintaining the distinct rights to control public performances and to make new copies (even for self-replicating technologies) is not too disruptive of ordinary commercial law (although Bowman has a nontrivial effect on sales of seeds for farming), and exhausting such rights would seem to undermine the structure of the relevant IP statutes. In drawing the domain limitation that is the exhaustion doctrine, the courts are thus responsive to the structure of the relevant IP statute as they determine how that statute fits into the larger corpus of law.

3. International Exhaustion: An Apparently Puzzling Divergence

The Supreme Court’s decision in Kirtsaeng v. John Wiley & Sons, Inc. is one of the most important decisions on the commercial law of IP, and in particular, on the international dimensions of copyright’s first sale doctrine. Supap Kirtsaeng, an entrepreneurial Thai citizen studying

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188 Id. at 1768.
189 Id.
190 See supra Section I.C.
191 133 S. Ct. 1351 (2013).
at U.S. universities, had his friends and family buy in Thailand, and send to him, hundreds of English-language textbooks. Because the copyright holder, John Wiley & Sons, was charging much less for the textbooks in Thailand than in the U.S., Kirtsaeng could resell the books for profit. In textbooks sold in Thailand, however, Wiley included a notice stating that each book was authorized for sale only "in Europe, Asia, Africa, and the Middle East" and that any "importation of this book to another region without the Publisher's authorization is illegal and is a violation of the Publisher's rights."192 The Supreme Court held that Wiley's authorization of sales in Thailand exhausted not only the right to control subsequent sales of the books, but also the right to limit subsequent importation into the United States. The Court thus decided that U.S. copyright law follows a so-called "rule of international exhaustion": If a U.S. copyright holder authorizes another to own lawfully created copies anywhere in the world, the owner of those copies can import them into the United States notwithstanding Congress's grant of exclusive importation rights to copyright holders.193 Wiley's notice on the books sold in Thailand was no more effective than the notice in Bobbs-Merrill.

Kirtsaeng's rule of international exhaustion could have a significant practical effect if it were extended to patent law. Like Wiley, patent holders also segment their markets internationally, for example, by charging higher prices for patented pharmaceuticals in rich countries than in poor ones.194 A rule of international exhaustion would make such international price discrimination impossible to enforce through patent law, for goods purchased in a country with low prices could be resold at a profit in a country with higher prices without liability for infringement (as Kirtsaeng had done).

Surprisingly, six days after Kirtsaeng was decided, the Court refused to review a Federal Circuit patent decision—Ninestar v. ITC195—that applied circuit precedent rejecting international exhaustion in patent law. The Court's action baffled sophisticated legal observers because it means that, at least for now, the international scope of exhaustion is rad-

192 Id. at 1356.
ically different under copyright and patent law. In contrast to the copyright rule announced in *Kirtsaeng*, still-valid Federal Circuit law holds that if a U.S. patent holder authorizes a sale of the patented product in a foreign country, U.S. patent rights are not exhausted, and the U.S. patent holder can still prevent the goods from being imported into the United States.

Ordinarily, little weight might be given to a denial of certiorari, but the petition for certiorari in *Ninestar* was in a special procedural posture. Although the Supreme Court denies the vast majority of certiorari petitions, it typically grants, vacates, and remands to the lower court ("GVRs," in Supreme Court practice) any pending certiorari petitions raising issues the same as, or even similar to, the issues decided in a recently announced case. Such GVRs of pending petitions are commonplace because they take little effort on the part of the Court—they merely remand the case for the lower court to reconsider in light of the Court’s newly announced precedent. Even if there might be reasons (procedural or otherwise) for the lower court to reach the same result, a GVR gives the lower court the opportunity to reevaluate its prior decision in light of the new Supreme Court precedent.

While several commentators have already suggested that *Kirtsaeng*’s international exhaustion rule could soon be extended to patent law, the


197 The key case is *Jazz Photo Corp. v. International Trade Commission*, 264 F.3d 1094, 1105 (Fed. Cir. 2001). Recently, however, the Federal Circuit ordered en banc briefing on the issue of whether *Jazz Photo* should be overruled in light of *Kirtsaeng*. Lexmark v. *Impression Products*, 785 F.3d 565, 566 (Fed. Cir. 2015). As discussed in the text, our thesis would resolve that question in much the same way that the government, as amicus curiae, has urged the Federal Circuit to resolve it: Because of "the materially different context of patent law"—in particular, the very different statutory structures of the patent and copyright statutes—*Kirtsaeng* "provides no basis" for extending copyright’s rule of international exhaustion into patent law. Brief for United States as Amicus Curiae, Lexmark v. *Impression Products*, No. 14-1617, 14-1619 (Fed. Cir. 2015), 2015 WL 4112927, at *24, *2.

Court's denial of certiorari in *Ninestar* hints that Justices may view the issue quite differently in patent versus copyright law. Such a difference is justified: In patent law, the exclusive right to control importation is a freestanding right, separate and distinct from the exclusive right to control sales. That is not true in copyright law.

To appreciate this point, one needs to understand some of the details of the patent and copyright statutes. Both statutes confer an exclusive right to import, and the crucial issue is whether those exclusive rights to import should be treated like copyright's exclusive right to conduct public performances—that is, whether they should be treated as distinct, specialized rights not subject to exhaustion.

In copyright law, however, the right to import is defined in the statute to be *part of the exclusive right to distribute.* Section 106(3) of the Copyright Act defines the copyright holder's basic exclusive distribution right as being the authority "to distribute copies . . . by sale or other transfer of ownership, or by rental, lease, or lending."\(^{199}\) The exclusive right to control importation is defined to be a part of Section 106(3)'s distribution right, for Section 602 provides that unauthorized "[i]mportation into the United States" is "an infringement of the exclusive right to distribute . . . under section 106."\(^{200}\)

Copyright's codified exhaustion rule—Title 17 of the U.S. Code, Section 109(a)—specifically provides that the distribution right of "§ 106(3)" is the right being limited, or exhausted, where the copyright owner has permitted someone to become the "owner of a particular copy" of the copyrighted work. Prior to *Kirtsaeng*, the Supreme Court held that the codified exhaustion rule in Section 109(a) eliminates all of the copyright holder's Section 106(3) distribution rights, including the exclusive right to control importation.\(^{201}\) As Justice Kagan made clear in her *Kirtsaeng* concurrence, that prior holding (and the statutory language supporting that holding) is the crucial reason why U.S. copyright law now follows a rule of international exhaustion.\(^{202}\)

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\(^{200}\) Id. § 602(a)(1).
\(^{202}\) Justice Kagan also suggested that the Court's prior precedent was questionable. Section 109(a)'s codified exhaustion rule grants owners of lawfully made copies the right "to sell or otherwise dispose of the possession of that copy" without the permission of the copyright owner. 17 U.S.C. § 109(a) (2012). As Justice Kagan noted, the Solicitor General had offered a "cogent" reading of § 109(a), under which the statutory right to "sell or otherwise dispose of possession" of the copyrighted work does not include the right to import the work.
The situation is different with patent law. First, there is the obvious point that patent law’s first sale or exhaustion doctrine remains uncodified, so courts are not bound by a set of statutory linkages as they were in *Kirtsaeng*. Yet that point is probably not enough to command a different result in patent law, for the majority opinion in *Kirtsaeng* stated that the judge-made first sale doctrine incorporates “no geographical distinctions.” Thus, Professor Donald Chisum (among others) has noted that *Kirtsaeng* casts doubt on current Federal Circuit precedent because the Court described “the ‘common law’ ‘first sale’ doctrine as unrestricted geographically.”

Yet in our view, the international scope of patent law’s exhaustion doctrine should be governed not by common law policymaking but by the structure of the Patent Act and the theory of statutory interpretation undergirding the doctrine. Although it has become commonplace for courts and commentators to refer to exhaustion as a “common law” doctrine—and indeed, the majority opinion in *Kirtsaeng* itself refers to the doctrine in that way—a careful reading of *Kirtsaeng* shows that the Court believed itself to be engaged in statutory interpretation. The *Kirtsaeng* Court established the foundation for its entire discussion of the common law by invoking the “canon of statutory interpretation” disfavoring expansive readings of statutes that “invade the common law.” *Kirtsaeng* thus continues the tradition established by foundational cases such as *Bobbs-Merrill*, which emphasized that the issue was “purely a question of statutory construction” and relied on spatial metaphors in rejecting interpretations that would extend IP statutes beyond their proper realm to invade other areas of law.

Furthermore, *Kirtsaeng* relies on Lord Coke’s *Institutes of the Lawes of England* to demonstrate “the importance of leaving buyers of goods free to compete with each other when reselling or otherwise disposing of

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*Kirtsaeng v. John Wiley & Sons, Inc.*, 133 S. Ct. 1351, 1372 n.1 (2013) (Kagan, J., concurring). Justice Kagan recognized that the Court’s decisions have now limited a copyright holder’s exclusive importation right “to a fairly esoteric set of applications,” but thought that the “culprit” was the Court’s earlier decision interpreting the codified exhaustion doctrine to apply to the right to import. Id. at 1372.

204 See Chisum, supra note 4, § 16.05[3][a][iv], at 16.632 to 16.632.1.

205 See 133 S. Ct. at 1363 (stating that the doctrine “is a common-law doctrine”).

206 Id. (quoting Isbrandtsen Co. v. Johnson, 343 U.S. 779, 783 (1952)).

207 See supra note 14 and accompanying text.
those goods.” Coke’s condemnation of restraints on alienation was limited to complete restrictions on alienation, for the very next section of the Institutes after the section quoted by the Court affirms that more limited restrictions on alienation may be “good” because such “conditions do not take away all power of alienation.” Coke’s treatise therefore points out that the common law concerning restraints on alienation had a degree of complexity, and as we have emphasized, that complexity continues (perhaps even has increased) under modern commercial law. The rigid per se rule of the exhaustion doctrine cannot be justified as a direct implementation of common law policies, but rather as an explicit or inferred statutory limitation on the proper domain of IP statutes.

A proper determination of the statutory domain then requires attention to the specificity of rights in each statute, for that specificity may indicate what issues Congress did intend to be governed within the domain of intellectual property. Thus, the Supreme Court in Buck did not subject copyright’s public performance to an exhaustion limit because the specification of a separate right under copyright law provides good evidence that Congress devoted attention to the relevant issue. Recognition of such a specific right also does not much impinge on the common law tradition which, as discussed above, was not so much hostile to complete restraints on alienation.

Given the statutory structure of the Patent Act, the distinct right to control importation should be viewed as akin to copyright’s public performance right—a right separate from the set of rights subject to the exhaustion doctrine. Otherwise, the legislative decision to confer a separate right to control importation of patented goods would be largely worthless. This was not true in Kirtsaeng because the Copyright Act has a different structure of rights. The Kirtsaeng Court was able to conclude that, even under a rule of international exhaustion, copyright’s exclusive right over importation still had some meaningful content because “use” of infringing goods within the country is not an act of copyright infringement. Thus, even under a rule of international exhaustion, copyright law’s exclusive right to import prevents U.S. consumers from or-

208 133 S. Ct. at 1363.
210 133 S. Ct. at 1368 (discussing situations in which copyright’s right to control importation was meaningful even if the exhaustion doctrine applied internationally).
dering unlicensed copyrighted works from overseas, importing, and then using them (by reading, listening, etc.) in the United States. But under the Patent Act, patentees can already sue for infringement in such circumstances because the "use" in this country would be an act of infringement under the Patent Act.

If it were exhausted by overseas sales, the exclusive right to import would provide additional protection to patentees only in the implausible circumstance where parties order unlicensed patented goods from overseas, import them, and then do not use them at all in this country. It would seem unlikely in the extreme that Congress granted exclusive importation rights just to cover that extremely rare circumstance. Thus, the grant of a distinct right to control importation is best viewed as a legislative decision that the patentee's control of importation is a matter regulated by the Patent Act. In other words, interpreting the Patent Act to confer a distinct and separate right to control importation does not—to use Bobbs-Merrill's formation—"extend [the statute's] operation, by construction, beyond its meaning."  

IV. CIRCUMVENTING EXHAUSTION: LEASING, LICENSING, AND OTHER MECHANISMS

"So lease it"—that was Justice Breyer's advice for how a patentee should avoid the exhaustion doctrine to accommodate its business interests. The comment came late in oral argument in Bowman v. Monsanto, at a point when Monsanto's lawyer—former Solicitor General Seth Waxman—must have sensed (correctly) that his client would win on the fairly conventional ground that exhaustion does not allow purchasers to make new copies of a patented invention. Confident of victory, Waxman began to push his client's more dubious argument that, despite the exhaustion doctrine, conditions on sales could be enforced through patent infringement actions.

To demonstrate why patentees need a "conditional sale" exception to exhaustion, Waxman posited a situation where an inventor wanted to exploit a patented machine commercially but was willing to sell one copy of the machine to M.I.T. "with a research-only license." Waxman

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210 U.S. at 351.

argued that “[i]f that sale is exhausting for all purposes,” then a third party could buy the machine from M.I.T. and “go into competition with [the inventor].” Breyer’s solution was simple: Exhaustion could be avoided simply by leasing the machine to M.I.T.

Breyer’s enthusiasm for leasing accurately reflects the judicial stance. Courts do not balk at permitting a variety of commercial arrangements such as leasing and licensing to avoid exhaustion. Yet many IP scholars view these arrangements as unjustified circumventions of the exhaustion doctrine. The disjuncture between the judicial and scholarly attitudes is caused, we believe, by the scholarly misapprehension of policies underlying the exhaustion doctrine. If, as many scholars assert, the first sale or exhaustion doctrine were based on a federal policy to limit the economic power of IP rights, then the courts should be deeply skeptical of any attempts to circumvent exhaustion through clever, formalistic structuring of property rights. The judicial tolerance for such circumventions—a stumbling block for other scholars—is for us an obvious implication of the thesis that the doctrine is merely a limit on statutory domain: Courts are not trying to forbid IP owners from achieving particular business goals; they are trying to impose some limits on the reach of IP statutes so as to prevent the displacement of other areas of law. To the extent that IP owners can work within those formal limits to achieve their business goals, the courts will not attempt to stop them.

Yet this view presents another puzzle: If the courts are so willing to permit some circumventions of the doctrine, why do sophisticated clients like Monsanto, and sophisticated lawyers like Waxman, waste any time trying to create another circumvention such as a “conditional sale” exception? The answer highlights a central theme of this Article, and also a central justification for the exhaustion doctrine: Commercial law is complex.

Life would be much simpler for IP rightholders if they could sell goods with contractual restrictions and then have those restrictions enforceable against the whole world through infringement actions unburdened by the complexities of modern commercial law. Yet those complexities are important, for the overarching goal of the exhaustion doctrine is to prevent IP law from destabilizing the principles of generally applicable commercial law.

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213 Id.
214 See supra note 16.
A. Patent Circumventions

While the exhaustion doctrine can be effectively circumvented through a variety of formalisms, our discussion will begin with one formalistic circumvention—the “conditional sale”—that does not work, or at least does not work to the extent that patentees and the Federal Circuit once thought. The remaining Subsections below will explore more effective circumventions.

1. Conditional Sales: Federal Circuit Versus Supreme Court Views

*Mallinckrodt, Inc. v. Medipart, Inc.* is one of the most famous lower court decisions on exhaustion. It generated much scholarly commentary, often very critical, and it is now widely thought (correctly, we believe) to be undermined by the Supreme Court’s subsequent decision in *Quanta Computer v. LG Electronics.* Together *Mallinckrodt* and *Quanta* provide a good introduction into modern methods of circumventing the exhaustion doctrine.

*Mallinckrodt* involved patented devices sold to hospitals for delivering aerosol mists into patients’ lungs. Each device was sold with an inscription “Single Use Only,” and the patentee Mallinckrodt took the position that the devices were licensed to be used only once. The hospitals were, however, sending used devices to Medipart, which would clean and refurbish the devices so the hospitals could reuse them.

Mallinckrodt believed that the hospitals’ reuse constituted patent infringement, but following the time-honored wisdom of not suing one’s own customers, Mallinckrodt sued Medipart on the theory that the refurbishing was inducing the hospitals to infringe. The district court ruled that, “even if the [single use] notice was sufficient to constitute a valid condition of sale, violation of that condition can not be remedied under

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215 976 F.2d 700 (Fed. Cir. 1992).
217 553 U.S. 617 (2008); see also infra note 229.
218 *Mallinckrodt*, 976 F.2d at 702–03.
219 See id. at 701; see also 35 U.S.C. § 271(b) (2012) (providing a cause of action for inducing infringement).
the patent law." The Federal Circuit reversed, holding precisely the opposite.

The reasoning in *Mallinckrodt* highlights how imprecision can lead to confusion about exhaustion. For example, much of the court's opinion is devoted to deciding whether "Mallinckrodt's restriction on reuse was unenforceable," but that is not the right issue. Even if a restriction on reuse is perfectly enforceable, it may be enforceable only with contract, rather than patent infringement, remedies. Similarly, another part of the opinion correctly notes that "[a]s in other areas of commerce, private parties may contract as they choose, provided that no law is violated thereby." That statement is generally correct but also irrelevant to deciding the issue in the case, which is whether contractual conditions can be enforced against nonparties to the contract through patent infringement actions. Indeed, if anything, the principle that parties to a sale of patented goods are generally free to contract "[a]s in other areas of commerce" points to the wisdom of the domain limit: As in other areas of commerce, such contracts should be enforced through the ordinary remedies of commercial law (including contract, tortious interference with contract, etc.).

*Mallinckrodt* produced an era in which the Federal Circuit maintained that the "exhaustion doctrine [did] not apply to an expressly conditional sale or license." That era ended with the Supreme Court's decision in *Quanta Computer v. LG Electronics*. In that case, LG Electronics ("LGE") granted the Intel Corporation a license to make and sell chips that would use a number of LGE's patents. The LGE-Intel license claimed that it did not convey to Intel's customers the right to combine the chips with components made by any manufacturer other than Intel. LGE insisted that Intel provide its customers with notice of this limitation, and Intel did so. After Quanta Computer purchased Intel chips and installed them in computers with non-Intel components, LGE sued Quanta for patent infringement. Quanta argued in defense that LGE's

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220 *Mallinckrodt*, 976 F.2d at 703.
221 Id. at 701 (holding that "if Mallinckrodt's [single use] restriction was a valid condition of the sale, then . . . it was not excluded from enforcement under the patent law").
222 Id. at 703.
223 Id.
patent rights in the chips were exhausted because LGE authorized Intel to make and sell the chips.\textsuperscript{226}

The Federal Circuit rejected Quanta’s exhaustion defense. The court applied its conditional sale doctrine to hold that, while LGE had authorized Intel to sell the chips, “those sales were conditional,” and the condition—that the purchasers not combine the chips with non-Intel components—was enforceable in a patent infringement suit.\textsuperscript{227} The Supreme Court reversed on the broad ground that “[b]ecause Intel was authorized to sell [the chips] to Quanta, the doctrine of patent exhaustion prevents LGE from further asserting its patent rights with respect to [those chips].”\textsuperscript{228}

The bulk of commentators and courts have—correctly, we believe—viewed the Supreme Court’s Quanta decision as overruling Mallinckrodt’s conditional sale doctrine.\textsuperscript{229} Even the Federal Circuit seems to appreciate this point, for in its 2011 Tessera decision, the court described “the fundamental purpose of patent exhaustion” as being “to prohibit postsale restrictions on the use of a patented article.”\textsuperscript{230} That view is, of course, flatly inconsistent with Mallinckrodt’s holding, which allowed enforcement of a post-sale “single use” restriction.

For purposes of our thesis, however, the most important point about the demise of Mallinckrodt’s conditional sale doctrine is contained in a

\textsuperscript{226} Id. at 624.
\textsuperscript{227} LG Elecs. v. Bizcom Elecs., 453 F.3d 1364, 1370 (Fed. Cir. 2006).
\textsuperscript{228} Quanta, 553 U.S. at 637–38.
\textsuperscript{230} Tessera, Inc. v. Int’l Trade Comm’n, 646 F.3d 1357, 1370 (Fed. Cir. 2011); see also Helferich Patent Licensing, LLC v. N.Y. Times Co., 778 F.3d 1293, 1301 (Fed. Cir. 2015) (stating that “[e]xhaustion protects an authorized acquirer’s freedom from the legal restrictions imposed by the patent statute”). In 2015, the Federal Circuit ordered an en banc hearing to decide whether Mallinckrodt should be formally overruled. See Lexmark v. Impression Products, 785 F.3d 565, 566 (Fed. Cir. 2015) (ordering en banc consideration of the issue whether, in light of Quanta, “this court [should] overrule Mallinckrodt, Inc. v. Medipart, Inc., 976 F.2d 700 (Fed. Cir. 1992), to the extent it ruled that a sale of a patented article, when the sale is made under a restriction that is otherwise lawful and within the scope of the patent grant, does not give rise to patent exhaustion”). The government has taken the position that Mallinckrodt should be overruled, see Lexmark v. Impression Products, No. 2014-1617, 2014-1619 (Fed. Cir. 2015), 2015 WL 4112927, at *4–13, and that seems like the most likely outcome given the Supreme Court’s reasoning in Quanta and the Federal Circuit’s own statements in cases decided after Quanta.
footnote of the Supreme Court’s *Quanta* opinion. There, the Court stated that “the authorized nature of the sale”—which, under the Court’s holding, fully triggers exhaustion—“does not necessarily limit LGE’s other contract rights,” and the Court “express[ed] no opinion on whether contract damages might be available even though exhaustion operates to eliminate patent damages.”

That footnote is not entirely good news for purchasers of patented goods because it means that patent exhaustion does not guarantee substantive freedom from any restrictions that the patentee may impose prior to parting with physical embodiments of a patented technology (including contractual limits on use, encumbrances, or restrictions on alienation). The footnote is also not entirely good news for the IP maximalists, who argue that patent owners should not be limited to enforcing licensing restrictions through contract law because “[w]ithout federal patent infringement remedies, the potential recovery of enhanced damages and attorneys fees would be greatly impaired, and as a result licensees would experience less deterrence with regard to breaching licenses.”

Yet in our view, the footnote is just right, for it confirms that exhaustion is merely a domain limit on patent infringement—a doctrine that expresses no substantive policy as to restraints on alienation or restrictions on use, but that instead leaves patentees and their customers subject to ordinary principles of commercial law.

2. Qualcomm’s *Chain-Contracting Approach*

While conditional sales cannot preserve a patentee’s remedies under the Patent Act, the contractual conditions of licensing agreements can provide fairly substantial protection for the patentee’s legitimate business interests. Contractual remedies are, of course, typically limited in that they operate only between the parties to the contract—that is a fundamental difference between contract and property. But clever contract drafters can mitigate this problem, as is demonstrated by the licensing

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231 *Quanta*, 553 U.S. at 637 n.7 (emphasis added). Modern Supreme Court precedent on copyright exhaustion also distinguishes sharply between statutory IP rights and contract rights. See Quality King Distsrs. v. L’anza Research Int’l, 523 U.S. 135, 143 (1998) (recognizing the distinction and noting that the plaintiff copyright holder was able to use contractual rights to achieve its commercial goals in many circumstances).

arrangement described in an amicus brief filed by Qualcomm, Inc. as part of the Quanta Computer litigation at the Supreme Court.\textsuperscript{233}

The amicus brief describes Qualcomm’s licensing system, under which each of Qualcomm’s licensed manufacturers agrees, as part of its patent license with Qualcomm, to sell the products embodying Qualcomm’s patented technology only to companies that also have a licensing agreement with Qualcomm.\textsuperscript{234} In other words, Qualcomm creates what might be called “a chain-contracting condition.”\textsuperscript{235} Qualcomm-licensed manufacturers are licensed to sell only to Qualcomm-licensed purchasers. The first set of purchasers can then in turn be required, as part of their agreements with Qualcomm, to sell only to other Qualcomm-licensed downstream purchasers. That licensing system can be repeated down the chain of distribution so that Qualcomm can maintain contractual control of its technology. Importantly, Qualcomm’s chain-contracting system does not stop the operation of the exhaustion doctrine. At the very first authorized sale—when a licensed manufacturer sells to the first licensed purchaser in the chain of distribution—exhaustion terminates Qualcomm’s patent rights. But Qualcomm still has its contract rights. If that first purchaser resells to an unlicensed downstream purchaser, Qualcomm will have a breach of contract action.

LGE could also have protected its rights through chain contracting. LGE’s license with Intel could have required that Intel sell only to LGE-licensed buyers, who themselves promise not to use the LGE-licensed chips with non-Intel (or non-licensed) components.\textsuperscript{236} If LGE-licensed components were then combined with non-Intel components, LGE would have a breach of contract against someone—either Intel, if it sold to an unlicensed buyer, or against the buyer who made the contractually impermissible use.

As a practical matter, contract remedies generally work only against a party to the contract. If, as in Tessera, the party breaching its obligations were difficult to sue, LGE might want to have a property-based cause of

\textsuperscript{233} Brief of Qualcomm Inc. as Amicus Curiae in Support of Respondent, Quanta, 553 U.S. 617 (No. 06-937), 2007 WL 4340879.

\textsuperscript{234} Id. at *8.

\textsuperscript{235} This is our term, but it reflects Qualcomm’s legal position, which urged the Court to permit patentees to have licensing contracts throughout “the chain of production.” Id. at *11.

\textsuperscript{236} As a matter of contract law, there are many ways to do this. The promise could be made to Intel with LGE as a third-party beneficiary. Restatement (Second) of Contracts § 304 (1981). The promise could be made to LGE with consideration coming from Intel. Id. § 71(4). Or the promise could be made to Intel and then assigned to LGE. Id. § 317.
action that would work against the whole world. But for the exhaustion doctrine, a patent infringement action would be such an action. While commercial law cannot provide a remedy identical to such an action, it can provide something similar: property encumbrances such as security interests.

3. Security Interests and Other Alternatives

If LGE wanted rights that "followed" or "ran with" the property created under the LGE-Intel license, it could try to create a servitude on that property. State common law sometimes recognizes such "personal property servitudes," but the case law is exceedingly thin and thus uncertain. Security interests, however, are a much more common mechanism for encumbering personal property. Moreover, as compared to personal property servitudes, security interests have a more solid legal foundation because they are authorized and governed by state statutory law (the UCC) rather than a few common law decisions.

Although security interests are usually employed to secure an obligation to repay a debt, they can secure performance of a much broader class of obligations. The text of the UCC makes this abundantly clear. Article 1 of the UCC defines a security interest as "an interest in personal property or fixtures which secures payment or performance of an obligation." UCC Article 9 uses this "payment or performance" language as well, and it uses the more limited term "monetary obligation" when an obligor's sole duty is payment. Furthermore, Article 9's remedies are also designed to allow for the enforcement of non-monetary obligations. A secured creditor can repossess collateral after default, and if the debtor wants the collateral back (redemption), it must offer not merely "payment in full of all monetary obligations then due" but also "performance in full of all other obligations then matured."

The official commentary in the UCC also states that "the par-

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237 See Robinson, supra note 7, at 1455-60 (reviewing the existing cases).
239 See, e.g., id. § 9-102(a)(59) ("'Obligor' means a person that, with respect to an obligation secured by a security interest in . . . the collateral, (i) owes payment or other performance of the obligation . . . .") (emphasis added).
240 See, e.g. id. § 9-102(a)(46) ("'Health-care-insurance receivable' means an interest in or claim under a policy of insurance which is a right to payment of a monetary obligation for health-care goods or services provided or to be provided.").
241 See id. § 9-609.
242 Id. § 9-623 cmt. 2.
ties are free to agree that a security interest secures any obligation whatsoever.\textsuperscript{243} As then-Professor (now Senator) Elizabeth Warren and her co-authors summarize the law, “Virtually any obligation can be secured if the parties make their intention clear.”\textsuperscript{244}

If patentees can use general commercial law to obtain not merely contractual rights, but even property encumbrances on goods embodying their technologies, we are left with the puzzle mentioned at the beginning of this Part: Why do patentees continue to object to the exhaustion doctrine rather than merely relying on mechanisms such as security interests to achieve their objectives? Part of the reason, we suspect, is that the practice of IP licensing is somewhat insular, and that IP lawyers are not aware of the full range of alternatives offered by non-IP law. To the extent that explanation is true, this Article offers advice to intellectual property holders: Seek commercial lawyers to supplement the advice that you are already receiving from your IP lawyers.

Another part of the reason is, however, that IP rights and remedies would be better, from the perspective of the intellectual property owner, than commercial law rights and remedies. Consider, for example, the issue of notice. Notice is typically irrelevant to an IP infringement action. By contrast, secured parties generally have rights only against those having actual or constructive notice of the secured party’s rights. Secured parties can provide constructive notice through a filing in the relevant state office, and commercial law tries to minimize costs by keeping filing fees low\textsuperscript{245} and allowing the encumbered property to be described in

\textsuperscript{243} See, e.g., id. § 9-204 cmt. 5 (further stating “[d]etermining the obligations secured by collateral is solely a matter of construing the parties’ agreement under applicable law”).

\textsuperscript{244} See Lynn M. LoPucki, Elizabeth Warren, Daniel Keating & Ronald J. Mann, Commercial Transactions: A Systems Approach 966 (5th ed. 2012). A small caveat might be needed. In real property, mortgages are the encumbrances analogous to security interests, and mortgage law requires that any obligation secured by a mortgage must be “measurable in terms of money” or “readily reducible to a monetary value at the time of enforcement.” See Restatement (Third) of Property: Mortgages § 1.4 (1997). The reason for that limitation is that “[m]ortgage enforcement would break down if mortgages were permitted to secure performance of obligations that could not be measured in terms of money” because, among other reasons, “[t]here would be no means of determining whether a foreclosure sale produced a surplus or a deficiency.” Id. Given that Article 9 and mortgage law grant the defaulting party and other interest holders similar protections in the event of foreclosure, courts may impose a similar limit on the obligations that could be protected by security interests. Thus, an intellectual property holder relying on security interests to enforce obligations would be wise to include a liquidated damages clause in the description of the obligation.

\textsuperscript{245} Forms and Fees, Cal. Secretary St., http://www.sos.ca.gov/business-programs/ucc/forms, archived at http://perma.cc/5Z2X-D5AT (requiring a $5.00 filing fee).
general terms covering many pieces of property. Yet the total cost of providing constructive notice could grow if the property passes through a long distribution chain and the secured party needs security agreements with everyone in the chain. Moreover, even actual notice of the security interest is insufficient to enforce a security interest against "a buyer in ordinary course of business." To prevent a buyer from claiming this status, the secured creditor must ensure that the buyer has actual knowledge that the sale violates the secured party's rights.

We can remain agnostic about whether or not commercial law's notice requirements would be burdensome in any particular case. Either way, our thesis suggests that the exhaustion doctrine is sensible. If commercial law's notice requirements are easily satisfied, exhaustion causes little harm to the interests of IP owners. If the notice requirements are burdensome, exhaustion serves the useful function of preventing IP owners from evading those requirements, which presumably are supported by sufficiently strong policies to justify their burdens.

One final point is worth making here. One predecessor of the modern security interest was the "conditional sale"—the very same term and concept that the Federal Circuit's Mallinckrodt decision briefly allowed as a means for encumbering patented goods. More than a century ago, state legislatures began replacing the common law conditional sale with statutory constructs (forerunners of modern security interests) precisely

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246 The security agreement itself may describe the encumbered property by "type"—for example all "equipment" or "inventory." U.C.C. §§ 9-102, 9-108 (2014). For constructive notice, the state filing may describe the property as in the security agreement, see id. § 9-504(1), or with an even greater degree of generality such as "all personal property." Id. § 9-504(2).

247 Id. § 9-320(a).

248 Id. § 1-201(b)(9).

249 In a conditional sale, the seller delivers goods to the buyer but reserves title until the buyer fulfills some obligation, typically paying for the goods. In the late nineteenth century, many courts ruled that a seller who makes a conditional sale retains title superior even to that of a subsequent buyer who takes title without knowledge of the conditional seller's interest. See Harkness v. Russell, 118 U.S. 663, 681–82 (1886); George Lee Flint, Jr., Secured Transaction History: Protecting Holmes' Notes Through the Conditional Sales Acts, 44 St. Mary's L.J. 317, 351–352 (2013) (noting that the common law priority rule favored the seller who transferred goods under a conditional sales contract even against a subsequent good faith purchaser of the goods). In effect, the common law treated breach of the conditional sales contract similar to cases of theft, for in both the original owner still held good title and subsequent purchasers—even good faith purchasers—were liable for conversion of the wrongly transferred goods. See Garrard Glenn, The Conditional Sale at Common Law and as a Statutory Security, 25 Va. L. Rev. 559, 574 (1939).
because the common law conditional sale was viewed as providing insufficient notice of the encumbrance. By 1909, twenty-eight states had enacted such statutes, and the widespread adoption of the UCC in the middle of the twentieth century completed the process. The current version of the UCC makes it abundantly clear that conditional sales and other reservations of title are to be treated like any other security interest.

If the exhaustion doctrine did not exist or did not cover conditional sales, the law governing encumbrances on patented goods would be

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250 Conditional sales create a cloud of uncertainty over goods (an ostensible ownership problem) if creditors and subsequent buyers cannot easily determine if a conditional seller claims title in the goods. In the late nineteenth century, state legislatures began to overrule the courts that gave favorable rulings to conditional sellers by enacting statutes that gave priority to the subsequent purchaser unless the original owner recorded its interest in a central database. See Harkness, 118 U.S. at 675; Francis M. Burdick, Codifying the Law of Conditional Sales, 18 Colum. L. Rev. 103, 105-07 (1918); Glenn, supra note 249, at 578–82; see also Grant Gilmore, Security Interests in Personal Property § 3.2, at 67 (1965) ("[O]ne of the most firmly rooted doctrines of the common law is] the protection of creditors against undisclosed interests in property."); id. § 8.7, at 274 ("In the history of our security law there has been one constant factor: whenever a common law device has been covered by a statute, some form of public recordation or filing has been required as a condition of perfection of the security interest.").


252 The UCC was first published in 1952, Robert Braucher, The Legislative History of the Uniform Commercial Code, 58 Colum. L. Rev. 798, 800 (1958), and every state except Louisiana had adopted it by 1967. William A. Schnader, A Short History of the Preparation and Enactment of the Uniform Commercial Code, 22 U. Miami L. Rev. 1, 10 (1967). The original version of the UCC explicitly treated conditional sales as security interests, see U.C.C. § 9-102(2), at 604 (Am. Law Inst. 1962) (stating that "[t]his Article applies to security interests created by contract including . . . conditional sale"), and required filing to perfect the security interest in order to prevail against third-party purchasers without knowledge of the conditional sale, except under a few exceptions set out in section 9-302, see id. §§ 9-301 to 9-302, at 654–58. It also recognized the rights of a buyer in the ordinary course of business. Id. § 9-307. The 1918 Uniform Conditional Sales Act was an earlier effort to reach the same basic result, but it was adopted by just eleven states by 1943 when it was withdrawn as a recommended law given the impending preparation of the U.C.C. See Handbook of the National Conference of Commissioners on Uniform State Laws and Proceedings of the Fifty-Third Annual Conference 67 (1943).

253 See U.C.C. § 1-201(b)(35) (2014) ("‘Security interest’ means an interest in personal property or fixtures which secures payment or performance of an obligation. . . . The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer under Section 2-401 is limited in effect to a reservation of a ‘security interest.’"); see also id. § 2-401 (similar).
weirdly immune to a century’s worth of change—it would be a throwback to commercial law generally abandoned in this country for the better part of a century. By limiting the domain of patent law, the exhaustion doctrine prevents such a divergence. The end result simplifies the law, for it leaves the commercial law for goods embodying intellectual property the same as that for all other goods.

B. Copyright Circumventions

Copyright owners have often tried to avoid exhaustion by retaining title to the copies of their copyrighted works. During much of the twentieth century, for example, movie studios would not sell copies of their copyrighted films, and lower court decisions like United States v. Wise held that licensing possession to theaters did not trigger exhaustion. More recently, licensing has become an important means for preserving IP rights in copyrighted software. Avoiding sales through licensing or leasing has been controversial. Nevertheless, those strategies almost certainly allow rightholders to achieve their business goals even if, as some commentators argue, courts should treat some leases and licenses as de facto sales.

1. Leasing Books and the “Connected Casebook” Controversy

In May of 2014, Aspen Publishers announced its “Connected Casebook” program, which at first appeared to mean that Aspen would no longer sell certain casebooks. Instead, Aspen would sell students semester-long leases of new physical books combined with perpetual li-

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254 550 F.2d 1180 (9th Cir. 1977). As discussed earlier in Subsection III.A.1, supra, we disagree with the result in Wise under pre-1976 statutory law, though not under current law. 255 Most of that commentary has focused on software and has criticized the courts for allowing copyright owners to use nominal licensing to evade the first sale doctrine. See, e.g., Brian W. Carver, Why License Agreements Do Not Control Copy Ownership: First Sales and Essential Copies, 25 Berkeley Tech. L.J. 1887, 1889–90 (2010); Perzanowski & Schultz, supra note 7, at 945 (calling on courts “to reinvigorate exhaustion in the face of digital distribution” and thereby “to preserve the traditional balance between the rights of copyright holders and those of copy owners despite technological change”); Rothchild, supra note 7, at 4–6; Jenny Lynn Sheridan, Does the Rise of Property Rights Theory Defeat Copyright’s First Sale Doctrine?, 52 Santa Clara L. Rev. 297, 302–03 (2012). 256 A copy of the program’s announcement is in a May 5, 2014 blog posting by Professor Josh Blackman. See Josh Blackman, Aspen Casebook Connect Textbooks Must Be Returned at End of Class, Cannot Be Resold, Josh Blackman’s Blog (May 5, 2014), http://joshblackman.com/blog/2014/05/05/aspen-casebook-connect-textbooks-must-be-returned-at-end-of-class-cannot-be-resold, archived at http://perma.cc/6RD6-7U8X.
licenses to electronic books. The physical books would have to be returned at the end of the semester and, it was widely suspected, would be recycled. 257 Ironically, the announced program covered the popular Dukeminier casebook on property law, 258 so many students would have no permanent property interest in their property casebook. Almost immediately, Professor James Grimmelmann posted a petition on Change.org pledging a boycott of Connected Casebooks and "insist[ing] that our books be sold as books always have been: subject to first sale and free to circulate in the world." 259 After the petition garnered hundreds of signatories in two days, Aspen announced that Connected Casebook would be optional—students could still purchase (and thus resell) casebooks.

Although Change.org counted that result as a "victory," Aspen's program could still tamp down the used-book market. One key issue will be the price differential between purchased and leased books. As of December 2015, that differential is about 18% of the purchase price for the Dukeminier casebook ($211.95 for purchases; $172.95 for Connected Casebooks) on the website used for Aspen's distribution; the differential is about the same if books were purchased on Amazon.com ($210.34). 260 Even with those prices, the number of used books on the market will likely decrease if Connected Casebooks appeal to some students who prefer new copies of casebooks but are willing to return them at semester's end. 261 Moreover, Aspen might raise the price for purchasing books

257 See id. (quoting Professor Grimmelmann that "[i]t seems most likely that the returned books will be pulped").

258 Jesse Dukeminier et al., Property (8th ed. 2014).


261 Such students would prefer Connected Casebook unless they could anticipate getting about $38 or more for the used book. For casebook editions published more than a couple of years ago, $38 is probably on the high side of resale prices (for example, the 2012 edition of Aspen’s Epstein/Sharkey torts casebook currently has a trade-in value of $22.63 on Amazon.com). See Book Trade-in, Cases and Materials on Torts, Tenth Edition (Aspen Casebooks), Amazon, http://www.amazon.com/gp/search/s/ref=tradeinavs?url=rh%3Dn%3A2205237011&field-keywords=978-0735599925&Go=Search (last visited Dec. 10, 2015), archived at https://perma.cc/T4WA-TLJ2?type=source.
in future years, and it might be difficult to generate enthusiasm for pro-
testing incremental price increases, especially if the lease price remains
unchanged.

A quick analysis might suggest that leasing arrangements like Con-
nected Casebook avoid exhaustion. Copyright’s codified exhaustion
document protects only an “owner” of a particular copy.262 Under the
common law of property, lessors do not own the leased property. Indeed,
the Copyright Act itself grants exclusive rights to distribute copies “by
sale or other transfer of ownership, or by rental, lease, or lending”263—
language implicitly recognizing a lease is not a “transfer of ownership.”

The analysis is not quite so simple, however, because commercial law
precedents sometimes hold transactions characterized as leases to be de
facto sales.264 Under our thesis (which emphasizes avoiding conflicts be-
tween IP and general commercial law), that body of commercial law
provides appropriate precedents to determine whether leases should be
considered de facto sales for purposes of exhaustion.

Section 1-203 of the UCC and the case law under it provide the rele-
vant guidance. Section 1-203(b) includes a per se rule that characterizes
certain purported leases as de facto sales, but the rule is limited to de-
tecting transactions that are really sales coupled with loans with continu-
ing payments due.265 Book leases structured with a single up-front pay-
ment would not trigger Section 1-203’s per se rule.

Yet Section 1-203 also includes a more general “economic realities
analysis.”266 Under that analysis, the most important characteristic of a
true lease is that the lessor must retain “an economically meaningful re-
sidual interest” in the property or, stated similarly, the property must be
returned while “it retains some substantial economic life.”267 That test
presents some problems for arrangements like Connected Casebook be-

263 Id. § 106(3) (emphasis added).
264 See, e.g., In re Pillowtex, 349 F.3d 711, 721 (3d Cir. 2003); Robert Downey et al., Sur-
265 Section 1-203(b)’s per se rule applies only where the “consideration” paid for the lease
is “an obligation for the term of the lease,” which the official commentary interprets as being
“an obligation to continue paying consideration for the term of the lease.” U.C.C. § 1-203(b)
& cmt. 2 (2014).
266 See, e.g., William D. Warren & Steven D. Walt, Secured Transactions in Personal
Property 356 (9th ed. 2013) (describing the analysis required under section 1-203(a), which
requires leases to be evaluated by the “facts of each case”).
267 Id. at 342.
cause Aspen is almost certainly destroying the returned books. Thus, in a real sense, the returned books are at the end of their economic life. Case law also indicates that leases are more likely to be considered bona fide where the property must be returned in good condition. Aspen's program, however, imposes "no writing or highlighting restrictions" on the leased books and guarantees that "there can be no damage fees" as long as the book is returned.

Despite those facts, which cut against viewing Aspen's program as a true leasing program, there remain two very strong reasons for believing that the program will achieve Aspen's business goals. First, in the most likely litigation scenario, Aspen would be suing a reseller who would be arguing that Aspen's purported lease was in fact a sale (thus triggering exhaustion) because the books had no "substantial economic life" remaining when they should have been returned. Yet that book reseller would be engaged in selling those books—an activity that, to put it mildly, undercuts the argument that the books have no remaining economic life. There is a deep paradox here, of course, because if the books had been returned, Aspen would have destroyed them. Still, it is difficult to envision a court holding that unreturned books have no remaining economic life where the defendant is actually reselling them.

Second, even if Aspen's book leasing scheme were deemed a sale—thus triggering exhaustion—book resellers would gain immunity only from copyright infringement. If nominal leases are viewed as de facto sales under the UCC, the transactions are restructured as sales subject to security interests. At worst then, Aspen's purported leases would be viewed as sales subject to security interests securing the obligation to re-

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270 Connected Casebook, supra note 268 (detailing the program). To be sure, Aspen could distinguish some precedents in this area. For example, In re Pillowtex, 349 F.3d 711, 720 (3d Cir. 2003), held nominal leases to be sales because the transferor had no "plausible intent" to repossess the goods due to the unreasonably "high costs necessary" for repossession in that case. Clearly, Aspen intends to repossess the leased books, and the costs of repossession (return postage) are not high.

271 As previously explained in Subsection IV.A.3, supra, a security interest can secure not only payment obligations, but also a broad class of other obligations.
turn the books. Because students buy books for their personal use, the
publisher need not make any filing to perfect each security interest; it is
perfected upon attachment. The security interest is then an encum-
brance that, in general, runs with the property and applies against almost
all subsequent purchasers.

Under that scenario, publishers like Aspen would have no copyright
infringement actions but would have actions like replevin and conver-
sion. Such causes of action have their intricacies, for the relevant
commercial law balances the interests of buyers, sellers, and prior
rightholders. Yet even commercial law’s more limited remedies should
prove sufficient to deter book resellers from making a market in used
books distributed through programs such as Connected Casebook.

2. Software Licensing

If book leasing seems like a thin formalism to evade exhaustion, it is
nothing compared to the ultimate in formalistic evasions: software li-
censing. Under this technique, copyright owners deliver copies of soft-
ware into the possession of end users, but the legal position of the copy-
right owners is that the end users are mere licensees and do not own the
copies. The copyright owners take this position even if, as is often the
case, the end user has the right to possess the copy not merely beyond
the copy’s economic life, but forever.

273 There would be some possible exceptions. For example, under UCC § 9-320(b), another
student who purchased the book for personal use without knowledge of the encumbrance
could take the book free of the publisher’s security interest if the publisher did not provide
constructive notice through a filing pursuant to UCC Article 9. The publisher could avoid
that exception by imprinting on the book a prominent notice providing all purchasers actual
knowledge of the encumbrance.
275 See United States v. Tugwell, 779 F.2d 5, 7 (4th Cir. 1985); Madison Capital Co. v. S & S
276 For example, some precedent holds that conversion lies only if the security interest
holder first makes a demand for the encumbered goods and the possessor refuses the de-
mand. See, e.g., Fleet Capital Corp. v. Yamaha Motor Corp., U.S.A., No. 01 Civ. 1047(AJP),
Runnells Grain Elevator, 272 F. Supp. 2d 800, 805 (S.D. Iowa 2003) (not requiring a de-
mand for the return of the goods prior to conversion action); Stevens v. Smith, 71 So. 3d
Software licensing thus appears to be the *ne plus ultra* of all formalisms, and yet many courts have seemed perfectly willing to accept the formalism. As a result, the exhaustion doctrine often has little application to copyrighted software. Several commentators have argued that the position of copyright owners is wrong and that, looking to the substance of these transactions, courts should view the end users as de facto owners protected by copyright's codified exhaustion rule. To that wealth of commentary, we will add only a little. Our thesis provides three insights necessary to understanding the path of law and the limited stakes of the issue.

Our first point is that, if the exhaustion doctrine is viewed as a domain limitation that prevents IP laws from displacing ordinary commercial law, then the doctrine's complete (or nearly complete) absence in the area of software is understandable. In a nutshell, the software industry grew up without an established commercial law of software to displace, and as the industry grew, copyright licensing was (and still is) the dominant method for distributing programs.

The dominance of software licensing, especially in the early stages of the industry, can be traced to two features that distinguish computer programs from other copyrighted works, such as books. First, in order to function, a computer program often needs to create a copy of itself in the computer's main memory. So basic is this aspect of programs that, in 1980, Congress added a provision to the Copyright Act giving "the owner of a copy" of copyrighted software the right to make another copy to the extent necessary "as an essential step in the utilization of the computer program in conjunction with a machine." Before the enactment of that statute, end users of programs were in much the same position as the farmer in *Bowman v. Monsanto Co.* The exhaustion doctrine has never allowed an owner of one copy of a patented invention or copy-

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See Nimmer et al., supra note 7, at 38 n.84 (noting that an article co-authored by two officials at Microsoft "conceded with admirable candor" that "'software publishers license rather than sell software in order to negate the doctrine of first sale'" (quoting William H. Neukom & Robert W. Gomulkiewicz, Licensing Rights to Computer Software, in Technology Licensing and Litigation 1993, at 775, 778 (1993))).

See, e.g., Aaron Perzanowski & Jason Schultz, Copyright Exhaustion and the Personal Use Dilemma, 96 Minn. L. Rev. 2067, 2128 (2012) (arguing that a software licensing transfer should be viewed as a sale if the "transaction is characterized by a one-time payment and perpetual possession"); Rothchild, supra note 7, at 105 (characterizing as "not supportable" software publishers' claims that they retain ownership of the software copies they distribute).

righted work to make additional copies, so prior to 1980 end users of programs needed licenses because the programs (like the seeds in *Bowman*) were making copies of themselves as part of their ordinary use. Thus, during the first decade and a half of copyrighted software, end users became accustomed to a commercial reality in which ownership of a copy of a program was useless without a license.

Another feature of early computer programs— one that continues to this day—is that programs straddle the line between goods and services. As then-Professor (now Justice) Breyer noted in 1970, even “packages” of computer programs were sold along with “a promise that the seller [would] install the program, iron out its ‘bugs,’ update it as advances are made, and make adjustments from time to time to keep it compatible with [other programs] in the machine.” All of that is (surprisingly) still true today, but the more important point is that, to the extent that a computer program “package” contains a service component, having that component governed by contract (that is, a license) presents no conflict with ordinary principles of commercial law governing property rights in goods.

Because of these features of software (and perhaps because of other reasons), the software industry developed with copyright licensing as the central feature of its unique commercial law. If the exhaustion doctrine has been a do-little doctrine in software, that is because, as a domain limitation, the doctrine has had little to do. Outside of licensing, the practical commercial law governing the sale and transfer of physical copies of computer programs was poorly developed originally and has languished ever since.

Our second point is that the commercial law governing sales of copies of software need not remain so underdeveloped. The fiction attacked vociferously by commentators—the fiction that the copyright owner retains title to the software *copy* sold and delivered to consumers—is based on an old retention-of-title fiction that was prevalent in commercial law over a century ago. But modern commercial law rejects this fiction; indeed, it is expressly addressed in the UCC, which provides that any

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281 Id. at 345.
282 See supra notes 249–53 and accompanying text.
"retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer . . . is limited in effect to a reservation of a 'security interest.'"\(^{283}\) In other words, the UCC recognizes the buyer as owner of the goods, and the seller's attempt to retain title merely creates a security interest.

Prior commentary has noted that the UCC provides a sensible approach to the software industry's reliance on the retention-of-title fiction, but IP scholars have generally been hesitant to endorse a rigorous application of that approach because it supposedly lacks the national uniformity demanded by IP policy.\(^{284}\) But in fact the UCC offers a great deal of uniformity—it is after all the *Uniform Commercial Code*. Moreover, the exhaustion doctrine has always been about defining the border between IP law and non-IP law, and much of the latter is state law. The doctrine sacrifices one form of uniformity to achieve another. It sacrifices *national* uniformity (which would occur if the statutory domain of IP statutes were expanded to cover all transactions in goods embodying intellectual property) to achieve uniformity *within a particular jurisdiction* concerning all transactions in goods, both those embodying and not embodying intellectual property. If national uniformity were a trump card, the exhaustion doctrine would not exist.

Our third point is similar to that made in connection with leased books: Even if the exhaustion doctrine were to operate on nominally licensed software, software copyright owners would still have significant protection under commercial law. Consider one of the most famous cases concerning the exhaustion doctrine's application (or lack thereof) to software, *Vernor v. Autodesk, Inc.*\(^{285}\)

\(^{283}\) U.C.C. § 1-201(b)(35) (2014); see also id. § 2-401(1) (setting forth the same rule).

\(^{284}\) See, e.g., Carver, supra note 255, at 1914–15 (noting that the UCC would mandate a transfer of title); Rothchild, supra note 7, at 39, 62 (same). Both Carver and Rothchild balk at accepting the full implications of the UCC's approach, which might (depending on state law) leave the seller with valid contractual rights enforceable via the security interest. Thus, Carver argues for the development of federal common law to govern software sales contracts, with the federal courts using the UCC merely as one source of persuasive authority. See Carver, supra note 255, at 1951–52. Similarly, Rothchild argues in favor of very broad copyright preemption so that all contractual restrictions on use or resale of purchased copies (and thus, presumably, all security interests to enforce such restrictions) would be rendered invalid. Rothchild, supra note 7, at 89–104. In advancing those arguments, both commentators expressly invoke the need for national uniformity of copyright law. See Carver, supra note 255, at 1951; Rothchild, supra note 7, at 93, 99.

\(^{285}\) 621 F.3d 1102 (9th Cir. 2010).
Autodesk produces sophisticated software for computer-aided design. At the time of the litigation, Autodesk sold the software on disks, but its customers had to accept a license to install the software. That license stated, among other things, that Autodesk’s customers were merely licensing a copy of the software; that they were prohibited from reselling the copy; and that Autodesk retained title to all of the copies. Vernor began purchasing and reselling copies of the software from Autodesk’s customers (who were obviously violating their licensing agreements). After Autodesk demanded that Vernor stop his re-sales because they constituted copyright infringement, Vernor sued for a declaratory judgment that the first sale doctrine protected his re-sales from Autodesk’s copyright infringement claim. Vernor lost. The Ninth Circuit ruled that Autodesk’s customers were mere licensees, not owners, of the software copies, and therefore Vernor was not protected by the first sale doctrine.286

The Vernor decision has produced significant scholarly criticism,287 and we agree that the court’s reasoning has its weaknesses. Yet our point here is entirely different from the points made in that commentary. If Autodesk’s customers did own their copies of the software, the first sale doctrine would have protected Vernor only against any liability for copyright infringement. But Autodesk could have used commercial law to achieve the same (or nearly the same) result.

A court ruling in Vernor’s favor on the first sale doctrine would have had to view the software copies as physical goods that can be bought and sold. That viewpoint would trigger application of the UCC, and a court applying the UCC would almost certainly have to rule that, if Autodesk’s transfer of the software-on-a-disk is viewed as a sale, it would be a sale subject to Autodesk’s retention of a security interest securing the obligations in the purported license.288 Even if Autodesk did not take

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286 Id. at 1111. In holding the software user was not an owner, Vernor relied on the restrictiveness of the user’s licensing agreement and the parties’ characterization of the transaction in the form contract.

287 See, e.g., Katz, supra note 7, at 130 (describing Vernor as “a palpable error”); Perzanowski & Schultz, supra note 278, at 2127–28 (criticizing Vernor and “hop[ing] that other circuits will resist its flawed approach to the question of copy ownership”).

288 Berkeley Professor Brian Carver appears to believe, incorrectly, that security interests may cover only obligations to make further payments. After correctly noting that the UCC would not permit a reservation of full title after a permanent transfer of goods, Carver asserts that “where one pays full price in one lump sum, no security interest exists and the transferee is simply deemed to hold title to goods upon full payment.” See Carver, supra note 255, at 1914. Carver offers no authority for that assertion, and it is not the law. See supra notes 238–
steps to perfect its security interest (by making a proper filing in the relevant state office), Vernor would still take the software-containing disks subject to a security interest because Vernor actually knew about Autodesk’s rights (that is, he knew about Autodesk’s licensing terms)\(^{289}\) and Autodesk’s customers were not in the business of selling the software.\(^{290}\) Because Autodesk’s customers were breaching the secured obligations by re-selling their disks, UCC Article 9 would give Autodesk the right to repossess the disks.\(^{291}\) Moreover, because Vernor’s purchase of the disks interferes with Autodesk’s right to repossess, Vernor would be liable for conversion.\(^{292}\) And if Vernor insisted on selling the copies after Autodesk tried to assert their right to repossess, Vernor might be liable for punitive damages.\(^{293}\) In sum, the first sale doctrine would protect Vernor from copyright infringement, but that would not thwart Autodesk from winning under commercial law theories.

### C. Preemption and Statutory Domain

The prior analysis assumes that, for goods embodying intellectual property, courts would generally enforce contracts between sellers and purchasers and any property encumbrances (such as security interests) created by such contracts. That assumption is clearly correct for patented goods because no court has ever held that patent law’s uncodified exhaustion doctrine preempts state commercial law.\(^{294}\) Under our thesis,  

\(^{289}\) U.C.C. § 9-317(b) (2014).

\(^{290}\) This prevents Vernor from claiming the protection afforded to buyers in the ordinary course of business. See id. §§ 1-201(b)(9), 9-320(a). Also, because Vernor did not purchase the software for his own use, he could not claim the protections afforded buyers of consumer goods under UCC § 9-320(b).

\(^{291}\) Id. § 9-609.

\(^{292}\) As noted above, some states would require that Autodesk first make a demand for the return of the encumbered goods. See supra note 276.

\(^{293}\) See, e.g., JCB, Inc. v. Union Planters Bank, NA, 539 F.3d 862, 873 (8th Cir. 2008) (awarding punitive damages to senior secured creditor because junior creditor seized and sold collateral “with reckless disregard for [the secured creditor’s] rights in them”).

\(^{294}\) A small number of commentators have suggested that patent exhaustion \textit{might} preempt some portions of state contract law, but with no case support for that position, even those commentators have remained tentative in their discussions. See, e.g., Shubha Ghosh, \textit{Carte Blanche, Quanta, and Competition Policy}, 34 J. Corp. L. 1209, 1226, 1237 (2009) (suggesting that “[a] contract term that limits the application of the [patent] exhaustion doctrine may
any such argument would fundamentally misconceive the nature and function of the doctrine. Exhaustion is a doctrine of demarcation and separation designed to restrict IP statutes to their proper domain and thereby to prevent interference with other bodies of law.

Several commentators have argued that copyright's codified exhaustion principle should preempt at least contractual rights restricting distribution (and, logically, also any property encumbrances securing distribution restrictions). Such arguments have a quite reasonable textual basis in Section 301 of the Copyright Act, which broadly preempts all legal and equitable rights "equivalent to" rights "within the general scope of copyright as specified by section 106." Because one right in Section 106 is the exclusive right to control distribution of copies, those commentators have argued that Section 301 preempts state contract law to the extent that a copyright owner would use contracts to restrict distribution, including distribution after the copies are initially sold.

Yet such broad preemption arguments have had very little success in the courts. The most famous appellate decision on the issue—the Seventh Circuit's ProCD, Inc. v. Zeidenberg (written by none other than Judge Easterbrook)—held that contract rights are inherently not "equivalent" to rights within the scope of copyright because contracts "generally affect only their parties; strangers may do as they please," whereas the copyright statute creates "rights established by law—rights that restrict the options of persons who are strangers to the author." This is the basic distinction between contract and property. Contract rights are typically limited to the parties; property rights are good against the world.

At least one other circuit—the Eleventh—has expressly adopted ProCD's reasoning. Other circuits have adopted reasoning that could potentially preempt some contractual rights but have also ruled that Sec-

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295 See, e.g., Nimmer et al., supra note 7, at 45–63; Rothchild, supra note 7, at 88–104.
297 86 F.3d 1447, 1454 (7th Cir. 1996) (emphasis omitted).
298 See id. ("A copyright is a right against the world.").
299 Utopia Provider Sys. v. Pro-Med Clinical Sys., 596 F.3d 1313, 1326 (11th Cir. 2010).
tion 301 does not preempt a contractual promise to pay some specified amount for engaging in an act that would otherwise be within the scope of a copyright owner’s rights (such as making or distributing copies). These courts reason that the breach of the promise to pay is an “extra element” distinguishing such contractual claims from rights under copyright. Most other circuits have embraced the “extra element” analysis and have routinely found that contract claims do require proof of at least one “extra element” sufficient to distinguish them from copyright claims.

Our thesis points to a broader theoretical reason, in addition to the doctrinal reasons articulated in circuit precedent, for holding that post-sale contractual restrictions on copyrighted materials are not preempted: Copyright law has never granted anything “equivalent” to a right to control post-sale distributions. As Bobbs-Merrill concluded, “[t]o add to the right of exclusive sale the authority to control all future retail sales . . . would give a right not included in the terms of the statute, and,

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300 See, e.g., Forest Park Pictures v. Universal Television Network, 683 F.3d 424, 433 (2d Cir. 2012) (“A claim for breach of a contract including a promise to pay is qualitatively different from a suit to vindicate a right included in the Copyright Act and is not subject to preemption.”); Wrench LLC v. Taco Bell Corp., 256 F.3d 446, 456 (6th Cir. 2001) (similar).

301 See, e.g., Wrench, 256 F.3d at 456 (holding that state-created causes of action are not preempted if they include an “extra element . . . instead of or in addition to the acts of reproduction, performance, distribution or display” and that “the promise to pay” is a sufficient extra element). As previously discussed, see supra note 244, copyright holders seeking to enforce contractual promises through security interests might be well advised to “monetize” such promises (that is, specify the amount payable in the event of breach). The circuit law on preemption provides a further reason for specifying an amount payable.

302 Montz v. Pilgrim Films & Television, 649 F.3d 975, 980 (9th Cir. 2011) (concluding that “contract claims generally survive [copyright] preemption because they require proof of such an extra element” and that a contract claim requiring proof of an “implied agreement of payment for use of a concept” has a sufficient extra element); Bowers v. Baystate Techs., 320 F.3d 1317, 1324 (Fed. Cir. 2003) (applying the “extra element” test to sustain a contractual restriction on the use of a computer program). Two older circuit court opinions include dicta that could be cited to support preempting some contract claims, but neither case actually holds any contract claim preempted. In Vault Corp. v. Quaid Software, 847 F.2d 255, 269–70 (5th Cir. 1988), the court held that the copyright holder’s licensing contract was unenforceable as a contract of adhesion and then held preempted a state statute that would have allowed enforcement of the copyright holder’s licensing terms even without a valid contract. In National Car Rental System v. Computer Associates International, 991 F.2d 426, 431 (8th Cir. 1993), the court held that a contractual restriction on the “use” of a copyrighted program was not preempted because a use restriction “constitutes an extra element in addition to the copyright rights making this cause of action qualitatively different from an action for copyright.” National Car does, however, suggest in dicta that contractual restrictions on “distribution” might be preempted. See id.
in our view, extend its operation, by construction, beyond its mean-
ing.\textsuperscript{303} That spatial metaphor—that a right to control downstream sales would “extend” the Copyright Act “beyond” its proper operation and meaning—is itself sufficient grounds for holding that any contractual re-
strictions on activities occurring after a first sale are not “equivalent,”
within the meaning of copyright’s preemption provision, to any rights
that have been protected by the Copyright Act.

Indeed, we can make one further point. Commentators arguing for
broad preemption make the same error that IP owners make in arguing
against exhaustion. Both want IP law to expand into, and to displace, the
ordinary commercial law governing the trade of physical goods. True,
the outcomes sought by each group are diametrically opposed. Pro-
preemption commentators want IP law to diminish commercial law
rights; IP owners want to augment such rights. But the two positions
share the overarching intellectual similarity of seeking to expand IP law.
The core policy of exhaustion is the opposite—it is to confine the ambit
of IP law and thereby neither augment nor abridge the operation of ordi-
nary commercial law once goods embodying IP “pass[] outside” (to use
the words of \textit{Bloomer v. McQuewan}\textsuperscript{304}) the domain of IP statutes.

CONCLUSION

This Article qualifies the common notion that IP law \textit{includes} a com-
mercial law of IP. The most important and controversial doctrine in the
area, the exhaustion doctrine, serves as a statutory domain limitation—a
frontier excluding from the province of IP those issues properly gov-
erned by more general commercial law.

Our thesis redeems the exhaustion doctrine from the criticism heaped
on it. Some commentators, like Richard Epstein, complain that the doc-
trine unjustifiably interferes with freedom of contract.\textsuperscript{305} Others, like
Herbert Hovenkamp, see the doctrine as too rigid—a “ham-handed” rule
that is “quaint and out of step” in an era when antitrust law takes a more
flexible approach toward contractual restrictions on alienation (such as
resale price maintenance agreements).\textsuperscript{306} Still others think the doctrine

\textsuperscript{303} 210 U.S. at 351.
\textsuperscript{304} 55 U.S. (14 How.) 539, 549 (1852).
\textsuperscript{305} See Epstein, supra note 7, at 503.
\textsuperscript{306} See Hovenkamp, supra note 29, at 2155.
does not go far enough; they seek preemption of contractual conditions and encumbrances limiting the use or resale of goods embodying IP.\textsuperscript{307}

All the above criticisms suffer from a common mistake. They ignore the Court’s repeated assertions in the seminal exhaustion cases that it was merely engaged in statutory interpretation and instead presume that the Court must be engaged in common law assessments of policy. Treating the doctrine as a statutory domain limitation explains why the foundational decisions claimed to be engaged in statutory interpretation; why they relied on spatial metaphors in deciding that some matters were “outside,” “beyond,” or “not within” the relevant IP statute; and why they remained agnostic about whether parties could achieve their desired results through other areas of law.\textsuperscript{308} The approach also explains the doctrine’s formalism—a characteristic not unusual for boundaries dividing one legal regime from another.

The exhaustion doctrine thus supplies what the statutory interpretation literature has long lacked—a clear example in which the Supreme Court has, over many years, restricted statutory domain in ways that cannot be completely explained by other canons and presumptions of statutory interpretation. This example shows that such domain limitations have particular importance in separating complex areas of law, such as IP and commercial law, for the modest goal of such limitations is to prevent an overly broad interpretation of a few words from imposing substantial policy changes not decided in the legislative process.

\textsuperscript{307} See Section IV.C, supra.

\textsuperscript{308} See Part I, supra.