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## The Interaction of Exhaustion and the General Law

Aaron K. Perzanowski

Case Western University School of Law, akp73@case.edu

Ariel Katz

Guy A. Rub

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## *ESSAY*

### THE INTERACTION OF EXHAUSTION AND THE GENERAL LAW: A REPLY TO DUFFY AND HYNES

*Ariel Katz, Aaron Perzanowski, and Guy A. Rub\**

#### INTRODUCTION

**I**N *Statutory Domain and the Commercial Law of Intellectual Property*,<sup>1</sup> Professors John Duffy and Richard Hynes argue that exhaustion—the doctrine that limits a patentee’s or copyright holder’s control over goods in the stream of commerce—was created and functions to confine Intellectual Property (“IP”) law within its own domain and prevent it from displacing other laws. Exhaustion, in their description, sets aside a space that other areas of the law, such as contracts and property, are left to regulate.

Like Duffy and Hynes, we believe that the intersection of IP and commercial law is an important topic with serious ramifications that would benefit from more scholarly attention, so we welcome their contribution to the ongoing debate over exhaustion. It is a debate in which the three of us have been deeply engaged, and one in which we rarely

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\* Ariel Katz is an Associate Professor, Innovation Chair–Electronic Commerce, Faculty of Law, University of Toronto. Aaron Perzanowski is an Associate Professor, Case Western Reserve University School of Law. Guy A. Rub is an Associate Professor, Michael E. Moritz College of Law, The Ohio State University. We would like to thank John Rothchild, Molly Van Houweling, and Chris Walker for their helpful comments. All remaining errors are, of course, our own.

<sup>1</sup> John F. Duffy & Richard Hynes, *Statutory Domain and the Commercial Law of Intellectual Property*, 102 Va. L. Rev. 1, 1–2 (2016).

find ourselves entirely aligned.<sup>2</sup> However, when it comes to many of Duffy and Hynes's fundamental insights about the relationship between IP and other areas of law, we not only agree with each other, we also agree with them. And we suspect most scholars engaged in the exhaustion debate would as well. Like Duffy and Hynes, the scholarly consensus acknowledges that other areas of law—most notably contracts—have a role to play in structuring transactions even when exhaustion limits copyright and patent exclusivity. IP law does not and should not exist in a vacuum. It must take into account the rights and obligations established under other bodies of law.

So far so good. But Duffy and Hynes make broader claims about the origins of exhaustion and its relationship to other bodies of law. That is where we part ways. They argue that the desire to confine IP law within its own domain and prevent it from displacing other laws is the *exclusive* explanation for both the emergence of exhaustion and its current function. In doing so they reject the idea that courts developed exhaustion in light of long-standing common law principles. Acknowledging the common law origins of the doctrine, they suggest, requires courts to wield exhaustion as a bludgeon, pummeling any commercial law doctrine that stands in its way.

In this Essay, we explain why we are not persuaded. We first discuss the role of the common law in shaping the exhaustion doctrine. We show that the evidence Duffy and Hynes offer is inconclusive, incomplete, and at times inaccurate. Close examination of early exhaustion cases paints a more complex picture that cannot be squared with the idea that exhaustion was created independently of common law principles. Next, we explain how Duffy and Hynes mischaracterize the prevailing scholarly understanding of exhaustion and how the approach they advocate would strip exhaustion of any normative content. While we agree that exhaustion draws a line between the domain of IP law and other laws and thus prevents the former from displacing the latter, the placement of that line is far from arbitrary, and has always reflected policy considerations. Finally, we note that Duffy and Hynes's theory oversimplifies the relationship between IP law and state law, partly because it does not fully consider federal preemption.

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<sup>2</sup> See, e.g., Ariel Katz, *The First Sale Doctrine and the Economics of Post-Sale Restraints*, 2014 *BYU L. Rev.* 55, 55, 59–60 (2014); Aaron Perzanowski & Jason Schultz, *Digital Exhaustion*, 58 *UCLA L. Rev.* 889, 892 (2011); Guy A. Rub, *Rebalancing Copyright Exhaustion*, 64 *Emory L.J.* 741, 743–44 (2015).

## I. THE COMMON LAW AND THE EMERGENCE OF EXHAUSTION

Did the common law play a role in the emergence of exhaustion? Duffy and Hynes vigorously argue it did not. But in reaching that conclusion, they largely ignore a line of early exhaustion decisions that invoke common law principles. And they struggle to square their approach with the Supreme Court's most recent copyright exhaustion decision—in their own words, “one of the most important decisions on the commercial law of [intellectual property]”<sup>3</sup>—that described exhaustion as “a common-law doctrine with an impeccable historic pedigree.”<sup>4</sup>

Duffy and Hynes insist the common law played no part in the creation of exhaustion; the doctrine is a matter of statutory interpretation and nothing else. Our claim is modest by comparison. We argue that the common law did play an important role. But unlike Duffy and Hynes, we don't see the common law and statutory interpretation as incompatible. Courts are not forced to either faithfully interpret statutes, or alternatively exercise “a free ranging power to create federal common law.”<sup>5</sup> We instead argue that courts rely on existing common law principles in choosing between competing statutory interpretations. Framing the alternative as a power to fabricate federal common law conjures up an activist bogeyman when in fact, the courts that developed the principle of exhaustion followed a well-trodden judicial path of erring on the side of the common law.

As Duffy and Hynes point out, statutory interpretation is not confined to the text alone.<sup>6</sup> Courts must look to—among a range of sources—other bodies of existing law. This is especially true when a statute is enacted against an existing body of common law. When Congress legislates in an area “previously governed by the common law,” courts must start from the assumption “that Congress intended to retain the substance of the common law.”<sup>7</sup> Where the courts have already spoken, “Congress does not write upon a clean slate.”<sup>8</sup> If Congress wants to depart from common law principles, the statute “must ‘speak directly’ to the ques-

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<sup>3</sup> Duffy & Hynes, *supra* note 1, at 41.

<sup>4</sup> *Kirtsaeng v. John Wiley & Sons, Inc.*, 133 S. Ct. 1351, 1363 (2013).

<sup>5</sup> Duffy & Hynes, *supra* note 1, at 28.

<sup>6</sup> *Id.*

<sup>7</sup> *Samantar v. Yousuf*, 560 U.S. 305, 320 n.13 (2010); see *Microsoft Corp. v. i4i Ltd. Partnership*, 131 S. Ct. 2238, 2245–46 (2011); *Isbrandtsen Co. v. Johnson*, 343 U.S. 779, 783 (1952).

<sup>8</sup> *United States v. Texas*, 507 U.S. 529, 534 (1993).

tion.”<sup>9</sup> That canon of construction is as old as Congress itself<sup>10</sup> and is still accepted today.<sup>11</sup>

*Bobbs-Merrill Co. v. Straus* demonstrates this point.<sup>12</sup> There the Supreme Court had to decide whether the copyright owner’s right to “vend” gave it control over just the first authorized sale or extended to subsequent sales too. The Court limited the right to “vend” to the first sale.<sup>13</sup> Many scholars and subsequent courts explain that choice as at least partly motivated by common law principles—in particular those favoring the free alienability of personal property and reflecting skepticism of servitudes on chattels.<sup>14</sup> We agree with Duffy and Hynes that the text of the opinion does not compel that reading; the Court did not explicitly invoke the common law. But neither did it explain exhaustion as a bulwark against copyright law encroaching upon the “commercial law generally,” as Duffy and Hynes argue.<sup>15</sup>

As such, *Bobbs-Merrill* does not contradict the consensus view that centuries-old common law principles played an important role in the creation of exhaustion. *Bobbs-Merrill* might not have made the connection explicit, but when read together with other contemporaneous decisions, the link between the emergence of exhaustion and those common law principles becomes apparent. In this short Essay we cannot explore every contemporaneous opinion that explicitly or implicitly used com-

<sup>9</sup> *Id.* (quoting *Mobil Oil v. Higginbotham*, 536 U.S. 618, 625 (1978)).

<sup>10</sup> *Brown v. Barry*, 3 U.S. (3 Dall.) 365, 367 (1797) (noting that an act “in derogation of the common law is to be taken strictly”); Theodore Sedgwick, *The Interpretation and Construction of Statutory and Constitutional Law* 267 (2d ed. 1874) (“[S]tatutes are not to be presumed to alter the common law farther than they expressly declare . . .”). That treatise was broadly used by courts, including the Supreme Court, including at the time in which the principles of exhaustion were developed. See, e.g., *Ca. Reduction Co. v. Sanitary Reduction Works*, 199 U.S. 306, 324 (1905).

<sup>11</sup> Antonin Scalia & Bryan A. Garner, *Reading Law: The Interpretation of Legal Texts* 318 (2012) (“[S]tatutes will not be interpreted as changing the common law unless they effect the change with clarity.”).

<sup>12</sup> 210 U.S. 339 (1908).

<sup>13</sup> *Id.* at 339–40.

<sup>14</sup> See, e.g., Herbert Hovenkamp, *Post-Sale Restraints and Competitive Harm: The First Sale Doctrine in Perspective*, 66 N.Y.U. Ann. Surv. Am. L. 487, 493–94 (2011); Christina Mulligan, *A Numerus Clausus Principle for Intellectual Property*, 80 Tenn. L. Rev. 235, 251 (2013); Aaron Perzanowski & Jason Schultz, *Reconciling Intellectual and Personal Property*, 90 Notre Dame L. Rev. 1211, 1249–52 (2015); John A. Rothchild, *The Incredible Shrinking First-Sale Rule: Are Software Resale Limits Lawful?*, 57 Rutgers L. Rev. 1, 12–13 (2004); Rub, *supra* note 2, at 759–62; Molly Shaffer Van Houweling, *The New Servitudes*, 96 Geo. L.J. 885, 910–14 (2008).

<sup>15</sup> Duffy & Hynes, *supra* note 1, at 8.

mon law principles in constructing exhaustion, but in the next few paragraphs we would like to point to a few of them.<sup>16</sup>

Consider, for example, *Doan v. American Book Co.*,<sup>17</sup> one of the decades-long line of copyright exhaustion cases that culminated in *Bobbs-Merrill*. In that decision the Seventh Circuit held that a purchaser of a book could repair and restore it notwithstanding the copyright holder's objections. The decision was not rooted in any statutory text, but in the intrinsic nature of personal property rights, as the court explained: "It would be intolerable and odious" to deny that a "right of ownership in the book carries with it and includes the right to maintain" it.<sup>18</sup>

To take another example, the same year the U.S. Supreme Court decided *Bobbs-Merrill*, the Australian High Court interpreted the term "vend" in that country's patent statute.<sup>19</sup> The High Court, in light of "the recognized rule that the legislature is not to be taken to have made a change in the fundamental principles of the common law without express and clear words announcing such an intention," concluded that the right to vend did "not refer to any sale of the article after it has once, without violation of the monopoly, become part of the common stock."<sup>20</sup> On appeal the Privy Council reversed, focusing on the need to reconcile the apparent inconsistency between the common law principles and the patent statute. The U.S. Supreme Court would rely on this judgment a year later in *Henry v. A.B. Dick Co.*,<sup>21</sup> and courts continue to cite it, including the Federal Circuit in an important 2016 patent exhaustion decision.<sup>22</sup>

This brings us to the early twentieth century Supreme Court patent exhaustion case law. In 1912, in *Henry*, the Court held that patentees could impose restraints on downstream purchasers and that "[t]here is no

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<sup>16</sup> See also Samuel F. Ernst, *Why Patent Exhaustion Should Liberate Products (And Not Just People)*, *Denver L. Rev.* (forthcoming 2016) (manuscript at \*21–\*27) (on file with authors) (noting the role of the policy against servitudes on chattels in early patent exhaustion cases, as well as the impact of the single recovery and statutory domain theories).

<sup>17</sup> 105 F. 772 (7th Cir. 1901).

<sup>18</sup> *Id.* at 777.

<sup>19</sup> See, e.g., *Nat'l Phonograph Co. of Austl. Ltd. v. Menck* (1908) 7 CLR 481 (Austl.), *rev'd in part Nat'l Phonograph Co. of Austl. Ltd. v. Menck* (1911) 12 CLR 15, 24 (Austl.) (holding that "the general doctrine of absolute freedom of disposal" can be restricted in the case of patented goods).

<sup>20</sup> *Nat'l Phonograph Co. of Austl. Ltd. v. Menck* (1908) 7 CLR 481, 512 (Austl.).

<sup>21</sup> 224 U.S. 1 (1912).

<sup>22</sup> *Lexmark Int'l, Inc. v. Impression Products, Inc.*, Nos. 2014–1617, 2014–1619, 2016 WL 559042 (Fed. Cir. Feb. 12, 2016) (en banc).

collision between the rule against restrictions upon the alienation or use of chattels not made under the protection of a patent and the right of the patentee through his control over his invention.”<sup>23</sup> Duffy and Hynes describe the disagreement between the majority and dissent in *Henry* as “primarily about the scope or domain of the patent statute, not about common law policies.”<sup>24</sup> But, read in context, it is clear that the common law baseline, and whether Congress intended to deviate from it, was one of the key points of contention in a rather bitter division among the Justices.

Both the majority and the dissent in this long decision relied heavily not just on the statutory language and existing precedent, but also on general legal principles and on the need to promote public policy goals. Writing for the dissent, Chief Justice White raised concerns regarding the expansive reading of patentees’ rights. His views were partly rooted in the common law. For example, he noted that the various forms in which patentees purported to extend their control “tend to increase monopoly and to burden the public to the exercise of *their common rights*.”<sup>25</sup> In another place, the dissent chastised the majority for not applying the rule that the Court had set forth a year earlier in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*<sup>26</sup> In that decision the Court—relying explicitly and extensively on the common law aversion to restraints of trade—held that downstream control of nonpatented goods, in the form of a retail price maintenance scheme, was invalid.<sup>27</sup>

Chief Justice White’s dissenting views prevailed five years later when the Court explicitly reversed *Henry*.<sup>28</sup> The same day, in *Straus v. Victor Talking Machine Co.*, another patent exhaustion case, the Court offered its most explicit early reference to the common law, stating that “[c]ourts would be perversely blind” if they failed to recognize restric-

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<sup>23</sup> *Henry*, 224 U.S. at 39.

<sup>24</sup> Duffy & Hynes, *supra* note 1, at 23.

<sup>25</sup> *Henry*, 224 U.S. at 70 (White, C.J., dissenting) (emphasis added). The term “common rights” is synonymous with “common law rights.” See, e.g., *Strother v. Lucas*, 37 U.S. (12 Pet.) 410, 437 (1838) (“[The right] exists by a common right, which means a right by common law . . .”).

<sup>26</sup> 220 U.S. 373 (1911), *cited in Henry*, 224 U.S. at 54–55 (White, C.J., dissenting).

<sup>27</sup> *Dr. Miles*, 220 U.S. at 404 (citing the common law and holding that “a general restraint upon alienation is ordinarily invalid. ‘The right of alienation is one of the essential incidents of a right of general property in movables, and restraints upon alienation have been generally regarded as obnoxious to public policy.’” (quoting *Park & Sons Co. v. Hartman*, 153 F. 24, 39 (6th Cir. 1907))).

<sup>28</sup> *Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 243 U.S. 502, 518 (1917).

tive patent licenses as an attempt “to sell property for a full price, and yet to place restraints upon its further alienation, such as *have been hateful to the law from Lord Coke’s day to ours, because obnoxious to the public interest.*”<sup>29</sup> Lord Coke is, of course, Edward Coke, one of the greatest common law jurists, whose opposition to restraints on trade influences exhaustion case law to this day.

A much more recent exhaustion case reinforces the point that even when the Court is undeniably engaged in statutory interpretation, the common law has informed its reasoning. In *Kirtsaeng v. John Wiley & Sons, Inc.*,<sup>30</sup> the question was whether the first sale doctrine embraced the importation and resale of books manufactured and lawfully sold abroad. Specifically, the case turned on the meaning of the phrase “lawfully made under this title.”<sup>31</sup> Despite the clearly statutory nature of the question, the majority described the first sale doctrine as one “with an impeccable historic pedigree” dating back to “the early 17th century.”<sup>32</sup> The Court relied on the fact that “[t]he common-law doctrine makes no geographical distinctions” to bolster its statutory reading.<sup>33</sup> And it emphasized the policy considerations disfavoring “restraints on the alienation of chattels” and embracing the “importance of leaving buyers of goods free to compete with each other when reselling or otherwise disposing of those goods.”<sup>34</sup> Those considerations, along with “§ 109(a)’s language, its context, and the common-law history of the ‘first sale’ doctrine, taken together, favor a non-geographical interpretation.”<sup>35</sup> The Court thus had no trouble reconciling the common law with statutory interpretation.

The Court’s approach in *Kirtsaeng* thus strongly reinforces our views and the consensus among scholars that the common law played a role in the development of exhaustion and thus challenges Duffy and Hynes’s rejection of that consensus. In discussing *Kirtsaeng*, Duffy and Hynes are forced to concede that the court was invoking a “‘canon of statutory interpretation’ disfavoring expansive readings of statutes that ‘invade the common law.’”<sup>36</sup> We are, however, unsure how that acknowledgement

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<sup>29</sup> 243 U.S. 490, 500–01 (1917) (emphasis added).

<sup>30</sup> 133 S. Ct. 1351 (2013).

<sup>31</sup> 17 U.S.C. § 109(a) (2012).

<sup>32</sup> *Kirtsaeng*, 133 S. Ct. at 1363.

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> *Id.* at 1358 (emphasis omitted).

<sup>36</sup> Duffy & Hynes, *supra* note 1, at 51 (quoting *Kirtsaeng*, 133 S. Ct. at 1363).

squares with their overall rejection of the consensus approach. In other words, we are puzzled by Duffy and Hynes's failure to consider that other decisions, including those that established the core of IP exhaustion doctrine, were similarly relying on this centuries-old canon of interpretation.<sup>37</sup>

Duffy and Hynes make another claim to support their account of the emergence of exhaustion. They note that a number of early exhaustion decisions "disclaim any attempt to adjudicate the relief plaintiffs might obtain outside of IP law"<sup>38</sup> and argue that "[s]uch agnosticism about ultimate results would be difficult to explain if the Court were engaged in pure policymaking directed toward substantive goals."<sup>39</sup> For example, in *Bobbs-Merrill*, the Court noted there was no contract claim before it.<sup>40</sup> Similarly, in *Motion Picture Patents Co. v. Universal Film Manufacturing Co.*, the Court noted that whether the patentee can restrict the buyer "by special contract between the owner of the patent and a purchaser or licensee is a question outside the patent law and with it we are not here concerned."<sup>41</sup>

We are unpersuaded that the courts were agnostic to the consequences or substance of post-sale restraints, and that their only concern was ensuring the correct legal form and forum for implementing them. We disagree with Duffy and Hynes for two reasons. First, reading the Court's unsurprising failure to decide an issue that was not properly before it as a disavowal of the common law and other policy considerations is a leap we are unwilling to take. Second, a close examination of contemporaneous decisions reveals statements that are inconsistent with the agnosticism hypothesis. Rather than conveying agnosticism, those courts objected to certain contracts on substantive policy grounds and expressed skepticism as to their enforcement as a matter of general commercial law. For example, Chief Justice White, in his dissent in *Henry*, recog-

<sup>37</sup> See supra note 13.

<sup>38</sup> Duffy & Hynes, supra note 1, at 8.

<sup>39</sup> Id. at 12.

<sup>40</sup> *Bobbs-Merrill*, 210 U.S. at 346.

<sup>41</sup> 243 U.S. 502, 509 (1917). It should be noted that later in the opinion the Court expressed deep concerns with legal mechanisms that allow patentees to exercise control over downstream usage, stating that "[t]he perfect instrument of favoritism and oppression which such a system of doing business, if valid, would put into the control of the owner of such a patent *should make courts astute, if need be, to defeat its operation.*" Id. at 515 (emphasis added). While the Court does not *explicitly* state that its concerns extend beyond a patent cause of action, we believe that if the Court were truly agnostic with respect to enforcing post-sale restrictions through contract law, it would not have used such strong language.

nized that the validity of contractual post-sale restrictions ought to be governed by contract law. However, he noted that if not for the majority opinion, those contracts would be void as against public policy, asking rhetorically: “Who . . . can put a limit upon the extent of monopoly and wrongful restriction which will arise, especially if by such a power a contract which otherwise would be void as against public policy may be successfully maintained?”<sup>42</sup> That majority opinion was, as we already noted, short lived.

In *Boston Store of Chicago v. American Graphophone Co.*, Chief Justice White, now writing for the majority, continued to express skepticism as to whether post-sale restrictions are enforceable under “general law.”<sup>43</sup> He explored the Court’s recent case law and concluded that

[a]pplying the cases thus reviewed there can be no doubt that the alleged price-fixing contract disclosed in the certificate was *contrary to the general law and void*. There can be equally no doubt that the power to make it in derogation of the general law was not within the monopoly conferred by the patent law . . . .<sup>44</sup>

This statement, we believe, plainly indicates that the Court was not agnostic to the possibility of enforcing post-sale restrictions via contracts, as it perceived the contracts at issue as void under general law. Moreover, in relying on its recent case law—which included numerous IP exhaustion cases as well as *Dr. Miles*, which deals with nonpatented products—to reach this result, the Court indicated that it did not consider the rights under IP law and the rights under general law as completely separated, as Duffy and Hynes argue,<sup>45</sup> but as highly related.<sup>46</sup> As we further discuss below, the interaction between these two bodies of law is indeed complex.

In short, the arguments raised by Duffy and Hynes do not convince us that courts ignored well-established common law principles while developing exhaustion. We remain persuaded that the history of exhaustion

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<sup>42</sup> *Henry*, 224 U.S. at 70–71 (emphasis added).

<sup>43</sup> 246 U.S. 8, 20 (1918).

<sup>44</sup> *Id.* at 25 (emphasis added).

<sup>45</sup> Cf. Duffy & Hynes, *supra* note 1, at 27 (noting that the *Boston Store* Court “distinguishes between issues within the patent domain from those governed by ‘the general law’; *id.* at 28 (“[I]n creating the exhaustion doctrine, the Supreme Court did sharply distinguish statutory issues under federal IP laws from common law issues concerning contract and property.”)).

<sup>46</sup> See also *Boston Store*, 246 U.S. at 20–21, 27.

shows that those principles played—and continue to play—a role in shaping the doctrine. Likewise, we reject their assertion that the courts showed no interest in public policy and specifically that the courts’ concern about post-sale restraints had nothing to do with the substance of those restraints.

## II. THE NORMATIVE IMPACT OF STATUTORY DOMAIN

Duffy and Hynes view exhaustion as exclusively a matter of statutory domain. That claim plays a dual role in their analysis. First, it contrasts their theory with what they describe as the prevailing wisdom about exhaustion’s relationship to other areas of law. But as we will describe, in drawing that distinction, Duffy and Hynes mischaracterize much of the prior exhaustion scholarship. Second, it restricts the ability of courts to consider broader policy goals, reducing the judicial function to identifying largely arbitrary triggers for exhaustion and stripping the doctrine of much of its normative content.

The consensus view among modern commentators, Duffy and Hynes suggest, leads to IP doctrine running roughshod over distinct bodies of law like contract and property. Exhaustion, they argue, is required to preserve these other areas of law undisturbed. Modern commentators, they say, hold very different beliefs. Skeptics of exhaustion want “complete freedom to contract around exhaustion.”<sup>47</sup> And exhaustion proponents see the doctrine as a “free ranging power”<sup>48</sup> to “allow or forbid a particular transaction.”<sup>49</sup> Many scholars, they tell us, “want the courts to forbid any circumvention[s]” of exhaustion.<sup>50</sup> Later, they claim that many of those same scholars view leases as “unjustified circumventions of the exhaustion doctrine.”<sup>51</sup> But they fail to cite any scholars who actually espouse these categorical views.

We do not think this characterization reflects the majority of scholarship on exhaustion. It certainly does not reflect our views. We believe that even if exhaustion applies, a valid agreement may often give rise to a claim of breach and contractual remedies.<sup>52</sup> Similarly, we believe that

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<sup>47</sup> Duffy & Hynes, *supra* note 1, at 10.

<sup>48</sup> *Id.* at 28.

<sup>49</sup> *Id.* at 9.

<sup>50</sup> *Id.* at 10.

<sup>51</sup> *Id.* at 54.

<sup>52</sup> See, e.g., Perzanowski & Schultz, *supra* note 2, at 904–05, Rub, *supra* note 2, at 809–12. See also Ariel Katz, *The Economic Rationale of Exhaustion: Distribution and Post-Sale Re-*

exhaustion does not forbid rights holders from offering products through genuine leases, rentals, or subscriptions.<sup>53</sup> Of course, not all attempts at licensing or contracting around exhaustion will succeed. In some instances they might be preempted or invalid for violating public policy, a decision that might be partly guided by some of the same policies that informed the development of exhaustion. But it is not our position, nor, we believe, the position of most modern commentators, that exhaustion necessarily or routinely undermines general commercial law. The contention that contract and property law can coexist with exhaustion is entirely consistent with the prevailing wisdom.

That is not to say that the argument put forward by Duffy and Hynes is without consequences. If courts adopt the view advocated by Duffy and Hynes, it would significantly limit the tools at their disposal for resolving pressing questions about the scope of exhaustion. Duffy and Hynes claim that exhaustion draws a formal line between what is regulated by IP law and what is not. As they admit, “formalist boundary lines are inherently arbitrary.”<sup>54</sup> As a result, their theory urges courts to ignore the impact of exhaustion on other policy goals. We find this outcome inconsistent with well-established practices, difficult to sustain, and undesirable.

Consider, for example, two contemporary exhaustion questions: the choice between international and national exhaustion and the applicability of the doctrine to digital distribution. As a matter of copyright law, the Supreme Court resolved the first of these questions when it adopted international exhaustion in *Quality King Distributors, Inc. v. L'anza Research International, Inc.*<sup>55</sup> and *Kirtsaeng*.<sup>56</sup> Most commentators agree that the text of the Copyright Act provides plausible arguments both for and against international exhaustion. The Court's choice between them

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straints, in *Research Handbook on IP Exhaustion and Parallel Imports* (Irene Calboli & Edward Lee eds., Edward Elgar 2016) (suggesting that the common law doctrine of restraint of trade could evolve to distinguish between valid and invalid contracting around exhaustion); Katz, *supra* note 2, at 90–100 (proposing some parameters to distinguish between valid and invalid instances of contracting around exhaustion).

<sup>53</sup> See, e.g., Perzanowski & Schultz, *supra* note 2, at 904 (“Copyright owners committed to price discrimination can avoid [exhaustion] by structuring transactions not as sales but as leases or subscription services.”). This does not mean, however, that right holders should be able to avoid exhaustion by merely labeling a sale or other transfer of ownership a “license.” Rub, *supra* note 2, at 814–16.

<sup>54</sup> Duffy & Hynes, *supra* note 1, at 36.

<sup>55</sup> 523 U.S. 135, 152 (1998).

<sup>56</sup> 133 S. Ct. at 1359.

was not limited to a narrow examination of the Act; it also considered broader policy questions, including access to creative works,<sup>57</sup> “competition, including freedom to resell,”<sup>58</sup> judicial administrability,<sup>59</sup> and “basic constitutional copyright objectives.”<sup>60</sup>

The Federal Circuit recently provided a different answer to that question when it affirmed national patent exhaustion in *Lexmark International, Inc. v. Impression Products, Inc.*<sup>61</sup> Granted, both the majority and the dissent partly based their decisions on the language and the structure of the Patent Act, as compared to *Kirtsaeng*’s interpretation of the Copyright Act. However, both the majority and the dissent extensively addressed policy concerns. They analyzed how national and international exhaustion would affect certainty in the market, allow patentees to recoup their investments through price discrimination, might foster perpetual control over downstream distribution, and more.<sup>62</sup> Therefore, the *Lexmark* majority and dissent, like the *Kirtsaeng* majority and dissent, agree with the scholarly consensus that policy considerations play a vital role in interpreting and shaping exhaustion.

Digital distribution provides another example of the difficulty in understanding exhaustion as an “inherently arbitrary” line between IP law and general law, as Duffy and Hynes maintain,<sup>63</sup> because this view limits the ability of courts to adjust the scope of exhaustion over time and in response to changing conditions. The primary reason for the recent at-

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<sup>57</sup> *Quality King*, 523 U.S. at 151 (noting, for example, that the plaintiff’s position in that case, promoting national exhaustion, “would merely inhibit access to ideas without any countervailing benefit”).

<sup>58</sup> *Kirtsaeng*, 133 S. Ct. at 1363.

<sup>59</sup> *Id.* (noting the “burden of trying to enforce restrictions upon difficult-to-trace, readily movable goods”).

<sup>60</sup> *Id.* at 1364–65 (noting the impact of national exhaustion on libraries and museums).

<sup>61</sup> Nos. 2014–1617, 2014–1619, 2016 WL 559042 (Fed. Cir. Feb. 12, 2016) (en banc).

<sup>62</sup> See, e.g., *id.* at \*18–19 (discussing how patents provide “market-based reward” to the patentee and the problem of vagueness); *id.* at \*25 (discussing the need to “incentivize creation and disclosure”); *id.* at \*26 (discussing the social benefits from patentee’s ability to offer a menu of products); *id.* at \*33–34 (discussing the practical effects of national exhaustion on the market and noting that “there is no concomitant risk of ‘perpetual downstream control’”); *id.* at \*34–36 (discussing how exhaustion affects the patentees’ markets, income, and costs); *id.* at \*44–45 (comparing certain aspects of the markets for copyrighted and patented goods and analyzing the impact of exhaustion regimes on those markets); *id.* at \*58–59 (discussing the importance of allowing purchasers to compete, the effects of exhaustion on administrative costs, the need to allow free trade in goods embodying patented inventions, the impact on transaction costs and prices, and the role of international trade).

<sup>63</sup> Duffy & Hynes, *supra* note 1, at 36.

tention exhaustion has received is that modern markets are increasingly global and digital. As a result, those markets prompt questions about the ideal scope of IP rights and their exhaustion. The ability to apply long-standing IP doctrines to new technologies and market realities—as courts have done in various contexts<sup>64</sup>—depends on the recognition of broader principles. Those principles cannot flout statutory directives, of course, but they should not be ignored altogether either, when statutes lend themselves to more than one plausible meaning.<sup>65</sup>

Admittedly, Duffy and Hynes might see the elimination of the policy considerations as a feature, not a bug. If technological or market conditions alter the policy implications of exhaustion, they might argue that it is the task of Congress to weigh those concerns and enact a new statute. We agree that Congress could act, as it, from time to time, has acted.<sup>66</sup> And once Congress acts, courts would be bound to interpret the statute as faithfully as they can. But IP law regulates a fast moving technological world, and historically it has been the role of courts to help keep IP law up to speed. Moreover, when it comes to exhaustion, Congress has repeatedly signaled its acceptance of the judicial role in defining the broad contours of the doctrine.<sup>67</sup>

The theory offered by Duffy and Hynes has two primary normative implications. The first—that their theory avoids the trampling of commercial law by IP law—rests on a false premise. The bulk of the cases and commentary reveal that the IP-domination Duffy and Hynes fear is more specter than reality. The second implication—that courts should ignore policy considerations in favor of focusing solely on the statutory text—unnecessarily ties the hands of courts applying the exhaustion doctrine, even when no conflict between IP and commercial law is at

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<sup>64</sup> There are numerous decisions that demonstrate this phenomenon. See, e.g., *Am. Broad. Cos. v. Aereo, Inc.*, 134 S. Ct. 2498, 2503 (2014) (applying public performance policy to online streaming); *Authors Guild, Inc. v. HathiTrust*, 755 F.3d 87, 91–92 (2d Cir. 2014) (applying fair use to a mass digitalization project); *Perfect 10, Inc. v. Amazon.com.*, 508 F.3d 1146, 1155–57 (9th Cir. 2007) (applying fair use to an online search engine).

<sup>65</sup> *Twentieth Century Music Corp. v. Aiken*, 422 U.S. 151, 156 (1975) (“When technological change has rendered its literal terms ambiguous, the Copyright Act must be construed in light of this basic purpose.”).

<sup>66</sup> See, e.g., Digital Millennium Copyright Act, Pub. L. No. 105-304, 112 Stat. 2860 (1998); Audio Home Recording Act of 1992, Pub. L. No. 102-563, 106 Stat. 4237.

<sup>67</sup> In 1909, Congress had “no intention [of] enlarg[ing] in any way the construction to be given to the word ‘vend.’” H.R. Rep. No. 60-2222, at 19 (1909). In 1976, Congress affirmed its intent to “restate[ ] and confirm[ ]” the first sale rule “established by the court decisions.” H.R. Rep. No. 94-1476, at 79 (1976), *reprinted in* 1976 U.S.C.C.A.N. 5659, 5693.

stake. Below, we explore a final question left unresolved by Duffy and Hynes's discussion on the interaction between exhaustion and commercial law—the role of preemption.

### III. EXHAUSTION AND STATE LAW: THE PREEMPTION PROBLEM

Duffy and Hynes claim that non-IP law was and should be taken into account in developing and applying exhaustion. We agree. In fact, when courts utilized the common law to develop exhaustion, they did just that. When *Bobbs-Merrill* was decided, more than forty years before the Uniform Commercial Code was created, commercial law was, in large part, the common law. From that perspective, the stark dichotomy Duffy and Hynes describe between “general commercial law,” which exhaustion was designed to preserve, and “the common law,” which was allegedly irrelevant, is more of a porous membrane. We also agree with Duffy and Hynes that non-IP laws have a role to play even when exhaustion limits the rights of copyright owners and patentees. That role should be considered when developing IP policy.<sup>68</sup>

Duffy and Hynes explore the interaction between exhaustion and other areas of commercial law that regulate secondary markets. This in-depth analysis can lead to important normative insights regarding the desirable scope of IP rights. It is indeed vital that IP commentators acknowledge the role of general commercial laws within IP policy. The contribution of Duffy and Hynes will surely advance that discussion. We want, however, to make two comments on the interaction between IP law and general commercial law.

First, this interaction is not limited to exhaustion. IP laws incorporate—but do not define—basic commercial terms, such as sale, license, assignment, or mortgage.<sup>69</sup> Federal IP laws rely on state law definitions of those terms.<sup>70</sup> This symbiosis between federal IP law and general commercial law cuts across many IP doctrines. Because each of those doctrines must be developed in tandem with state commercial law, it is

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<sup>68</sup> Many have discussed the role of non-IP laws, as well as non-legal tools, in developing IP policy. See, e.g., William M. Landes & Richard A. Posner, *The Economic Structure of Intellectual Property Law* 23 (2003); Julie E. Cohen, *Lochner* in Cyberspace: The New Economic Orthodoxy of “Rights Management,” 97 *Mich. L. Rev.* 462, 464 (1998); Trotter Hardy, *Property (and Copyright) in Cyberspace*, 1996 *U. Chi. Legal F.* 217, 223–24.

<sup>69</sup> See, e.g., 17 U.S.C. § 101 (2012); 35 U.S.C. § 261 (2012).

<sup>70</sup> David Nimmer et al., *The Metamorphosis of Contract into Expand*, 87 *Calif. L. Rev.* 17, 24–29 (1999).

hard to see why exhaustion should be singled out as a unique doctrine that is meant to preserve general commercial law, as Duffy and Hynes suggest. In some respects, this makes their analysis of the role of state law in regulating secondary markets even more valuable. It could serve as a model to explore similar interactions with other IP law doctrines.

Second, considering the interaction between federal IP law and state law requires a careful analysis of federal preemption, and in particular copyright preemption. Copyright preemption is a thorn in the side of the Duffy and Hynes theory. Exhaustion cannot be a doctrine that is purely designed to preserve other laws, such as contract and private property, if it might also preempt some of those other arrangements. However, federal IP law does not give state commercial law unlimited power to regulate secondary markets. While state law does generally regulate those markets,<sup>71</sup> the power of states to create certain legal regimes—for example, one that grants copyright owners a copyright-like exclusive right over the resale of copyrighted works—is limited by federal preemption law.

Duffy and Hynes make two arguments to prevent preemption from casting a shadow over their theory. First, they suggest that because exhaustion limits the scope of the exclusive rights under federal law, then rights created under state law to circumvent exhaustion are, by definition, not equivalent to rights under the Copyright Act, as required by § 301(a), its explicit preemption provision.<sup>72</sup> Second, they argue that “broad preemption arguments have had very little success in the courts”<sup>73</sup> following the Seventh Circuit decision in *ProCD v. Zeidenberg*.<sup>74</sup>

We find both arguments problematic. The main difficulty with their first argument is that it ignores the purpose and uniform interpretation of § 301(a). Limiting the scope of copyright preemption to the scope of the exclusive rights, as suggested by Duffy and Hynes, will allow states to interfere with federal policy in a way that is inconsistent with the pur-

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<sup>71</sup> And, in doing so, they take into account some of the policy considerations that are also reflected in exhaustion doctrine. For example, the Restatement of Contracts suggests that a contractual promise is unenforceable as a matter of state law “on grounds of public policy if it is unreasonably in restraint of trade.” Restatement (Second) of Contracts § 186 (Am. Law Inst. 1981), a policy that, as we have seen, played a role in the development of exhaustion as well.

<sup>72</sup> Duffy & Hynes, *supra* note 1, at 73–74.

<sup>73</sup> *Id.* at 74.

<sup>74</sup> 86 F.3d 1447 (7th Cir. 1996).

pose of the Act. For example, such an approach would give states carte blanche to regulate ideas, methods, and fair uses. This approach has been consistently rejected by courts. In fact, the Seventh Circuit rejected it in *ProCD*, stating that

[o]ne function of § 301(a) is to prevent states from giving special protection to works of authorship that Congress has decided should be in the public domain, which it can accomplish only if “subject matter of copyright” includes all works of a type covered by sections 102 and 103, even if federal law does not afford protection to them.<sup>75</sup>

The Sixth Circuit has similarly stated that “the shadow actually cast by the [Copyright] Act’s preemption is notably broader than the wing of its protection.”<sup>76</sup>

The second argument, which relies on *ProCD*, faces two weaknesses. First, while *ProCD* was adopted by several federal circuit courts, it is not the law of the land.<sup>77</sup> The Second Circuit, for example, refused to endorse it,<sup>78</sup> and the Sixth Circuit expressly rejected it.<sup>79</sup> Second, and more important, the argument that Duffy and Hynes make is significantly broader than the Seventh Circuit’s approach in *ProCD*. *ProCD* and its progeny deal exclusively with contractual rights. In fact, the distinction between property rights and contractual rights is the main rationale for those decisions.<sup>80</sup> Therefore, *ProCD* does not support the proposition that states are free to create any property-like arrangement they please with respect to information goods.

Again, our claim is not that IP law and policy necessarily trump any or even most state law claims and doctrines. We, however, maintain that courts do not and should not be categorically denied the opportunity to

<sup>75</sup> *Id.* at 1453.

<sup>76</sup> *Wrench LLC v. Taco Bell Corp.*, 256 F.3d 446, 454 (6th Cir. 2001) (quoting *United States ex rel. Berge v. Bd. of Trs. of Univ. of Ala.*, 104 F.3d 1453, 1463 (4th Cir. 1997)).

<sup>77</sup> See Guy A. Rub, *Contracting Around Copyright: The Uneasy Case for Unbundling of Rights in Creative Works*, 78 U. Chi. L. Rev. 257, 258 (2011).

<sup>78</sup> *Forest Park Pictures v. Universal Television*, 683 F.3d 424, 432 (2d Cir. 2012) (“In this case, we need not address whether preemption is precluded whenever there is a contract claim . . .”).

<sup>79</sup> *Wrench*, 256 F.3d at 457–58 (“[W]e do not embrace the proposition that all state law contract claims survive preemption . . .”).

<sup>80</sup> *ProCD*, 86 F.3d at 1454 (explaining that “rights created by contract” are not “equivalent to any of the exclusive rights within the general scope of copyright” because “[a] copyright is a right against the world. Contracts, by contrast, generally affect only their parties; strangers may do as they please, so contracts do not create ‘exclusive rights.’”).

consider IP policy and preemption when a dispute touches on areas that are regulated by commercial law, including secondary markets. While commercial law should undoubtedly help shape IP law, preemption doctrine makes the relationship between exhaustion and other areas of the law more complex than Duffy and Hynes suggest.

#### CONCLUSION

The three of us do not always agree on the socially desirable scope of IP exhaustion. However, we do agree on the ways in which that scope should ideally be set. It should explore the justifications for exhaustion, examine how strong and applicable they are nowadays and going forward, study the effects it has on initial and secondary markets for copyrighted goods, and yes—consider other legal (as well as non-legal) ways to regulate those markets. The various competing interests and considerations should continue to inform the evolution of the law. Duffy and Hynes focus on one of these considerations, the role of general commercial law, and provide important insights about it. But focusing exclusively on that single consideration significantly narrows the perspective of what exhaustion is and what it should be. We find such an approach neither consistent with a century and a half of existing law nor advisable.