

First Sale and Exhaustion

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When you buy a physical book from your local bookshop or online retailer, you exchange a sum of money for legal title to the physical copy of that book (we'll cover electronic books shortly). Of course, buying a book does not give you any ownership interest in the author's copyright. Thus, by spending \$30 to acquire a physical book, you do not gain the right to make additional copies of that book, to adapt it for television or to translate it into another language. You simply own the physical copy that you bought. By the same token, once you purchase the book from a retailer, neither the author nor the publisher has any further right to limit or charge you for the right to read the book, to lend it to your sister or to sell it on eBay. The publisher has authorized the retailer to sell you the book, and once they have granted that right they have no ability to further control its destiny.

This result, which should correspond with your intuitive understanding of how markets in copyrighted goods work, arises from what is known as the "first sale" doctrine. A similar doctrine known as "exhaustion" applies with respect to goods marked with trademarks and to patented articles. Despite their intuitive and straightforward origins, the modern application of the first sale and exhaustion doctrines to multi-component technologies distributed through multi-tier, international supply chains is fraught with complications that have made these doctrines among the most complex in the intellectual property (IP) transactional landscape. In this chapter we will review the basic doctrines of first sale and exhaustion, and then explore how they have evolved in the modern marketplace.

23.1 COPYRIGHT FIRST SALE

Today, the copyright first sale doctrine is embodied in Section 109(a) of the Copyright Act. It provides that "the owner of a particular copy ... lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy." That is, someone who owns a valid copy of

a copyrighted work may further sell, transfer, donate or otherwise dispose of that copy without permission of the copyright owner, notwithstanding the copyright owner's exclusive right to distribute copies of the work under Section 106(3) of the Act.

Prior to the enactment of the 1976 version of the Act, the extent of the first sale doctrine was not so clear. The following case is one of the first to wrestle with the extent and scope of the first sale doctrine.

Bobbs-Merrill Co. v. Straus

210 U.S. 339 (1908)

DAY, JUSTICE

The complainant in the circuit court, appellant here, the Bobbs-Merrill Company, brought suit against the respondents, appellees here, Isidor Straus and Nathan Straus, partners as R. H. Macy & Company, in the Circuit Court of the United States for the Southern District of New York to restrain the sale of a copyrighted novel, entitled "The Castaway," at retail at less than \$1 for each copy. The circuit court dismissed the bill on final hearing. The decree of the circuit court was affirmed on appeal by the circuit court of appeals.

The appellant is the owner of the copyright upon "The Castaway," obtained on the eighteenth day of May, 1904, in conformity to the copyright statutes of the United States. Printed immediately below the copyright notice, on the page in the book following the title page, is inserted the following notice:

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.

Macy & Company, before the commencement of the action, purchased copies of the book for the purpose of selling the same at retail. Ninety percent of such copies were purchased by them at wholesale at a price below the retail price by about forty percent, and

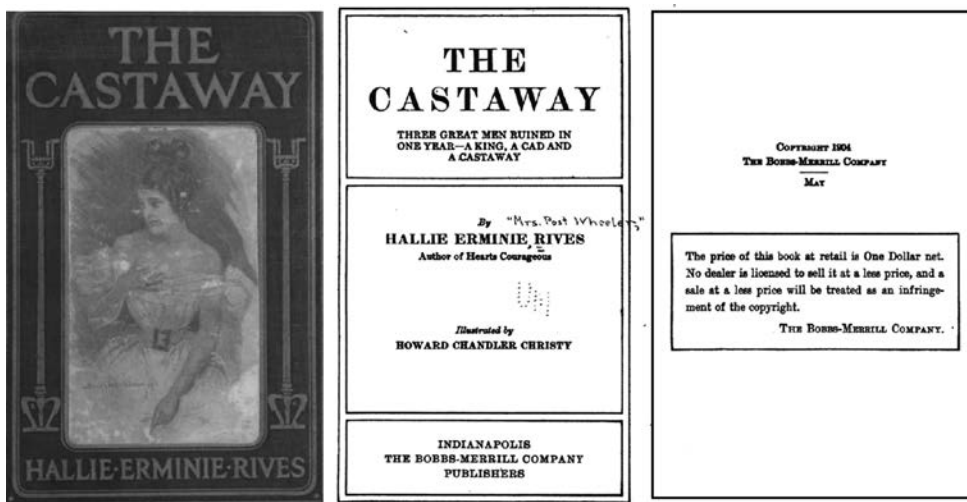


FIGURE 23.1 *The Castaway: Three Great Men Ruined in One Year – A King, A Cad and a Castaway*, by Hallie Ermine Rives (1904).

ten percent of the books purchased by them were purchased at retail, and the full price paid therefor.

It is stipulated in the record:

Defendants at the time of their purchase of copies of the book, knew that it was a copyrighted book, and were familiar with the terms of the notice printed in each copy thereof, as above set forth, and knew that this notice was printed in every copy of the book purchased by them.

The wholesale dealers from whom defendants purchased copies of the book obtained the same either directly from the complainant or from other wholesale dealers at a discount from the net retail price, and at the time of their purchase knew that the book was a copyrighted book, and were familiar with the terms of the notice printed in each copy thereof, as described above, and such knowledge was in all wholesale dealers through whom the books passed from the complainants to defendants. But the wholesale dealers were under no agreement or obligation to enforce the observance of the terms of the notice by retail dealers, or to restrict their sales to retail dealers who would agree to observe the terms stated in the notice.

The defendants have sold copies of the book at retail at the uniform price of eighty-nine cents a copy, and are still selling, exposing for sale, and offering copies of the book at retail at the price of eighty-nine cents per copy, without the consent of the complainant.

The present case involves rights under the copyright act. The facts disclose a sale of a book at wholesale by the owners of the copyright at a satisfactory price, and this without agreement between the parties to such sale obligating the purchaser to control future sales, and where the alleged right springs from the protection of the copyright law alone. It is contended that this power to control further sales is given by statute to the owner of such a copyright in conferring the sole right to "vend" a copyrighted book.

Recent cases in this Court have affirmed the proposition that copyright property under the federal law is wholly statutory, and depends upon the right created under the acts of Congress passed in pursuance of the authority conferred under Article I, § 8, of the federal Constitution:

To promote the progress of science and useful arts, by securing, for limited times, to authors and inventors, the exclusive right to their respective writings and discoveries.

The learned counsel for the appellant in this case, in the argument at bar, disclaims relief because of any contract, and relies solely upon the copyright statutes, and rights therein conferred. The copyright statutes ought to be reasonably construed with a view to effecting the purposes intended by Congress. They ought not to be unduly extended by judicial construction to include privileges not intended to be conferred, nor so narrowly construed as to deprive those entitled to their benefit of the rights Congress intended to grant.

At common law, an author had a property in his manuscript, and might have redress against anyone who undertook to realize a profit from its publication without authority of the author.

While the nature of the property and the protection intended to be given the inventor or author as the reward of genius or intellect in the production of his book or work of art is to be considered in construing the act of Congress, it is evident that to secure the author the right to multiply copies of his work may be said to have been the main purpose of the copyright statutes.

This fact is emphasized when we note the title to the act of Congress, passed at its first session: "An Act for the Encouragement of Learning, by Securing the Copies of Maps, Charts, and Books, to the Authors and Proprietors of Such Copies, during the Times Therein Mentioned." 1 Stat. at Large, by Peters, c. 15, p. 124.

In order to secure this right, it was provided in that statute, as it has been in subsequent ones, that the authors of books, their executors, administrators, or assigns, shall have the "sole right and liberty of printing, reprinting, publishing, and vending" such book for a term of years, upon complying with the statutory conditions set forth in the act as essential to the acquiring of a valid copyright. Each and all of these statutory rights should be given such protection as the act of Congress requires, in order to secure the rights conferred upon authors and others entitled to the benefit of the act. Let us see more specifically what are the statutory rights, in this behalf, secured to one who has complied with the provisions of the law and become the owner of a copyright. They may be found in §§ 4952 ... of the Revised Statutes of the United States, and are as follows:

Any citizen of the United States or resident therein, who shall be the author, inventor, designer, or proprietor of any book, map, chart, dramatic or musical composition, engraving, cut, print, or photograph or negative thereof, or of a painting, drawing, chromo, statue, statuary, and of models or designs intended to be perfected as works of the fine arts, and the executors, administrators, or assigns of any such person, shall, upon complying with the provisions of this chapter, have the sole liberty of printing, reprinting, publishing, completing, copying, executing, finishing, and vending the same.

It is the contention of the appellant that the circuit court erred in failing to give effect to the provision of § 4952, protecting the owners of the copyright in the sole right of vending the copyrighted book or other article, and the argument is that the statute vested the whole field of the right of exclusive sale in the copyright owner; that he can part with it to another to the extent that he sees fit, and may withhold to himself, by proper reservations, so much of the right as he pleases.

What does the statute mean in granting "the sole right of vending the same?" Was it intended to create a right which would permit the holder of the copyright to fasten, by notice in a book or upon one of the articles mentioned within the statute, a restriction upon the subsequent alienation of the subject matter of copyright after the owner had parted with the title to one who had acquired full dominion over it and had given a satisfactory price for it? It is not denied that one who has sold a copyrighted article, without restriction, has parted with all right to control the sale of it. The purchaser of a book, once sold by authority of the owner of the copyright, may sell it again, although he could not publish a new edition of it.

In this case, the stipulated facts show that the books sold by the appellant were sold at wholesale, and purchased by those who made no agreement as to the control of future sales of the book, and took upon themselves no obligation to enforce the notice printed in the book, undertaking to restrict retail sales to a price of one dollar per copy.

The precise question therefore in this case is, does the sole right to vend (named in § 4952) secure to the owner of the copyright the right, after a sale of the book to a purchaser, to restrict future sales of the book at retail, to the right to sell it at a certain price per copy, because of a notice in the book that a sale at a different price will be treated as an infringement, which notice has been brought home to one undertaking to sell for less than the named sum? We do not think the statute can be given such a construction, and

it is to be remembered that this is purely a question of statutory construction. There is no claim in this case of contract limitation, nor license agreement controlling the subsequent sales of the book.

In our view, the copyright statutes, while protecting the owner of the copyright in his right to multiply and sell his production, do not create the right to impose, by notice, such as is disclosed in this case, a limitation at which the book shall be sold at retail by future purchasers, with whom there is no privity of contract. This conclusion is reached in view of the language of the statute, read in the light of its main purpose to secure the right of multiplying copies of the work – a right which is the special creation of the statute. True, the statute also secures, to make this right of multiplication effectual, the sole right to vend copies of the book, the production of the author's thought and conception. The owner of the copyright in this case did sell copies of the book in quantities and at a price satisfactory to it. It has exercised the right to vend. What the complainant contends for embraces not only the right to sell the copies, but to qualify the title of a future purchaser by the reservation of the right to have the remedies of the statute against an infringer because of the printed notice of its purpose so to do unless the purchaser sells at a price fixed in the notice. To add to the right of exclusive sale the authority to control all future retail sales by a notice that such sales must be made at a fixed sum 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.

The decree of the circuit court of appeals is Affirmed.

Notes and Questions

1. *Resale price maintenance.* In *Bobbs-Merrill*, the court analyzes, as a matter of statutory interpretation, whether the copyright owner's exclusive right to "vend" includes a right to dictate the prices at which future owners may resell a book. The practice of setting minimum resale prices is referred to as "resale price maintenance," and it warrants special scrutiny under the antitrust laws (see [Section 25.4](#)). Antitrust issues aside, why do you think that *Bobbs-Merrill* wished to set a minimum resale price for books that it had already sold to retailers? How would *Bobbs-Merrill* profit from Macy's sale of the book at \$1.00 rather than \$0.89?
2. *Contract.* *Bobbs-Merrill* incorporated its price maintenance clause in the book itself. From a contract law standpoint, how binding to you think this restriction was on retailers like Macy's?
3. *The right to vend.* The Court in *Bobbs-Merrill* held that a copyright owner's statutory exclusive right to vend a book did not extend to the control of the terms of downstream sales of the book. Why not? What language in the Copyright Act persuaded the Court that this was the correct outcome?
4. *Limits of first sale.* As set forth in Section 109(a) of the Copyright Act today, the owner of a particular copy of a work has the right to "sell or otherwise dispose of the possession of that copy." In other words, the first sale exhausts the copyright owner's exclusive right to transfer a copy of a work, which was granted under Section 106(3) of the Copyright Act. But the first sale doctrine does not exhaust the other exclusive rights granted to a copyright holder under Section 106, namely, the right to reproduce the work (§ 106(1)), the right to make derivative works (§ 106(2)) and the right to publicly perform the work (§§ 106(4)–(6)). Why is the first sale doctrine limited to transfers of copies of copyrighted works?

23.2 SOFTWARE SALE VERSUS LICENSE

The *Bobbs-Merrill* case established the first sale principle in copyright law, a principle that was later codified in Section 109(a) of the Copyright Act. But the first sale doctrine depends on there being an authorized *sale* of a copyrighted work. What if a work is licensed rather than sold? Does the first sale doctrine apply?

These questions are extremely important in the case of computer software. Even though software vendors convey copies of their software to users, either on tangible media (discs or memory devices) or electronically, the common practice in the software industry is to refer to software as licensed rather than sold. So, what rights does a consumer obtain when she downloads an app to her smartphone? Does she “own” a copy of the software, which she can then resell or exploit as she would a book, or is she merely a licensee who does not own the copy in her possession? Numerous cases considered this issue from the 1990s through the 2000s, most questioning the software vendor’s ability to impose restrictions on further transfer of the software on the user. The following case, decided in the circuit that is home to the majority of the US software industry, effectively put the issue to rest.

Vernor v. Autodesk, Inc.

621 F.3d 1102 (9th Cir. 2010)

CALLAHAN, CIRCUIT JUDGE

Timothy Vernor purchased several used copies of Autodesk, Inc.’s AutoCAD Release 14 software (“Release 14”) from one of Autodesk’s direct customers, and he resold the Release 14 copies on eBay. Vernor brought this declaratory judgment action against Autodesk to establish that these resales did not infringe Autodesk’s copyright. The district court issued the requested declaratory judgment, holding that Vernor’s sales were lawful because of two of the Copyright Act’s affirmative defenses that apply to owners of copies of copyrighted works, the first sale doctrine and the essential step defense.

Autodesk distributes Release 14 pursuant to a limited license agreement in which it reserves title to the software copies and imposes significant use and transfer restrictions on its customers. We determine that Autodesk’s direct customers are licensees of their copies of the software rather than owners, which has two ramifications. Because Vernor did not purchase the Release 14 copies from an owner, he may not invoke the first sale doctrine, and he also may not assert an essential step defense on behalf of his customers. For these reasons, we vacate the district court’s grant of summary judgment to Vernor and remand for further proceedings.

I.

A. Autodesk’s Release 14 Software and Licensing Practices

The material facts are not in dispute. Autodesk makes computer-aided design software used by architects, engineers, and manufacturers. It has more than nine million customers. It first released its AutoCAD software in 1982. It holds registered copyrights in all versions of the software including the discontinued Release 14 version, which is at issue in this case. It provided Release 14 to customers on CD-ROMs.

Since at least 1986, Autodesk has offered AutoCAD to customers pursuant to an accompanying software license agreement (“SLA”), which customers must accept before installing the software. A customer who does not accept the SLA can return the software for a full refund. Autodesk offers SLAs with different terms for commercial, educational institution, and student users. The commercial license, which is the most expensive, imposes the fewest restrictions on users and allows them software upgrades at discounted prices.

The SLA for Release 14 first recites that Autodesk retains title to all copies. Second, it states that the customer has a nonexclusive and nontransferable license to use Release 14. Third, it imposes transfer restrictions, prohibiting customers from renting, leasing, or transferring the software without Autodesk’s prior consent and from electronically or physically transferring the software out of the Western Hemisphere. Fourth, it imposes significant use restrictions:

YOU MAY NOT: (1) modify, translate, reverse engineer, decompile, or disassemble the Software ... (3) remove any proprietary notices, labels, or marks from the Software or Documentation; (4) use ... the Software outside of the Western Hemisphere; (5) utilize any computer software or hardware designed to defeat any hardware copy-protection device, should the software you have licensed be equipped with such protection; or (6) use the Software for commercial or other revenue-generating purposes if the Software has been licensed or labeled for educational use only.

Fifth, the SLA provides for license termination if the user copies the software without authorization or does not comply with the SLA’s restrictions. Finally, the SLA provides that if the software is an upgrade of a previous version:

[Y]ou must destroy the software previously licensed to you, including any copies resident on your hard disk drive ... within sixty (60) days of the purchase of the license to use the upgrade or update Autodesk reserves the right to require you to show satisfactory proof that previous copies of the software have been destroyed.

Autodesk takes measures to enforce these license requirements. It assigns a serial number to each copy of AutoCAD and tracks registered licensees. It requires customers to input “activation codes” within one month after installation to continue using the software. The customer obtains the code by providing the product’s serial number to Autodesk. Autodesk issues the activation code after confirming that the serial number is authentic, the copy is not registered to a different customer, and the product has not been upgraded. Once a customer has an activation code, he or she may use it to activate the software on additional computers without notifying Autodesk.

B. Autodesk’s Provision of Release 14 Software to CTA

In March 1999, Autodesk reached a settlement agreement with its customer Cardwell/Thomas & Associates, Inc. (“CTA”), which Autodesk had accused of unauthorized use of its software. As part of the settlement, Autodesk licensed ten copies of Release 14 to CTA. CTA agreed to the SLA, which appeared (1) on each Release 14 package that Autodesk provided to CTA; (2) in the settlement agreement; and (3) on-screen, while the software is being installed.

CTA later upgraded to the newer, fifteenth version of the AutoCAD program, AutoCAD 2000. It paid \$495 per upgrade license, compared to \$3,750 for each new license. The SLA for AutoCAD 2000, like the SLA for Release 14, required destruction of copies of previous

versions of the software, with proof to be furnished to Autodesk on request. However, rather than destroying its Release 14 copies, CTA sold them to Vernor at an office sale with the handwritten activation codes necessary to use the software.

C. Vernor's eBay Business and Sales of Release 14

Vernor has sold more than 10,000 items on eBay. In May 2005, he purchased an authentic used copy of Release 14 at a garage sale from an unspecified seller. He never agreed to the SLA's terms, opened a sealed software packet, or installed the Release 14 software. Though he was aware of the SLA's existence, he believed that he was not bound by its terms. He posted the software copy for sale on eBay.

Autodesk filed a Digital Millennium Copyright Act ("DMCA") take-down notice with eBay claiming that Vernor's sale infringed its copyright, and eBay terminated Vernor's auction.¹ Autodesk advised Vernor that it conveyed its software copies pursuant to non-transferable licenses, and resale of its software was copyright infringement. Vernor filed a DMCA counter-notice with eBay contesting the validity of Autodesk's copyright claim. Autodesk did not respond to the counter-notice. eBay reinstated the auction, and Vernor sold the software to another eBay user.

In April 2007, Vernor purchased four authentic used copies of Release 14 at CTA's office sale. The authorization codes were handwritten on the outside of the box. He listed the four copies on eBay sequentially, representing, "This software is not currently installed on any computer." On each of the first three occasions, the same DMCA process ensued. Autodesk filed a DMCA take-down notice with eBay, and eBay removed Vernor's auction. Vernor submitted a counter-notice to which Autodesk did not respond, and eBay reinstated the auction.

When Vernor listed his fourth, final copy of Release 14, Autodesk again filed a DMCA take-down notice with eBay. This time, eBay suspended Vernor's account because of Autodesk's repeated charges of infringement. Vernor also wrote to Autodesk, claiming that he was entitled to sell his Release 14 copies pursuant to the first sale doctrine, because he never installed the software or agreed to the SLA. In response, Autodesk's counsel directed Vernor to stop selling the software. Vernor filed a final counter-notice with eBay. When Autodesk again did not respond to Vernor's counter-notice, eBay reinstated Vernor's account. At that point, Vernor's eBay account had been suspended for one month, during which he was unable to earn income on eBay.

Vernor currently has two additional copies of Release 14 that he wishes to sell on eBay. Although the record is not clear, it appears that Vernor sold two of the software packages that he purchased from CTA, for roughly \$600 each, but did not sell the final two to avoid risking further suspension of his eBay account.

III.

The Copyright Act confers several exclusive rights on copyright owners, including the exclusive rights to reproduce their works and to distribute their works by sale or rental. *Id.* § 106(1), (3). The exclusive distribution right is limited by the first sale doctrine, an

¹ Under the Digital Millennium Copyright Act, 17 U.S.C. § 512(c)(3), a copyright holder may notify an online service provider such as eBay that a user of the service has posted infringing material on the service. In order to benefit from the liability exclusions under the Act, the service provider must act promptly to take down the infringing content – Ed.

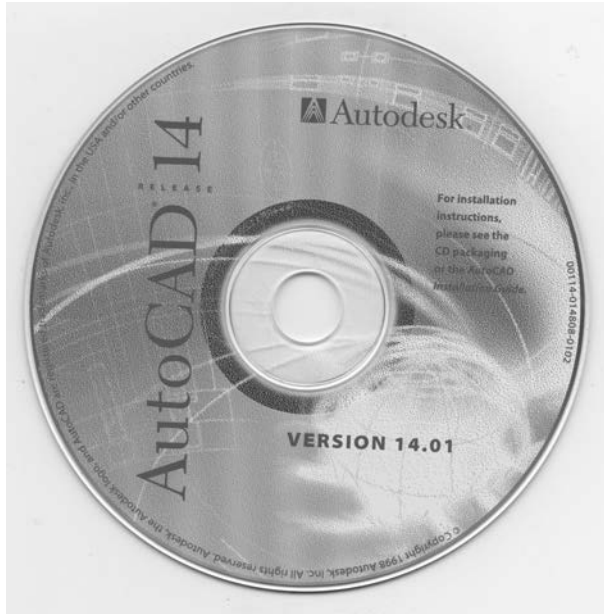


FIGURE 23.2 Autodesk's AutoCAD 14 software.

affirmative defense to copyright infringement that allows owners of copies of copyrighted works to resell those copies. The exclusive reproduction right is limited within the software context by the essential step defense, another affirmative defense to copyright infringement that is discussed further *infra*. Both of these affirmative defenses are unavailable to those who are only licensed to use their copies of copyrighted works.

This case requires us to decide whether Autodesk sold Release 14 copies to its customers or licensed the copies to its customers. If CTA owned its copies of Release 14, then both its sales to Vernor and Vernor's subsequent sales were non-infringing under the first sale doctrine. However, if Autodesk only licensed CTA to use copies of Release 14, then CTA's and Vernor's sales of those copies are not protected by the first sale doctrine and would therefore infringe Autodesk's exclusive distribution right.

We turn to our precedents governing whether a transferee of a copy of a copyrighted work is an owner or licensee of that copy. We then apply those precedents to CTA's and Vernor's possession of Release 14 copies.

1. *United States v. Wise*, 550 F.2d 1180 (9th Cir. 1977)

In *Wise*, a criminal copyright infringement case, we considered whether copyright owners who transferred copies of their motion pictures pursuant to written distribution agreements had executed first sales. The defendant was found guilty of copyright infringement based on his for-profit sales of motion picture prints. The copyright owners distributed their films to third parties pursuant to written agreements that restricted their use and transfer. On appeal, the defendant argued that the government failed to prove the absence of a first sale for each film. If the copyright owners' initial transfers of the films were first sales, then the defendant's resales were protected by the first sale doctrine and thus were not copyright infringement.

To determine whether a first sale occurred, we considered multiple factors pertaining to each film distribution agreement. Specifically, we considered whether the agreement

(a) was labeled a license, (b) provided that the copyright owner retained title to the prints, (c) required the return or destruction of the prints, (d) forbade duplication of prints, or (e) required the transferee to maintain possession of the prints for the agreement's duration. Our use of these several considerations, none dispositive, may be seen in our treatment of each film print.

For example, we reversed the defendant's conviction with respect to *Camelot*. It was unclear whether the *Camelot* print sold by the defendant had been subject to a first sale. Copyright owner Warner Brothers distributed *Camelot* prints pursuant to multiple agreements, and the government did not prove the absence of a first sale with respect to each agreement. We noted that, in one agreement, Warner Brothers had retained title to the prints, required possessor National Broadcasting Company ("NBC") to return the prints if the parties could select a mutual agreeable price, and if not, required NBC's certification that the prints were destroyed. We held that these factors created a license rather than a first sale.

We further noted, however, that Warner Brothers had also furnished another *Camelot* print to actress Vanessa Redgrave. The print was provided to Redgrave at cost, and her use of the print was subject to several restrictions. She had to retain possession of the print and was not allowed to sell, license, reproduce, or publicly exhibit the print. She had no obligation to return the print to Warner Brothers. We concluded, "While the provision for payment for the cost of the film, standing alone, does not establish a sale, when taken with the rest of the language of the agreement, it reveals a transaction strongly resembling a sale with restrictions on the use of the print." There was no evidence of the print's whereabouts, and we held that "[i]n the absence of such proof," the government failed to prove the absence of a first sale with respect to this Redgrave print. Since it was unclear which copy the defendant had obtained and resold, his conviction for sale of *Camelot* had to be reversed.

Thus, under *Wise*, where a transferee receives a particular copy of a copyrighted work pursuant to a written agreement, we consider all of the provisions of the agreement to determine whether the transferee became an owner of the copy or received a license. We may consider (1) whether the agreement was labeled a license and (2) whether the copyright owner retained title to the copy, required its return or destruction, forbade its duplication, or required the transferee to maintain possession of the copy for the agreement's duration. We did not find any one factor dispositive in *Wise*: we did not hold that the copyright owner's retention of title itself established the absence of a first sale or that a transferee's right to indefinite possession itself established a first sale.

2. The "MAI Trio" of Cases

Over fifteen years after *Wise*, we again considered the distinction between owners and licensees of copies of copyrighted works in three software copyright cases, the "MAI trio". See *MAI Sys. Corp. v. Peak Computer, Inc.*, 991 F.2d 511 (9th Cir. 1993); *Triad Sys. Corp. v. Se. Express Co.*, 64 F.3d 1330 (9th Cir. 1995); *Wall Data, Inc. v. Los Angeles County Sheriff's Dep't*, 447 F.3d 769 (9th Cir. 2006). In the MAI trio, we considered which software purchasers were owners of copies of copyrighted works for purposes of a second affirmative defense to infringement, the essential step defense.

The enforcement of copyright owners' exclusive right to reproduce their work under the Copyright Act, 17 U.S.C. § 106(1), has posed special challenges in the software context. In order to use a software program, a user's computer will automatically copy the software

into the computer's random access memory ("RAM"), which is a form of computer data storage. Congress enacted the essential step defense to codify that a software user who is the "owner of a copy" of a copyrighted software program does not infringe by making a copy of the computer program, if the new copy is "created as an essential step in the utilization of the computer program in conjunction with a machine and ... is used in no other manner." 17 U.S.C. § 117(a)(1).

The Copyright Act provides that an "owner of a copy" of copyrighted software may claim the essential step defense, and the "owner of a particular copy" of copyrighted software may claim the first sale doctrine. 17 U.S.C. §§ 109(a), 117(a)(1). The *MAI* trio construed the phrase "owner of a copy" for essential step defense purposes. Neither Vernor nor Autodesk contends that the first sale doctrine's inclusion of the word "particular" alters the phrase's meaning, and we "presume that words used more than once in the same statute have the same meaning throughout." Accordingly, we consider the *MAI* trio's construction of "owner of a copy" controlling in our analysis of whether CTA and Vernor became "owner[s] of a particular copy" of Release 14 software.

In *MAI* and *Triad*, the defendants maintained computers that ran the plaintiffs' operating system software. When the defendants ran the computers, the computers automatically loaded plaintiffs' software into RAM. The plaintiffs in both cases sold their software pursuant to restrictive license agreements, and we held that their customers were licensees who were therefore not entitled to claim the essential step defense. We found that the defendants infringed plaintiffs' software copyrights by their unauthorized loading of copyrighted software into RAM. In *Triad*, the plaintiff had earlier sold software outright to some customers. We noted that these customers were owners who were entitled to the essential step defense, and the defendant did not infringe by making RAM copies in servicing their computers.

In *Wall Data*, plaintiff sold 3,663 software licenses to the defendant. The licenses (1) were non-exclusive; (2) permitted use of the software on a single computer; and (3) permitted transfer of the software once per month, if the software was removed from the original computer. The defendant installed the software onto 6,007 computers via hard drive imaging, which saved it from installing the software manually on each computer. It made an unverified claim that only 3,663 users could simultaneously access the software.

The plaintiff sued for copyright infringement, contending that the defendant violated the license by "over-installing" the software. The defendant raised an essential step defense, contending that its hard drive imaging was a necessary step of installation. On appeal, we held that the district court did not abuse its discretion in denying the defendant's request for a jury instruction on the essential step defense. Citing *MAI*, we held that the essential step defense does not apply where the copyright owner grants the user a license and significantly restricts the user's ability to transfer the software. Since the plaintiff's license imposed "significant restrictions" on the defendant's software rights, the defendant was a licensee and was not entitled to the essential step defense.

In *Wall Data*, we acknowledged that *MAI* had been criticized in a Federal Circuit decision, but declined to revisit its holding, noting that the facts of *Wall Data* led to the conclusion that any error in the district court's failure to instruct was harmless. Even if the defendant owned its copies of the software, its installation of the software on a number of computers in excess of its license was not an essential step in the software's use.

We read *Wise* and the *MAI* trio to prescribe three considerations that we may use to determine whether a software user is a licensee, rather than an owner of a copy. First, we consider

whether the copyright owner specifies that a user is granted a license. Second, we consider whether the copyright owner significantly restricts the user's ability to transfer the software. Finally, we consider whether the copyright owner imposes notable use restrictions. Our holding reconciles the *MAI* trio and *Wise*, even though the *MAI* trio did not cite *Wise*.

In response to *MAI*, Congress amended § 117 to permit a computer owner to copy software for maintenance or repair purposes. See 17 U.S.C. § 117(c). However, Congress did not disturb *MAI*'s holding that licensees are not entitled to the essential step defense.

IV.

We hold today that a software user is a licensee rather than an owner of a copy where the copyright owner (1) specifies that the user is granted a license; (2) significantly restricts the user's ability to transfer the software; and (3) imposes notable use restrictions. Applying our holding to Autodesk's SLA, we conclude that CTA was a licensee rather than an owner of copies of Release 14 and thus was not entitled to invoke the first sale doctrine or the essential step defense.

“a software user is a licensee rather than an owner of a copy [of a software program] where the copyright owner (1) specifies that the user is granted a license; (2) significantly restricts the user's ability to transfer the software; and (3) imposes notable use restrictions.”

Autodesk retained title to the software and imposed significant transfer restrictions: it stated that the license is nontransferable, the software could not be transferred or leased without Autodesk's written consent, and the software could not be transferred outside the Western Hemisphere. The SLA also imposed use restrictions against the use of the software outside the Western Hemisphere and against modifying, translating, or reverse-engineering the software, removing any proprietary marks from the software or documentation, or defeating any copy protection device. Furthermore, the SLA provided for termination of the license upon the licensee's unauthorized copying or failure to comply with other license restrictions. Thus, because Autodesk reserved title to Release 14 copies and imposed significant transfer and use restrictions, we conclude that its customers are licensees of their copies of Release 14 rather than owners.

CTA was a licensee rather than an “owner of a particular copy” of Release 14, and it was not entitled to resell its Release 14 copies to Vernor under the first sale doctrine. 17 U.S.C. § 109(a). Therefore, Vernor did not receive title to the copies from CTA and accordingly could not pass ownership on to others. Both CTA's and Vernor's sales infringed Autodesk's exclusive right to distribute copies of its work.

Because Vernor was not an owner, his customers are also not owners of Release 14 copies. Therefore, when they install Release 14 on their computers, the copies of the software that they make during installation infringe Autodesk's exclusive reproduction right because they too are not entitled to the benefit of the essential step defense.

V.

Although our holding today is controlled by our precedent, we recognize the significant policy considerations raised by the parties and amici on both sides of this appeal.

Autodesk, the Software & Information Industry Association (“SIIA”), and the Motion Picture Association of America (“MPAA”) have presented policy arguments that favor our result. For instance, Autodesk argues in favor of judicial enforcement of software license agreements that restrict transfers of copies of the work. Autodesk contends that this (1) allows for tiered pricing for different software markets, such as reduced pricing for students or educational institutions; (2) increases software companies’ sales; (3) lowers prices for all consumers by spreading costs among a large number of purchasers; and (4) reduces the incidence of piracy by allowing copyright owners to bring infringement actions against unauthorized resellers. SIIA argues that a license can exist even where a customer (1) receives his copy of the work after making a single payment and (2) can indefinitely possess a software copy, because it is the software code and associated rights that are valuable rather than the inexpensive discs on which the code may be stored. Also, the MPAA argues that a customer’s ability to possess a copyrighted work indefinitely should not compel a finding of a first sale, because there is often no practically feasible way for a consumer to return a copy to the copyright owner.

Vernor, eBay, and the American Library Association (“ALA”) have presented policy arguments against our decision. Vernor contends that our decision (1) does not vindicate the law’s aversion to restraints on alienation of personal property; (2) may force everyone purchasing copyrighted property to trace the chain of title to ensure that a first sale occurred; and (3) ignores the economic realities of the relevant transactions, in which the copyright owner permanently released software copies into the stream of commerce without expectation of return in exchange for upfront payment of the full software price. eBay contends that a broad view of the first sale doctrine is necessary to facilitate the creation of secondary markets for copyrighted works, which contributes to the public good by (1) giving consumers additional opportunities to purchase and sell copyrighted works, often at below-retail prices; (2) allowing consumers to obtain copies of works after a copyright owner has ceased distribution; and (3) allowing the proliferation of businesses.

The ALA contends that the first sale doctrine facilitates the availability of copyrighted works after their commercial lifespan, by inter alia enabling the existence of libraries, used bookstores, and hand-to-hand exchanges of copyrighted materials. The ALA further contends that judicial enforcement of software license agreements, which are often contracts of adhesion, could eliminate the software resale market, require used computer sellers to delete legitimate software prior to sale, and increase prices for consumers by reducing price competition for software vendors. It contends that Autodesk’s position (1) undermines 17 U.S.C. § 109(b)(2), which permits non-profit libraries to lend software for non-commercial purposes, and (2) would hamper efforts by non-profits to collect and preserve out-of-print software. The ALA fears that the software industry’s licensing practices could be adopted by other copyright owners, including book publishers, record labels, and movie studios.

These are serious contentions on both sides, but they do not alter our conclusion that our precedent from *Wise* through the *MAI* trio requires the result we reach. Congress is free, of course, to modify the first sale doctrine and the essential step defense if it deems these or other policy considerations to require a different approach.

Notes and Questions

1. *Policy factors.* In Part V of its opinion, the court in *Vernor* discusses a number of public policy rationales both supporting and refuting the treatment of software as licensed rather than sold. It acknowledges that while there are “serious contentions on both sides,” these do not alter the court’s conclusion, which it purports to base on its own binding precedent. Which side of the debate do you feel has the stronger policy arguments in its favor?
2. *The essential step defense.* As noted by the court in *Vernor*, § 117(a)(1) of the Copyright Act provides that the “owner of a copy” of a copyrighted software program does not infringe by making a copy of the computer program if the new copy is “created as an essential step in the utilization of the computer program in conjunction with a machine and ... is used in no other manner.” In effect, this provision was intended to insulate the vast majority of software users whose computers “copy” every software program into their memory as part of the execution of that program. But what happens to this essential step defense if software users do not “own” copies of the software programs? Is anything still covered by the essential step defense? How does the court deal with this issue? Should Congress step in to amend § 117(a)(1) further? If so, what amendment would you propose?
3. *Doubling down on MAI.* In *Vernor*, the Ninth Circuit acknowledges that its 1993 decision in *MAI* was criticized by the Federal Circuit. In *DSC Commc’ns Corp. v. Pulse Commc’ns, Inc.*, 170 F.3d 1354, 1360 (Fed. Cir. 1999), the Federal Circuit states:

In the leading case on section 117 ownership, the Ninth Circuit considered an agreement in which MAI, the owner of a software copyright, transferred copies of the copyrighted software to Peak under an agreement that imposed severe restrictions on Peak’s rights with respect to those copies. The court held that Peak was not an “owner” of the copies of the software for purposes of section 117 and thus did not enjoy the right to copy conferred on owners by that statute. The Ninth Circuit stated that it reached the conclusion that Peak was not an owner because Peak had licensed the software from MAI. That explanation of the court’s decision has been criticized for failing to recognize the distinction between ownership of a copyright, which can be licensed, and ownership of copies of the copyrighted software. Plainly, a party who purchases copies of software from the copyright owner can hold a license under a copyright while still being an “owner” of a copy of the copyrighted software for purposes of section 117. We therefore do not adopt the Ninth Circuit’s characterization of all licensees as non-owners.

Despite this criticism, the Federal Circuit later concedes that the Ninth Circuit was correct to consider Peak to be a licensee, and not an owner, of the software in question. What’s more, the Federal Circuit found that the software user in its own case should be treated as a licensee and not an owner. Given these results, is it surprising that the Ninth Circuit effectively doubled-down on *MAI* in *Vernor*?

4. *MAI and software maintenance.* The Ninth Circuit’s *MAI* case is perhaps most infamous for its holding that a computer maintenance provider was liable for infringement when it ran a client’s software for maintenance purposes. As noted by the Ninth Circuit in *Vernor*, “In response to *MAI*, Congress amended § 117 to permit a computer owner to copy software for maintenance or repair purposes.” Section 117(c) of the Copyright Act reads as follows:

(c) Machine Maintenance or Repair.—Notwithstanding the provisions of section 106, it is not an infringement for the owner or lessee of a machine to make or authorize the making of a copy of a computer program if such copy is made solely by virtue of the activation of a

machine that lawfully contains an authorized copy of the computer program, for purposes only of maintenance or repair of that machine, if—

- (1) such new copy is used in no other manner and is destroyed immediately after the maintenance or repair is completed; and
- (2) with respect to any computer program or part thereof that is not necessary for that machine to be activated, such program or part thereof is not accessed or used other than to make such new copy by virtue of the activation of the machine.

Thus, the exception to infringement under Section 117(c) is based on a user's ownership of a "machine," rather than its ownership of a copy of a software program, as is the exclusion under § 117(a)(1). Did Congress get it right in § 117(c) but not § 117(a)(1)? Should Congress seek to reconcile these statutory provisions?

5. *Back to books.* Suppose that the *Bobbs-Merrill* case had been heard the year after *Vernor* was decided. Do you think that the court would have reached a different conclusion? What if Bobbs-Merrill, instead of printing its \$1.00 resale price limitation on the copyright page of each book, packaged the book in a cellophane wrapper through which the resale limitation was clearly visible. Would this change the outcome? What if Bobbs-Merrill distributed books under a "shrinkwrap" license agreement (see [Section 17.1](#)) that included the resale price limitation? Finally, what if Bobbs-Merrill had entered into a "Book Supply and Resale Agreement" with Macy's which contained a contractual clause imposing the resale price limitation? At what point would the first sale doctrine yield to a contractual arrangement between the parties?
6. *Software and things.* Even if software programs themselves are licensed to consumers, software increasingly inhabits tangible products from kitchen appliances to automobiles. These products are still bought and sold. What does it mean, then, to purchase a programmable toaster? Does the consumer own the aluminum body and circuitry, but not the software inside the device? What does that mean when the consumer wishes to sell the toaster, or donate it to charity, or throw it away? Licensees are not usually permitted to exercise these rights with respect to licensed software. Does the software producer thus begin to exert control over the consumer's right to dispose of his or her tangible property? If not, do we need to rethink the answer to the sale versus license question?
7. *A step back?* A year after *Vernor*, the Ninth Circuit decided *UMG Recordings v. Augusto*, 628 F.3d 1175 (9th Cir. 2011). The case related to promotional music CDs that UMG distributed to music critics and radio disc jockeys. The CDs were labeled with printed notices such as:

This CD is the property of the record company and is licensed to the intended recipient for personal use only. Acceptance of this CD shall constitute an agreement to comply with the terms of the license. Resale or transfer of possession is not allowed and may be punishable under federal and state laws.

Augusto acquired some of these CDs through unknown channels and sold them on eBay. UMG sued Augusto for copyright infringement, alleging that he violated UMG's exclusive right to distribute the CDs. The Ninth Circuit ruled in favor of Augusto, holding that, unlike copies of computer software,

under all the circumstances of the CDs' distribution, the recipients were entitled to use or dispose of them in any manner they saw fit, and UMG did not enter a license agreement for the CDs with the recipients. Accordingly, UMG transferred title to the particular copies of its promotional CDs and cannot maintain an infringement action against Augusto for his subsequent sale of those copies.

What do you make of this holding, especially in view of the express language on the CD labels that “This CD is the property of the record company and is licensed to the intended recipient”? Is this case consistent with *Vernor*? How does the holding of *UMG* gibe with shrinkwrap license cases such as *ProCD v. Zeidenberg* (see [Chapter 17](#))?

8. *First sale in the digital world*? Some argue that the debate over whether the “purchase” of software on physical media is moot today, as almost all consumer software is distributed via online download, either to a computer or a phone. In addition to software, most music and a growing percentage of books are also delivered electronically, with no physical copy conveyed. As such, most of this electronic content is explicitly licensed to consumers, with no pretense of sale. What does this mean for the first sale doctrine under *Bobbs-Merrill*? Do consumers own any of their books, music or software today? What are the implications of not owning one’s content?
9. *Digital exhaustion*? Professor Ariel Katz resists the rumor that “the first-sale doctrine is dying.” He reasons:

Once we ... recall that the legal significance of property rights, including intellectual property rights, lies not in the object to which the property rights relate, but in the legal relations between people with respect to that object, we can realize what exhaustion simply means: the right to transfer a lawfully obtained bundle of rights with respect to a work from one person to another, without seeking the ... owner’s permission. The bundle of rights may relate to a tangible object embodying a work (such as a book), or it may comprise a set of permissions obtained under a license in relation to a work in digital format (such as a license to download an e-book and install it on one or more devices). In principle, exhaustion could apply to the latter bundle just as it applies to the former.²

As such, Professor Katz argues that the “sale” of a software program, a song file or an electronic book should exhaust the copyright owner’s rights to the same degree as the sale of a computer disc, a music CD or a printed book. Do you agree?

23.3 TRADEMARK EXHAUSTION AND FIRST SALE

The gravamen of a trademark infringement claim is consumer confusion as to the source of a marked product. For this reason, the law generally recognizes the right of the owner of a marked product, whether a handbag or a luxury car, to resell it without permission of the manufacturer. The source is still the same manufacturer, even if the particular product has been used. As explained by the Ninth Circuit in *Sebastian Int’l, Inc. v. Longs Drug Stores Corp.*, 53 F.3d 1073, 1077 (9th Cir. 1995):

The right of a producer to control distribution of its trademarked product does not extend beyond the first sale of the product. Resale by the first purchaser of the original article under the producer’s trademark is neither trademark infringement nor unfair competition.

Yet complications arise when a marked product is altered or repackaged in some way before being resold. The following case summarizes the law surrounding first sale and exhaustion of trademark rights.

² Ariel Katz, *Digital Exhaustion: North American Observations* in *Research Handbook on Electronic Commerce Law* 137, 139 (John A. Rothchild, ed., Edward Elgar, 2016).

Au-Tomotive Gold Inc. v. Volkswagen of America, Inc.

603 F.3d 1133 (9th Cir. 2010)

WILLIAM A. FLETCHER, CIRCUIT JUDGE

We are asked to decide whether the sale by Au-Tomotive Gold (“Auto Gold”) of marquee license plates bearing Volkswagen badges purchased from Volkswagen constitutes trademark infringement, or whether the sale of the plates is protected by the “first sale” doctrine. In *Au-Tomotive Gold, Inc. v. Volkswagen of America, Inc.* (“*Auto Gold I*”), 457 F.3d 1062 (9th Cir. 2006), we concluded that Auto Gold’s production and sale of automobile accessories bearing Volkswagen’s trademarks created a sufficient likelihood of confusion to constitute trademark infringement. We remanded to the district court to address Auto Gold’s “first sale” and other defenses. On remand, the district court granted summary judgment and a permanent injunction to Volkswagen.

We affirm. We hold that the “first sale” doctrine does not provide a defense because Auto Gold’s marquee license plates create a likelihood of confusion as to their origin.

I. Facts and Proceedings Below

Auto Gold produces and sells automobile accessories for specific makes of cars. Volkswagen and its subsidiary Audi are car manufacturers with well-known trademarks. The trademark at issue in this appeal is the familiar Volkswagen logo consisting of the letters “VW” inside a circle.

Beginning in the 1990s, Auto Gold produced and sold products bearing Volkswagen and Audi trademarks without permission from Volkswagen or Audi. It sold four products: license plates, license plate frames, key chains, and marquee license plates. The first three products used replicas of the companies’ trademarks. However, the marquee license plates used actual VW badges purchased on the open market from a Volkswagen dealer. Auto Gold asserts its “first sale” defense only as to the marquee plates.

The marquee license plates are plain silver or black plates on which Auto Gold has mounted the VW badges. These badges are sold by Volkswagen and are ordinarily used as replacements for the badges found on the hoods or trunks of Volkswagen vehicles. Auto Gold purchased the badges, altered them by removing prongs and (in some cases) gold-plating them, and mounted them on the marquee plates. The plates were packaged with labels that explained that the plates were not produced or sponsored by Volkswagen.

Both parties accept for purposes of this appeal that Volkswagen had knowledge of Auto Gold’s products as early as January 1999. In September 1999, a Volkswagen representative sent a letter to Auto Gold requesting that it cease using the trademarks. When Auto Gold refused to do so, a Volkswagen representative sent a second letter in October 1999. A Volkswagen representative sent a third letter in February 2001.

On April 19, 2001, Auto Gold filed suit seeking a declaratory judgment that its activities did not constitute an infringement or dilution of Volkswagen or Audi trademarks. Volkswagen and Audi counterclaimed, alleging federal trademark counterfeiting and infringement under § 32 of the Lanham Act, false designation, trademark dilution, and related state-law claims. Both parties moved for summary judgment.

The district court granted summary judgment to Auto Gold on all claims, holding that under the doctrine of “aesthetic functionality” the trademarks were “functional” and

therefore not protected by trademark law. We reversed. We held that “the use of Volkswagen and Audi’s marks is neither aesthetic nor independent of source identification.” Rather, we held, consumers buy Auto Gold products because of the products’ identification with the companies’ brands. We then remanded to the district court for consideration of Auto Gold’s “first sale” and other related defenses.

The district court rejected Auto Gold’s “first sale” [defense] and granted Volkswagen summary judgment and a permanent injunction. Auto Gold timely appealed.

III. Discussion

Auto Gold argues that because it purchased actual VW badges from a Volkswagen dealer for use on the marquee license plates, the “first sale” doctrine protects the sale of the plates. We hold that the “first sale” doctrine does not provide a defense because the plates create a likelihood of confusion as to their origin. We do not base our holding on a likelihood of confusion among purchasers of the plates. Rather, we base it on the likelihood of post-purchase confusion among observers who see the plates on purchasers’ cars.

1. Background

The “first sale” doctrine was first introduced in an opinion by Justice Holmes in *Prestonettes, Inc. v. Coty*, 264 U.S. 359 (1924). *Prestonettes* purchased toilet powder and perfumes produced and trademarked by Coty. *Prestonettes* incorporated the Coty products into its own products by combining the powder with a binder to create a cream and by rebottling the perfumes into smaller bottles. The Supreme Court held that *Prestonettes* did not violate trademark law. “The defendant of course by virtue of its ownership had a right to compound or change what it bought, to divide either the original or the modified product, and to sell it so divided.”

The Court further held that *Prestonettes* could identify the components of its products as being Coty trademarked products so long as its labels were not misleading. For example, *Prestonettes* could place a label on the perfume bottles stating, “*Prestonettes, Inc.*, not connected with Coty, states that the contents are Coty’s ... independently rebottled in New York.” It rejected Coty’s argument that *Prestonettes* should not be allowed to use the Coty trademark in its description of the product because *Prestonettes*’s products might be inferior. It wrote, “If the compound was worse than the constituent, it might be a misfortune to [Coty], but [Coty] would have no cause of action, as [Prestonettes] was exercising the rights of ownership and only telling the truth. The existence of a trademark would have no bearing on the question.” The Court relied on the fact that consumers would not be confused about the manufacturer of the product. “A trade-mark only gives the right to prohibit the use of it so far as to protect the owner’s good will against the sale of another’s product as his.”

Application of the “first sale” doctrine has generally focused on the likelihood of confusion among consumers. In *Sebastian Int’l, Inc. v. Longs Drug Stores Corp.*, 53 F.3d 1073, 1077 (9th Cir. 1995), we held that the “first sale” doctrine protected Longs when it purchased Sebastian hair products from a distributor and sold them in its own store despite Sebastian’s efforts to allow only “Sebastian Collective Members” to sell the products. We recognized the principle that “the right of a producer to control distribution of its trademarked product does not extend beyond the first sale of the product.” We emphasized that this rule “preserves an area of competition by limiting the producer’s power to control the resale of its product,” while ensuring that “the consumer gets exactly what the consumer bargains for, the genuine product of the particular producer.”



FIGURE 23.3 In *Enesco v. Price/Costco*, Costco repackaged porcelain angels manufactured by Enesco in allegedly inferior packaging.

We also applied the “first sale” doctrine in *Enesco Corp. v. Price/Costco Inc.*, 146 F.3d 1083, 1084–85 (9th Cir. 1998), in which Costco purchased porcelain figurines manufactured by Enesco, repackaged them in allegedly inferior packaging, and sold them in its own stores. We held that Costco could repackage and sell the Enesco figurines, but that it was required to place labels on the packages that disclosed to the public that Costco had repackaged Enesco’s original product. We rejected Enesco’s argument that it would be harmed, even with this disclosure, because of the poor quality of the packaging. “The critical issue is whether the public is likely to be confused as a result of the lack of quality control.”

A separate line of cases further illustrates the central role of the likelihood of confusion, including post-purchase confusion, in trademark infringement claims. In this line of cases, we have held that producers committed trademark infringement by selling refurbished or altered goods under their original trademark. None of these cases directly addressed the “first sale” doctrine, but they establish that activities creating a likelihood of post-purchase confusion, even among non-purchasers, are not protected.

In *Karl Storz Endoscopy-America, Inc. v. Surgical Tech., Inc.* (“Surgi-Tech”), 285 F.3d 848, 852–53 (9th Cir. 2002), Surgi-Tech repaired Storz endoscopes at the request of hospitals that owned them. Surgi-Tech sometimes rebuilt the endoscopes, replacing every part and retaining only the block element bearing Storz’s trademarks. At an earlier time, Surgi-Tech had etched its own mark into rebuilt endoscopes to make clear what it had done, but Surgi-Tech had stopped that practice. Storz submitted evidence of confusion on the part of surgeons who were not the purchasers of the endoscopes but who used them and mistakenly blamed Storz when they malfunctioned. We held that there was a triable issue of fact on Storz’s trademark infringement claim, even though there was no claim of purchaser confusion. We relied entirely on the possibility of confusion among non-purchasers, noting that such confusion “may be no less injurious to the trademark owner’s reputation than confusion on the part of the purchaser at the time of sale.”

We also relied on the likelihood of non-purchaser confusion in *Rolex Watch, U.S.A., Inc. v. Michel Co.*, 179 F.3d 704 (9th Cir. 1999). The defendant sold used Rolex watches that had been “reconditioned” or “customized” with non-Rolex parts. We agreed with the district court that “retention of the original Rolex marks on altered ‘Rolex’ watches ... was deceptive and misleading as to the origin of the non-Rolex parts, and likely to cause confusion to subsequent or downstream purchasers, as well as to persons observing the product.”

In both *Surgi-Tech* and *Rolex*, we made clear that the defendants did not deceive the direct purchasers of the products. Rather, in both cases, we found trademark infringement based on a likelihood of confusion on the part of non-purchasers.

2. Application to the Marquee Plates

We held in *Auto Gold I* that the marquee license plates create a likelihood of post-purchase confusion on the part of observers of the plates. “Shorn of their disclaimer-covered packaging, Auto Gold’s products display no indication visible to the general public that the items are not associated with Audi or Volkswagen. The disclaimers do nothing to dispel post-purchase confusion.” It is likely that a person on the street who sees an Auto Gold marquee license plate with a VW badge will associate the plate with Volkswagen. Indeed, customers buy marquee license plates principally to demonstrate to the general public an association with Volkswagen. “The demand for Auto Gold’s products is inextricably tied to the trademarks themselves.”

Auto Gold, however, maintains that the likelihood of post-purchase confusion does not matter. Auto Gold argues, first, that confusion among non-purchasers is irrelevant in “first sale” cases. However, Auto Gold cannot point to any case in which a court has held that the “first sale” doctrine applies when there is a likelihood of post-purchase confusion. In *Prestonettes*, there was no suggestion that a third-party could be confused about, or even be aware of, the origin of the facial cream or perfume used by a purchaser. Likewise, there was no possibility of post-purchase confusion as to the origin of the hair products in *Sebastian* or the porcelain figurines in *Enesco*.

In each case in which a court has applied the “first sale” doctrine, the court either had good reason not to be concerned with post-purchase confusion or took steps to avoid addressing the issue. In *Alexander Binzel Corp.*, the court noted that Binzel sold its parts to be incorporated into welding guns produced by other manufacturers. The defendant’s “use of Binzel nozzles is fully consistent with Binzel’s profit motive as well as the manner Binzel has chosen to control its product’s reputation.” In *Dad’s Kid Corp.*, the court noted that baseball trading cards are regularly repackaged, displayed, or mounted, and that there was therefore “no likelihood that anyone will be confused as to origin by reason of Dad’s Kid’s treatment of genuine cards.” In *Scarves by Vera, Inc.*, the court noted that the plaintiff’s trademark could be seen on some of the defendant’s bags. It therefore insisted that a disclaimer label be sewn into the bag near the clasp, and plainly visible to anyone opening the handbag.

Post-purchase confusion creates a free-rider problem. Auto Gold contends that in “first sale” cases “the element of ‘free-riding’ present in other post-purchase confusion cases disappears because the producer has paid the price asked by the trademark owner for the ‘ride.’” This contention misses the point. When a producer purchases a trademarked product, that producer is not purchasing the trademark. Rather, the producer is purchasing a product that has been trademarked. If a producer profits from a trademark because of post-purchase confusion about the product’s origin, the producer is, to that degree, a free-rider.

For example, a producer may purchase non-functioning Rolex watches and refurbish them with non-Rolux parts, leaving only the original casing. Even if the producer adequately explains the nature of the refurbished watches to purchasers, the producer nonetheless infringes on Rolex's trademarks by profiting from the Rolex name. In such a case, the purchasers buy the watches in order to make others think that they have bought a true Rolex watch. The same holds true for new but relatively cheap products that prominently display a well-known trademark. If the producer purchases such a trademarked product and uses that product to create post-purchase confusion as to the source of a new product, the producer is free-riding even though it has paid for the trademarked product.

Next, Auto Gold argues that there is no trademark infringement because its marquee plates are of high quality. But likelihood of confusion, not quality control, is "the 'key-stone' of trademark law." *Westinghouse Elec. Corp. v. Gen. Circuit Breakers & Elec. Supply Inc.*, 106 F.3d 894, 900 (9th Cir. 1997). Courts have consistently held for plaintiffs where there is a possibility of confusion, even where defendants are not selling lower quality goods. See, e.g., *Levi Strauss & Co. v. Blue Bell, Inc.*, 632 F.2d 817, 821–22 (9th Cir. 1980) (pocket tabs on Wrangler jeans infringed upon Levi's trademark by creating a likelihood of post-purchase confusion despite no contention that Wrangler jeans were of lower quality). Similarly, courts have consistently held for defendants where there was no possibility of confusion, despite the fact that the defendants may have lowered the quality of goods. See, e.g., *Prestonettes*, 264 U.S. at 367; *Enesco Corp.*, 146 F.3d at 1087.

Finally, Auto Gold argues that the public interest is served by the competition that results from the availability of its products. It may be true that Auto Gold's activities serve to reduce the price paid by consumers for marquee plates. But trademark law protects trademark holders from the competition that results from trademark infringement, irrespective of its effect on prices.

We therefore conclude that the district court correctly granted summary judgment to Volkswagen on its trademark infringement claim.

AFFIRMED.

Notes and Questions

1. *Point of confusion.* Much of the court's reasoning in *Auto Gold* hangs on the distinction between confusion at the point of sale versus post-purchase confusion. What is the significance of this distinction in the first sale analysis? Do you agree with the court's determination that post-purchase confusion should be the deciding factor in such cases?
2. *Who is confused?* Closely related to the point at which confusion is measured is the question of whose confusion is relevant. If confusion is at the point of sale, then the customer making the purchase is the one likely to be confused, and the one that the law seeks to protect. But who is the victim of post-purchase confusion? If the purpose of trademark law is to prevent consumer confusion as to the source of goods, why should the law protect individuals who are not making the decision to purchase the particular good in question? Who is really being protected here?
3. *The public interest.* As noted by the court, "Auto Gold argues that the public interest is served by the competition that results from the availability of its products." Do you agree with Auto Gold? Why did the court summarily dismiss this argument? Are there public interest factors that should be considered in trademark exhaustion cases?

4. *Used, refurbished and like new.* As noted in the introduction to this section, the owner of a trademarked product is free to resell it without the authorization of the trademark owner on the theory that the product was genuinely produced by the trademark owner. This right is limited, however, if the reseller claims that the product is “new” or if the reseller has altered, reconditioned or repackaged the product. In *Surgi-Tech* and *Rolex*, discussed by the court in *Auto Gold*, substantial reconditioning of branded products altered them sufficiently that resale under their original brand was deemed to be likely to cause consumer confusion. But in cases such as *Prestonettes* and *Enesco*, repackaging of a branded product was permitted so long as the reseller adequately informed the consumer. Given that *Auto Gold* did not make any changes to the VW sticker that it used on its marquee license plates, how would you square the holding in *Auto Gold* with these precedents?

23.4 PATENT EXHAUSTION

Just as with copyrighted materials and goods bearing trademarks, patented articles are subject to an exhaustion doctrine. The Supreme Court offers the rationale for this doctrine in *United States v. Univis Lens Co.*, 316 U.S. 241, 251 (1942):

the purpose of the patent law is fulfilled with respect to any particular article when the patentee has received his reward for the use of his invention by the sale of the article, and that, once that purpose is realized, the patent law affords no basis for restraining the use and enjoyment of the thing sold.

Yet the patent exhaustion doctrine originated long before the Court’s decision in *Univis*. The following early case helped to establish the modern contours of the exhaustion doctrine.³

Adams v. Burke

84 U.S. 453 (1873)

On the 26th day of May, 1863, letters-patent were granted to Merrill & Horner, for a certain improvement in coffin lids, giving to them the exclusive right of making, using, and vending to others to be used, the said improvement.

On the 13th day of March, 1865, Merrill & Horner, the patentees, by an assignment duly executed and recorded, assigned Lockhart & Seelye, of Cambridge, in Middlesex County, Massachusetts, all the right, title, and interest which the said patentees had in the invention described in the said letters-patent, for, to, and in a circle whose radius is ten miles, having the city of Boston as a centre. They subsequently assigned the patent, or what right they retained in it, to one Adams.

Adams now filed a bill in the court below, against a certain Burke, an undertaker, who used in the town of Natick (a town about seventeen miles from Boston, and therefore outside of the circle above mentioned) coffins with lids of the kind patented, alleging him to be an infringer of their patent, and praying for an injunction, discovery, profits, and other relief suitable against an infringer.

³ For a more complete early history of the doctrine, see Alfred C. Server & William J. Casey, *Contract-Based Post-Sale Restrictions on Patented Products Following Quanta*, 64 Hastings L.J. 561, 564–75 (2013).

The Defendant Pleaded in Bar:

“That he carries on the business of an undertaker, having his place of business in Natick, in said district; that, in the exercise of his said business, he is employed to bury the dead; that when so employed it is his custom to procure hearses, coffins, and whatever else may be necessary or proper for burials, and to superintend the preparation of graves, and that his bills for his services in each case, and the coffin, hearse, and other articles procured by him, are paid by the personal representatives of the deceased; that, since the date of the alleged assignment to the plaintiff of an interest in the invention secured by the said letters-patent, he has sold no coffins, unless the use of coffins by him in his said business, as above described, shall be deemed a sale; has used no coffins, except in his said business as aforesaid; and has manufactured no coffins containing the said invention; and that since the said he has used in his business as aforesaid, in Natick, no coffin containing the invention secured by said letters-patent, except such coffins containing said invention as have been manufactured by said Lockhart & Seelye, within a circle, whose radius is ten miles, having the city of Boston as its centre, and sold within said circle by said Lockhart & Seelye, without condition or restriction.”

Mr. Justice MILLER delivered the opinion of the court.

The question presented by the plea in this case is a very interesting one in patent law, and the precise point in it has never been decided by this court, though cases involving some of the consideration which apply to it have been decided, and others of analogous character are frequently recurring. The vast pecuniary results involved in such cases, as well as the public interest, admonish us to proceed with care, and to decide in each case no more than what is directly in issue.

We have repeatedly held that where a person had purchased a patented machine of the patentee or his assignee, this purchase carried with it the right to the use of that machine so long as it was capable of use, and that the expiration and renewal of the patent, whether in favor of the original patentee or of his assignee, did not affect this right. The true ground on which these decisions rest is that the sale by a person who has the full right to make, sell, and use such a machine carries with it the right to the use of that machine to the full extent to which it can be used in point of time.

The right to manufacture, the right to sell, and the right to use are each substantive rights, and may be granted or conferred separately by the patentee. But, in the essential nature of things, when the patentee, or the person having his rights, sells a machine or instrument whose sole value is in its use, he receives the consideration for its use and he parts with the right to restrict that use. The article, in the language of the court, passes without the limit of the monopoly. That is to say, the patentee or his assignee having in the act of sale received all the royalty or consideration which he claims for the use of his invention in that particular machine or instrument, it is open to the use of the purchaser without further restriction on account of the monopoly of the patentees.

If this principle be sound as to a machine or instrument whose use may be continued for a number of years, and may extend beyond the existence of the patent, as limited at the time of the sale, and into the period of a renewal or extension, it must be much more applicable to an instrument or product of patented manufacture which perishes in the first use of it, or which, by that first use, becomes incapable of further use, and of no further value. Such is the case with the coffin-lids of appellant's patent.

It seems to us that, although the right of Lockhart & Seelye to manufacture, to sell, and to use these coffin-lids was limited to the circle of ten miles around Boston, that a

purchaser from them of a single coffin acquired the right to use that coffin for the purpose for which all coffins are used. That so far as the use of it was concerned, the patentee had received his consideration, and it was no longer within the monopoly of the patent. It would be to engraft a limitation upon the right of use not contemplated by the statute nor within the reason of the contract to say that it could only be used within the ten-miles circle. Whatever, therefore, may be the rule when patentees subdivide territorially their patents, as to the exclusive right to make or to sell within a limited territory, we hold that in the class of machines or implements we have described, when they are once lawfully made and sold, there is no restriction on their use to be implied for benefit of the patentee or his assignees or licensees.

A careful examination of the plea satisfies us that the defendant, who, as an undertaker, purchased each of these coffins and used it in burying the body which he was employed to bury, acquired the right to this use of it freed from any claim of the patentee, though purchased within the ten-mile circle and used without it.

The decree of the Circuit Court dismissing the plaintiff's bill is, therefore,
AFFIRMED.

Notes and Questions

1. *The power of exhaustion.* Lockhart & Seelye had the right to manufacture and sell patented coffin lids within a ten-mile radius of Boston. Burke, who purchased a coffin from them, used it in Natick, beyond the ten-mile radius. Yet the Court denied the claim of Adams, who

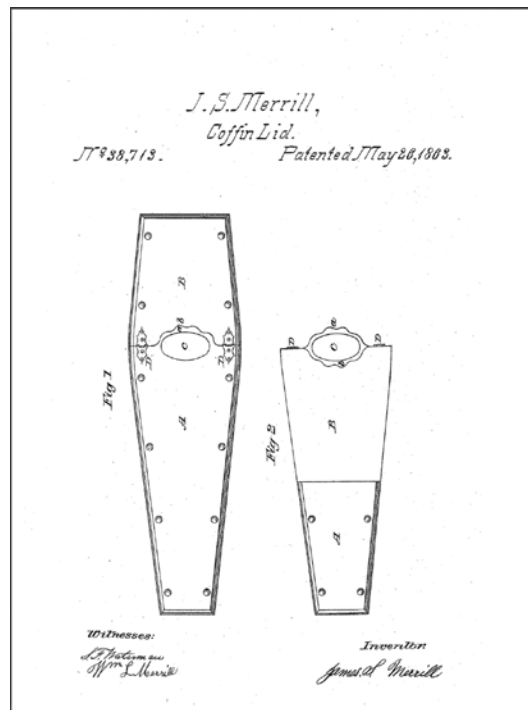


FIGURE 23.4 Figures from U.S. Patent No. 38,713 (May 26, 1863) “Improvement in Coffin Lids.”

was the owner of the patent rights beyond the ten-mile radius. Why? Because when Lockhart & Seelye made an authorized sale to Burke, the patent rights in that coffin were exhausted and Adams could no longer assert them against those particular coffins. This is a potent concept. What if Lockhart & Seelye set up a coffin factory and began to ship their coffins around the world? Should Adams feel aggrieved? At what point might Adams have a claim against a user of a Lockhart & Seelye coffin beyond the ten-mile radius?

2. *A limitation on use?* What if the original patentee had assigned to Lockhart & Seelye only the right to manufacture coffins *for use* within a ten-mile radius of Boston? Could Adams then have argued that the right to use the patented coffins outside of the ten-mile radius was never granted to Lockhart & Seelye, and thus could not be exhausted by their sale to Burke? How would such a limitation on the scope of the right conveyed differ from a contractual clause that simply prohibited Lockhart & Seelye from permitting any coffin they sold to be used outside of their permitted ten-mile radius? For more on this issue, see [Section 23.5](#).

Quanta Computer, Inc. v. LG Electronics

553 U.S. 617 (2008)

THOMAS, JUSTICE

For over 150 years this Court has applied the doctrine of patent exhaustion to limit the patent rights that survive the initial authorized sale of a patented item. In this case, we decide whether patent exhaustion applies to the sale of components of a patented system that must be combined with additional components in order to practice the patented methods. The Court of Appeals for the Federal Circuit held that the doctrine does not apply to method patents at all and, in the alternative, that it does not apply here because the sales were not authorized by the license agreement. We disagree on both scores. Because the exhaustion doctrine applies to method patents, and because the license authorizes the sale of components that substantially embody the patents in suit, the sale exhausted the patents.

I

Respondent LG Electronics, Inc. (LGE), purchased a portfolio of computer technology patents in 1999, including the three patents at issue here: U.S. Patent Nos. 4,939,641 ('641); 5,379,379 ('379); and 5,077,733 ('733) (collectively LGE Patents). The main functions of a computer system are carried out on a microprocessor, or central processing unit, which interprets program instructions, processes data, and controls other devices in the system. A set of wires, or bus, connects the microprocessor to a chipset, which transfers data between the microprocessor and other devices, including the keyboard, mouse, monitor, hard drive, memory, and disk drives.

The data processed by the computer are stored principally in random access memory, also called main memory. Frequently accessed data are generally stored in cache memory, which permits faster access than main memory and is often located on the microprocessor itself. *Id.*, at 84. When copies of data are stored in both the cache and main memory, problems may arise when one copy is changed but the other still contains the original "stale" version of the data. The '641 patent addresses this problem. It discloses a system for ensuring that the most current data are retrieved from main memory by monitoring data

requests and updating main memory from the cache when stale data are requested. The '379 patent relates to the coordination of requests to read from, and write to, main memory. The '733 patent addresses the problem of managing the data traffic on a bus connecting two computer components, so that no one device monopolizes the bus.

LGE licensed a patent portfolio, including the LGE Patents, to Intel Corporation (Intel). The cross-licensing agreement (License Agreement) permits Intel to manufacture and sell microprocessors and chipsets that use the LGE Patents (the Intel Products). The License Agreement authorizes Intel to “make, use, sell (directly or indirectly), offer to sell, import or otherwise dispose of” its own products practicing the LGE Patents. Notwithstanding this broad language, the License Agreement contains some limitations.

Relevant here, it stipulates that no license

is granted by either party hereto ... to any third party for the combination by a third party of Licensed Products of either party with items, components, or the like acquired ... from sources other than a party hereto, or for the use, import, offer for sale or sale of such combination.

The License Agreement purports not to alter the usual rules of patent exhaustion, however, providing that, “[n]otwithstanding anything to the contrary contained in this Agreement, the parties agree that nothing herein shall in any way limit or alter the effect of patent exhaustion that would otherwise apply when a party hereto sells any of its Licensed Products.”

In a separate agreement (Master Agreement), Intel agreed to give written notice to its own customers informing them that, while it had obtained a broad license “ensur[ing] that any Intel product that you purchase is licensed by LGE and thus does not infringe any patent held by LGE,” the license “does not extend, expressly or by implication, to any product that you make by combining an Intel product with any non-Intel product.”

The Master Agreement also provides that “a breach of this Agreement shall have no effect on and shall not be grounds for termination of the Patent License.”

Petitioners, including Quanta Computer (collectively Quanta), are a group of computer manufacturers. Quanta purchased microprocessors and chipsets from Intel and received the notice required by the Master Agreement. Nonetheless, Quanta manufactured computers using Intel parts in combination with non-Intel memory and buses in ways that practice the LGE Patents. Quanta does not modify the Intel components and follows Intel’s specifications to incorporate the parts into its own systems.

LGE filed a complaint against Quanta, asserting that the combination of the Intel Products with non-Intel memory and buses infringed the LGE Patents. The District Court granted summary judgment to Quanta, holding that, for purposes of the patent exhaustion doctrine, the license LGE granted to Intel resulted in forfeiture of any potential infringement actions against legitimate purchasers of the Intel Products. In a subsequent order limiting its summary judgment ruling, the court held that patent exhaustion applies only to apparatus or composition-of-matter claims that describe a physical object, and does not apply to process, or method, claims that describe operations to make or use a product.

The Court of Appeals for the Federal Circuit affirmed in part and reversed in part. It agreed that the doctrine of patent exhaustion does not apply to method claims. In the alternative, it concluded that exhaustion did not apply because LGE did not license Intel to sell the Intel Products to Quanta for use in combination with non-Intel products.

We granted certiorari.

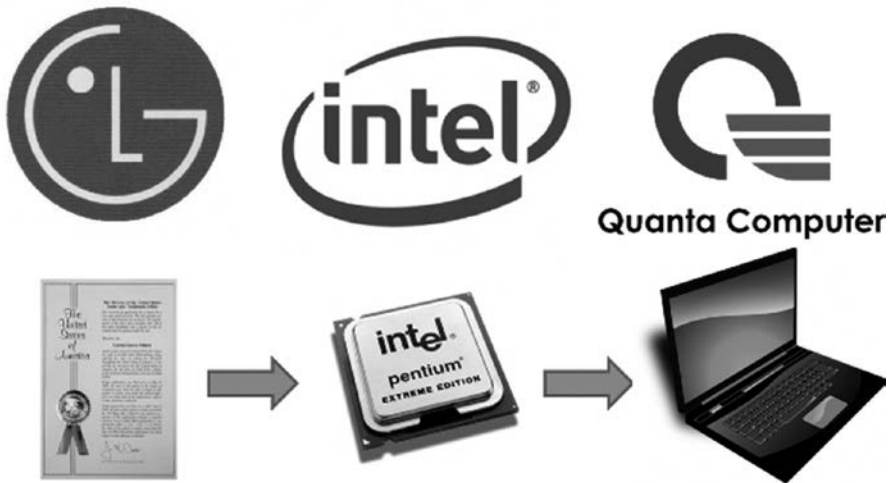


FIGURE 23.5 The parties in *Quanta v. LGE*: LGE, which held three patents covering aspects of a chip's design; Intel, which manufactured chips under license from LG; and Quanta, which purchased Intel chips for use in its computers.

II

The longstanding doctrine of patent exhaustion provides that the initial authorized sale of a patented item terminates all patent rights to that item.

[*The early history of patent exhaustion is omitted*]

This Court most recently discussed patent exhaustion in *United States v. Unis Lens Co.*, 316 U.S. 241 (1942), on which the District Court relied. Unis Lens Company, the holder of patents on eyeglass lenses, licensed a purchaser to manufacture lens blanks⁴ by fusing together different lens segments to create bi- and tri-focal lenses and to sell them to other Unis licensees at agreed-upon rates. Wholesalers were licensed to grind the blanks into the patented finished lenses, which they would then sell to Unis-licensed prescription retailers for resale at a fixed rate. Finishing retailers, after grinding the blanks into patented lenses, would sell the finished lenses to consumers at the same fixed rate. The United States sued Unis under the Sherman Act, alleging unlawful restraints on trade.⁵ Unis asserted its patent monopoly rights as a defense to the antitrust suit. The Court granted certiorari to determine whether Unis' patent monopoly survived the sale of the lens blanks by the licensed manufacturer and therefore shielded Unis' pricing scheme from the Sherman Act.

The Court assumed that the Unis patents containing claims for finished lenses were practiced in part by the wholesalers and finishing retailers who ground the blanks into lenses, and held that the sale of the lens blanks exhausted the patents on the finished lenses. The Court explained that the lens blanks “embodi[ed] essential features of the patented device and [were] without utility until ... ground and polished as the finished lens of the patent.” The Court noted that:

where one has sold an uncompleted article which, because it embodies essential features of his patented invention, is within the protection of his patent, and has destined the

⁴ Lens blanks are “rough opaque pieces of glass of suitable size, design and composition for use, when ground and polished, as multifocal lenses in eyeglasses.”

⁵ For a discussion of the Sherman Antitrust Act of 1890, see [Chapter 25](#) – Ed.

article to be finished by the purchaser in conformity to the patent, he has sold his invention so far as it is or may be embodied in that particular article.

In sum, the Court concluded that the traditional bar on patent restrictions following the sale of an item applies when the item sufficiently embodies the patent—even if it does not completely practice the patent—such that its only and intended use is to be finished under the terms of the patent.

With this history of the patent exhaustion doctrine in mind, we turn to the parties' arguments.

III. A

LGE argues that the exhaustion doctrine is inapplicable here because it does not apply to method claims, which are contained in each of the LGE Patents. LGE reasons that, because method patents are linked not to a tangible article but to a process, they can never be exhausted through a sale. Rather, practicing the patent—which occurs upon each use of an article embodying a method patent—is permissible only to the extent rights are transferred in an assignment contract. *Quanta*, in turn, argues that there is no reason to preclude exhaustion of method claims, and points out that both this Court and the Federal Circuit have applied exhaustion to method claims. It argues that any other rule would allow patent holders to avoid exhaustion entirely by inserting method claims in their patent specifications.

Quanta has the better of this argument. Nothing in this Court's approach to patent exhaustion supports LGE's argument that method patents cannot be exhausted. It is true that a patented method may not be sold in the same way as an article or device, but methods nonetheless may be "embodied" in a product, the sale of which exhausts patent rights. Our precedents do not differentiate transactions involving embodiments of patented methods or processes from those involving patented apparatuses or materials. To the contrary, this Court has repeatedly held that method patents were exhausted by the sale of an item that embodied the method. These cases rest on solid footing. Eliminating exhaustion for method patents would seriously undermine the exhaustion doctrine. Patentees seeking to avoid patent exhaustion could simply draft their patent claims to describe a method rather than an apparatus. Apparatus and method claims "may approach each other so nearly that it will be difficult to distinguish the process from the function of the apparatus." By characterizing their claims as method instead of apparatus claims, or including a method claim for the machine's patented method of performing its task, a patent drafter could shield practically any patented item from exhaustion.

This case illustrates the danger of allowing such an end-run around exhaustion. On LGE's theory, although Intel is authorized to sell a completed computer system that practices the LGE Patents, any downstream purchasers of the system could nonetheless be liable for patent infringement. Such a result would violate the longstanding principle that, when a patented item is "once lawfully made and sold, there is no restriction on [its] use to be implied for the benefit of the patentee." We therefore reject LGE's argument that method claims, as a category, are never exhaustible.

B

We next consider the extent to which a product must embody a patent in order to trigger exhaustion. *Quanta* argues that, although sales of an incomplete article do not necessarily

exhaust the patent in that article, the sale of the microprocessors and chipsets exhausted LGE's patents in the same way the sale of the lens blanks exhausted the patents in *Univis*. Just as the lens blanks in *Univis* did not fully practice the patents at issue because they had not been ground into finished lenses, Quanta observes, the Intel Products cannot practice the LGE Patents—or indeed, function at all—until they are combined with memory and buses in a computer system ... We agree with Quanta that *Univis* governs this case. As the Court there explained, exhaustion was triggered by the sale of the lens blanks because their only reasonable and intended use was to practice the patent and because they “embodie[d] essential features of [the] patented invention.” Each of those attributes is shared by the microprocessors and chipsets Intel sold to Quanta under the License Agreement.

First, *Univis* held that “the authorized sale of an article which is capable of use only in practicing the patent is a relinquishment of the patent monopoly with respect to the article sold.” Here, LGE has suggested no reasonable use for the Intel Products other than incorporating them into computer systems that practice the LGE Patents. Nor can we discern one: A microprocessor or chipset cannot function until it is connected to buses and memory. And here, as in *Univis*, the only apparent object of Intel's sales to Quanta was to permit Quanta to incorporate the Intel Products into computers that would practice the patents.

Second, the lens blanks in *Univis* “embodie[d] essential features of [the] patented invention.” Like the *Univis* lens blanks, the Intel Products constitute a material part of the patented invention and all but completely practice the patent. Here, as in *Univis*, the incomplete article substantially embodies the patent because the only step necessary to practice the patent is the application of common processes or the addition of standard parts. Everything inventive about each patent is embodied in the Intel Products.

C

Having concluded that the Intel Products embodied the patents, we next consider whether their sale to Quanta exhausted LGE's patent rights. Exhaustion is triggered only by a sale authorized by the patent holder.

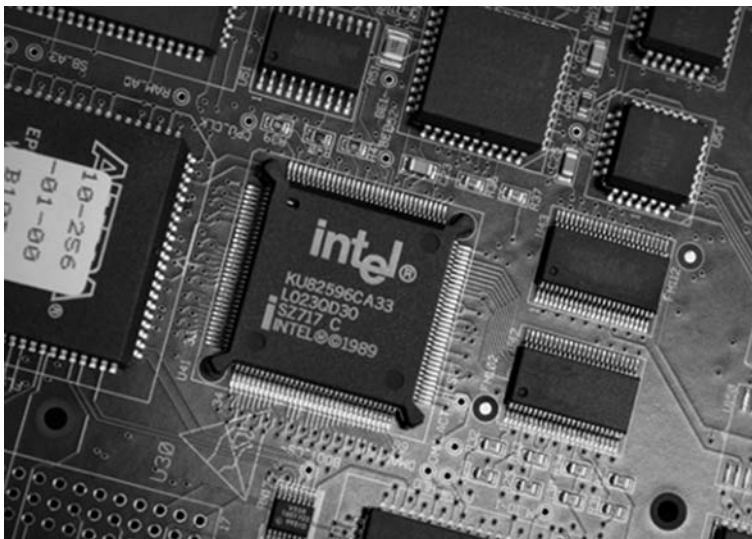


FIGURE 23.6 An Intel chip integrated into a computer board.

LGE argues that there was no authorized sale here because the License Agreement does not permit Intel to sell its products for use in combination with non-Intel products to practice the LGE Patents. It cites *General Talking Pictures Corp. v. Western Elec. Co.*, 304 U.S. 175 and 305 U.S. 124 (1938), in which the manufacturer sold patented amplifiers for commercial use, thereby breaching a license that limited the buyer to selling the amplifiers for private and home use. The Court held that exhaustion did not apply because the manufacturer had no authority to sell the amplifiers for commercial use, and the manufacturer “could not convey to petitioner what both knew it was not authorized to sell.” LGE argues that the same principle applies here: Intel could not convey to Quanta what both knew it was not authorized to sell, i.e., the right to practice the patents with non-Intel parts.

LGE overlooks important aspects of the structure of the Intel–LGE transaction. Nothing in the License Agreement restricts Intel’s right to sell its microprocessors and chipsets to purchasers who intend to combine them with non-Intel parts. It broadly permits Intel to “make, use, [or] sell” products free of LGE’s patent claims. To be sure, LGE did require Intel to give notice to its customers, including Quanta, that LGE had not licensed those customers to practice its patents. But neither party contends that Intel breached the agreement in that respect. In any event, the provision requiring notice to Quanta appeared only in the Master Agreement, and LGE does not suggest that a breach of that agreement would constitute a breach of the License Agreement. Hence, Intel’s authority to sell its products embodying the LGE Patents was not conditioned on the notice or on Quanta’s decision to abide by LGE’s directions in that notice.

LGE points out that the License Agreement specifically disclaimed any license to third parties to practice the patents by combining licensed products with other components. But the question whether third parties received implied licenses is irrelevant because Quanta asserts its right to practice the patents based not on implied license but on exhaustion. And exhaustion turns only on Intel’s own license to sell products practicing the LGE Patents.

Alternatively, LGE invokes the principle that patent exhaustion does not apply to post-sale restrictions on “making” an article. But this is simply a rephrasing of its argument that combining the Intel Products with other components adds more than standard finishing to complete a patented article. As explained above, making a product that substantially embodies a patent is, for exhaustion purposes, no different from making the patented article itself. In other words, no further “making” results from the addition of standard parts—here, the buses and memory—to a product that already substantially embodies the patent.

The License Agreement authorized Intel to sell products that practiced the LGE Patents. No conditions limited Intel’s authority to sell products substantially embodying the patents. Because Intel was authorized to sell its products to Quanta, the doctrine of patent exhaustion prevents LGE from further asserting its patent rights with respect to the patents substantially embodied by those products.⁶

⁶ [n. 7] We note that the authorized nature of the sale to Quanta does not necessarily limit LGE’s other contract rights. LGE’s complaint does not include a breach-of-contract claim, and we express no opinion on whether contract damages might be available even though exhaustion operates to eliminate patent damages. See *Keeler v. Standard Folding Bed Co.*, 157 U.S. 659, 666 (1895) (“Whether a patentee may protect himself and his assignees by special contracts brought home to the purchasers is not a question before us, and upon which we express no opinion. It is, however, 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”).

IV

The authorized sale of an article that substantially embodies a patent exhausts the patent holder's rights and prevents the patent holder from invoking patent law to control post-sale use of the article. Here, LGE licensed Intel to practice any of its patents and to sell products practicing those patents. Intel's microprocessors and chipsets substantially embodied the LGE Patents because they had no reasonable noninfringing use and included all the inventive aspects of the patented methods. Nothing in the License Agreement limited Intel's ability to sell its products practicing the LGE Patents. Intel's authorized sale to Quanta thus took its products outside the scope of the patent monopoly, and as a result, LGE can no longer assert its patent rights against Quanta. Accordingly, the judgment of the Court of Appeals is reversed.

Notes and Questions

1. *Exhaustion of method claims.* According to some observers, the Court thought that the principal holding of *Quanta* established that patent exhaustion applied to method claims. As Justice Thomas writes, failing to recognize patent exhaustion of method claims would be "an end-run around exhaustion." What did he mean?
2. *Embodiment of a patent.* The Court in *Quanta* relies heavily on its earlier reasoning in *Univis*, in which patents covering finished optical lenses were found to be exhausted upon the patentee's sale of unfinished lens blanks. How can an unpolished piece of glass embody the "essential features" of an optical lens? By the same token, how can Intel's chips, which lacked the buses and memory claimed in LGE's patents, exhaust those patents?
3. *Exhaustion policy?* As noted by Fred Server and William Casey, the *Quanta* decision has been criticized for

perpetuating a draconian per se rule against post-sale vertical restraints that runs counter to the trend in competition law to evaluate such restraints with greater subtlety and to view them more favorably ... exacerbated by the Court's recurring failure to articulate a clear and compelling policy rationale in support of the doctrine.⁷

Do you agree with this critique? What do you think the Court viewed as the overriding policy concern of patent exhaustion? Do you think that a more nuanced test for patent exhaustion, perhaps modeled on "rule of reason" analysis under antitrust law (see [Section 25.1](#)), is warranted?

4. *A license exclusion?* The license agreement between LGE and Intel stated that "no license is granted ... to any third party for the combination by a third party of Licensed Products ... with items, components, or the like acquired ... from sources other than a party hereto, or for the use, import, offer for sale or sale of such combination." What was the purpose of this clause? Why do you think it was written in terms of no license rights being granted to a third party? Why do you think that Intel, knowing that it planned to sell chips to computer manufacturers like Quanta, agreed to this exclusionary language?⁸

⁷ Server & Casey, *supra* note 3, at 580.

⁸ For a discussion of the parties' possible business motives in this transaction, see Amelia Smith Rinehart, *Contracting Patents: A Modern Patent Exhaustion Doctrine*, 23 Harv. J. L. Tech. 483, 521 (2010).

What do you make of the additional clause in the License Agreement, “nothing herein shall in any way limit or alter the effect of patent exhaustion that would otherwise apply when a party hereto sells any of its Licensed Products.” Why would the parties include such a clause in the License Agreement? Which of them do you think insisted on this clause?

Of course, the Court, in analyzing the license agreement, concluded that the exclusionary language was largely irrelevant. *Quanta* was not arguing that it had obtained a license from LGE, it was arguing that LGE’s patent rights were exhausted upon Intel’s sale of chips. Why was this such an important difference?

If LGE really wanted to limit the rights that Intel’s customers obtained, couldn’t LGE have limited the rights that it granted to Intel in the first place? That is, could LGE’s license to Intel have been limited to manufacturing and selling chips on a standalone basis, but not combining the chips with other computer components? Would such a limitation have defeated patent exhaustion? What might have Intel’s reaction been to such language?

5. *Customer notification and limitations.* Under a separate master agreement between LGE and Intel, Intel agreed to notify its customers that Intel’s broad license from LGE “does not extend, expressly or by implication, to any product that you make by combining an Intel product with any non-Intel product.” What was the purpose of this notification requirement? Why would Intel agree to this requirement? Did such a notice have any legal effect on Intel’s customers?
6. *Other contractual limitations?* Footnote 7 of the *Quanta* opinion (reproduced in the case above) has occasioned significant speculation. The Court seemingly leaves open the door to a breach of contract claim even if patent rights have been exhausted. Thus, if Intel had failed to notify *Quanta* of LGE’s position that computer manufacturers were not licensed under LGE’s patents, LGE might have a breach of contract claim against Intel. What damages might be available to LGE if such a claim were successful, given the exhaustion of LGE’s patents?
7. *What is an exhaustive license?* What constitutes a “license” for the purposes of patent exhaustion? The license that LGE granted to Intel clearly exhausted LGE’s patents. But what if the agreement were less clear? For example, in *De Forest Radio Telephone Co. v. United States*, 273 U.S. 236, 241 (1927), the Supreme Court held that “No formal granting of a license is necessary in order to give it effect. Any language used by the owner of the patent, or any conduct on his part exhibited to another from which that other may properly infer that the owner consents to his use of the patent in making or using it, or selling it, upon which the other acts, constitutes a license.” And in *Ortho Pharmaceutical Corp. v. Genetics Institute, Inc.*, 52 F.3d 1026, 1031 (Fed. Cir. 1995), the Federal Circuit wrote that “A license may amount to no more than a covenant by the patentee not to sue the licensee for making, using or selling the patented invention.” Given this precedent, could a patent holder’s conduct short of granting a formal license agreement exhaust its patents?

Consider, for example, the “CDMA ASIC Agreements” that patent owner Qualcomm entered into with makers of wireless telecommunication chips, as described in *FTC v. Qualcomm* (9th Cir., Aug. 11, 2020). As described by the court, these agreements “allow Qualcomm’s competitors to practice Qualcomm’s [patents] royalty-free,” though they are not called licenses. Could such agreements exhaust Qualcomm’s patents?⁹

8. *Exhaustion and self-propagating inventions – patented plants.* In *Bowman v. Monsanto*, 569 U.S. 278 (2013), Monsanto patented a genetic modification that makes soybean plants

⁹ For a more in-depth consideration of this question, see Jorge L. Contreras, “No License, No Problem” – Is Qualcomm’s Ninth Circuit Antitrust Victory a Patent Exhaustion Defeat?, Patently-O blog, August 31, 2020.

resistant to glyphosate, a potent herbicide marketed by Monsanto as Roundup.¹⁰ Monsanto and its licensees sell these seeds to growers who are contractually permitted to use or sell the resulting soybeans for consumption (human or animal). However, they must also agree not to save any of the harvested soybeans for replanting. One farmer, Vernon Bowman, however, thought he found a way to circumvent Monsanto's replanting restrictions. As the Court explains, he

went to a grain elevator; purchased "commodity soybeans" intended for human or animal consumption; and planted them in his fields. Those soybeans came from prior harvests of other local farmers. And because most of those farmers also used Roundup Ready seed, Bowman could anticipate that many of the purchased soybeans would contain Monsanto's patented technology. When he applied a glyphosate-based herbicide to his fields, he confirmed that this was so; a significant proportion of the new plants survived the treatment, and produced in their turn a new crop of soybeans with the Roundup Ready trait. Bowman saved seed from that crop to use in his late-season planting the next year—and then the next, and the next, until he had harvested eight crops in that way. Each year, that is, he planted saved seed from the year before (sometimes adding more soybeans bought from the grain elevator), sprayed his fields with glyphosate to kill weeds (and any non-resistant plants), and produced a new crop of glyphosate-resistant—i.e., Roundup Ready—soybeans.

After discovering this practice, Monsanto sued Bowman for infringing its patents on Roundup Ready seed. Bowman raised patent exhaustion as a defense, arguing that Monsanto could not control his use of the soybeans because they were the subject of a prior authorized sale (from local farmers to the grain elevator).

The Supreme Court, in a unanimous decision, ruled against Bowman, reasoning as follows:

Under the patent exhaustion doctrine, Bowman could resell the patented soybeans he purchased from the grain elevator; so too he could consume the beans himself or feed them to his animals ... But the exhaustion doctrine does not enable Bowman to make additional patented soybeans without Monsanto's permission (either express or implied). And that is precisely what Bowman did. He took the soybeans he purchased home; planted them in his fields at the time he thought best; applied glyphosate to kill weeds (as well as any soy plants lacking the Roundup Ready trait); and finally harvested more (many more) beans than he started with. That is how "to 'make' a new product," to use Bowman's words, when the original product is a seed. Because Bowman thus reproduced Monsanto's patented invention, the exhaustion doctrine does not protect him.

What do you think of the Court's reasoning with respect to patent exhaustion? Should all of Monsanto's patent rights have been exhausted with respect to each seed once it was sold the first time? Does it make a difference that a seed, by its very nature, will grow into a soybean plant without substantial alteration by its owner?

The Court, in supporting its result, also relies on several policy and instrumentalist arguments, attempting to demonstrate that any other result would be irrational:

Were the matter otherwise, Monsanto's patent would provide scant benefit. After inventing the Roundup Ready trait, Monsanto would, to be sure, "receiv[e] [its] reward" for the first seeds it sells. But in short order, other seed companies could reproduce the product and market it to growers, thus depriving Monsanto of its monopoly. And farmers themselves need only buy the seed once, whether from Monsanto, a competitor, or (as here) a grain elevator.

¹⁰ The plaintiffs in several class actions also allege that glyphosate is a carcinogen that has caused them significant personal injury and death.

The grower could multiply his initial purchase, and then multiply that new creation, ad infinitum—each time profiting from the patented seed without compensating its inventor. Bowman’s late-season plantings offer a prime illustration.

What alternative policy arguments would you raise if you represented Bowman?

9. *Exhaustion across IP types*. Now that you have seen how the first sale and exhaustion doctrines work across copyright, trademark and patent law, what common features can you identify among these three bodies of law? What important differences do you find?

23.5 CONDITIONAL SALES AND POST-SALE RESTRICTIONS

Ever since *Adams v. Burke*, patent licensors have experimented with contractual mechanisms to limit the rights that their licensees can impart to purchasers of licensed products. They sought to limit contractually the rights granted to licensees in such a way that the licensees’ sale of products would not, under the right circumstances, exhaust the patent. For example, what if the patent holders in *Adams v. Burke* had expressly limited Lockhart & Seelye’s rights to the sale of coffins for use within a ten-mile radius of Boston? Would Burke’s use outside of that radius have constituted patent infringement?

The question of the effect of “conditional sales” of patented articles was addressed by the Federal Circuit in *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700 (Fed. Cir. 1992). In that case, Mallinckrodt produced a patented device known as “UltraVent” which delivered a radio-active aerosol mist to the lungs of a patient for the diagnosis and treatment of pulmonary disease. Each UltraVent device was marked “Single Use Only.” The package insert provided with each unit stated that the entire contaminated device should be disposed of as biohazardous waste material. Contrary to these instructions, several hospitals that purchased UltraVent devices did not dispose of them after the first use, but instead shipped them to Medipart, which sterilized and returned them to the hospitals as “reconditioned” devices. The hospitals then used these reconditioned devices in apparent violation of their “single use only” labeling. Mallinckrodt, upon learning of this practice, sued Medipart for patent infringement and inducement to infringe. It argued, among other things, that:

- the restriction on reuse could be construed as a label license for a specified field of use, wherein the field is single (i.e., disposable) use;
- the restriction is valid and enforceable under the patent law because the use is within the scope of the patent grant, and the restriction does not enlarge the patent grant;
- a license to less than all uses of a patented article is well recognized and a valid practice under patent law;
- the restriction is reasonable because it is based on health, safety, efficacy, and liability considerations and violates no public policy; and
- use in violation of the restriction is patent infringement.

The federal circuit agreed with Mallinckrodt, reasoning that:

If the sale of the UltraVent was validly conditioned under the applicable law such as the law governing sales and licenses, and if the restriction on reuse was within the scope of the patent grant or otherwise justified, then violation of the restriction may be remedied by action for patent infringement.

UltraVent™
Radioaerosol Delivery System
For Single Patient Use

Caution:
Rx Federal (U.S.A.) Law restricts this ONLY device to sale by or on the order of a physician.

Ventilation Kit and Shield Instructions For Use

Warning:
 This ventilation kit is FOR SINGLE PATIENT USE ONLY. Reuse can cause cross-infection. After using this ventilation kit once, it should be disposed of using appropriate techniques for the disposal of biohazardous materials.

 This product contains DEHP. The intended use limits exposure to DEHP transient contact, minimizing the risk of DEHP release from the device. In order to avoid undue risk of DEHP exposure in children and nursing or pregnant women, product should only be used as directed.

Assembly Instructions:

1. Remove the UltraVent Ventilation Kit from its packaging. Components include:



FIGURE 23.7 A portion of the product information brochure for Mallinckrodt's UltraVent device.

Impression Products, Inc. v. Lexmark International, Inc.

137 S. Ct. 1523 (2017)

ROBERTS, CHIEF JUSTICE

I

The underlying dispute in this case is about laser printers—or, more specifically, the cartridges that contain the powdery substance, known as toner, that laser printers use to make an image appear on paper. Respondent Lexmark International, Inc. designs, manufactures, and sells toner cartridges to consumers in the United States and around the globe. It owns a number of patents that cover components of those cartridges and the manner in which they are used. When toner cartridges run out of toner they can be refilled and used again. This creates an opportunity for other companies—known as remanufacturers—to acquire empty Lexmark cartridges from purchasers in the United States and abroad, refill them with toner, and then resell them at a lower price than the new ones Lexmark puts

on the shelves. Not blind to this business problem, Lexmark structures its sales in a way that encourages customers to return spent cartridges. It gives purchasers two options: One is to buy a toner cartridge at full price, with no strings attached. The other is to buy a cartridge at roughly 20 percent off through Lexmark's "Return Program." A customer who buys through the Return Program still owns the cartridge but, in exchange for the lower price, signs a contract agreeing to use it only once and to refrain from transferring the empty cartridge to anyone but Lexmark. To enforce this single-use/no-resale restriction, Lexmark installs a microchip on each Return Program cartridge that prevents reuse once the toner in the cartridge runs out.

Lexmark's strategy just spurred remanufacturers to get more creative. Many kept acquiring empty Return Program cartridges and developed methods to counteract the effect of the microchips. With that technological obstacle out of the way, there was little to prevent the re-manufacturers from using the Return Program cartridges in their resale business. After all, Lexmark's contractual single-use/no-resale agreements were with the initial customers, not with downstream purchasers like the remanufacturers.

Lexmark, however, was not so ready to concede that its plan had been foiled. In 2010, it sued a number of remanufacturers, including petitioner Impression Products, Inc., for patent infringement with respect to two groups of cartridges. One group consists of Return Program cartridges that Lexmark sold within the United States. Lexmark argued that, because it expressly prohibited reuse and resale of these cartridges, the remanufacturers infringed the Lexmark patents when they refurbished and resold them. The other group consists of all toner cartridges that Lexmark sold abroad and that remanufacturers imported into the country. Lexmark claimed that it never gave anyone authority to import these cartridges, so the remanufacturers ran afoul of its patent rights by doing just that.

Eventually, the lawsuit was whittled down to one defendant, Impression Products, and one defense: that Lexmark's sales, both in the United States and abroad, exhausted its patent rights in the cartridges, so Impression Products was free to refurbish and resell them, and to import them if acquired abroad. Impression Products filed separate motions to dismiss with respect to both groups of cartridges. The District Court granted the motion as to the domestic Return Program cartridges, but denied the motion as to the cartridges Lexmark sold abroad. Both parties appealed.

The Federal Circuit considered the appeals *en banc* and ruled for Lexmark with respect to both groups of cartridges. The court began with the Return Program cartridges that Lexmark sold in the United States. Relying on its decision in *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F. 2d 700 (1992), the Federal Circuit held that a patentee may sell an item and retain the right to enforce, through patent infringement lawsuits, "clearly communicated ... lawful restriction[s] as to post-sale use or resale." The exhaustion doctrine, the court reasoned, derives from the prohibition on making, using, selling, or importing items "without authority." When you purchase an item you presumptively also acquire the authority to use or resell the item freely, but that is just a presumption; the same authority does not run with the item when the seller restricts post-sale use or resale. Because the parties agreed that Impression Products knew about Lexmark's restrictions and that those restrictions did not violate any laws, the Federal Circuit concluded that Lexmark's sales had not exhausted all of its patent rights, and that the company could sue for infringement when Impression Products refurbished and resold Return Program cartridges.

Judge Dyk, joined by Judge Hughes, dissented. In their view, selling the Return Program cartridges in the United States exhausted Lexmark's patent rights in those items because

any “authorized sale of a patented article ... free[s] the article from any restrictions on use or sale based on the patent laws.”

[*The Court's discussion of international exhaustion is contained in Section 23.6*]

We granted certiorari to consider the Federal Circuit's decisions ... and now reverse.

II. A

First up are the Return Program cartridges that Lexmark sold in the United States. We conclude that Lexmark exhausted its patent rights in these cartridges the moment it sold them. The single-use/no-resale restrictions in Lexmark's contracts with customers may have been clear and enforceable under contract law, but they do not entitle Lexmark to retain patent rights in an item that it has elected to sell.

The Patent Act grants patentees the “right to exclude others from making, using, offering for sale, or selling [their] invention[s].” 35 U. S. C. §154(a). For over 160 years, the doctrine of patent exhaustion has imposed a limit on that right to exclude. The limit functions automatically: When a patentee chooses to sell an item, that product “is no longer within the limits of the monopoly” and instead becomes the “private, individual property” of the purchaser, with the rights and benefits that come along with ownership. A patentee is free to set the price and negotiate contracts with purchasers, but may not, “by virtue of his patent, control the use or disposition” of the product after ownership passes to the purchaser. *United States v. Univis Lens Co.*, 316 U. S. 241, 250 (1942). The sale “terminates all patent rights to that item.” *Quanta Computer, Inc. v. LG Electronics, Inc.*, 553 U. S. 617, 625 (2008).

This well-established exhaustion rule marks the point where patent rights yield to the common law principle against restraints on alienation. The Patent Act “promote[s] the progress of science and the useful arts by granting to [inventors] a limited monopoly” that allows them to “secure the financial rewards” for their inventions. But once a patentee sells an item, it has “enjoyed all the rights secured” by that limited monopoly. *Keeler v. Standard Folding Bed Co.*, 157 U. S. 659, 661 (1895). Because “the purpose of the patent law is fulfilled ... when the patentee has received his reward for the use of his invention,” that law furnishes “no basis for restraining the use and enjoyment of the thing sold.” *Univis*, 316 U. S., at 251.

This venerable principle is not, as the Federal Circuit dismissively viewed it, merely “one common-law jurisdiction's general judicial policy at one time toward anti-alienation restrictions.” Congress enacted and has repeatedly revised the Patent Act against the backdrop of the hostility toward restraints on alienation. That enmity is reflected in the exhaustion doctrine. The patent laws do not include the right to “restrain[] ... further alienation” after an initial sale; such conditions have been “hateful to the law from Lord Coke's day to ours” and are “obnoxious to the public interest.” *Straus v. Victor Talking Machine Co.*, 243 U. S. 490, 501 (1917). “The inconvenience and annoyance to the public that an opposite conclusion would occasion are too obvious to require illustration.” *Keeler*, 157 U. S., at 667.

But an illustration never hurts. Take a shop that restores and sells used cars. The business works because the shop can rest assured that, so long as those bringing in the cars own them, the shop is free to repair and resell those vehicles. That smooth flow of commerce would sputter if companies that make the thousands of parts that go into a vehicle could keep their patent rights after the first sale. Those companies might, for instance, restrict resale rights and sue the shop owner for patent infringement. And even if they refrained from imposing such restrictions, the very threat of patent liability would force the shop

to invest in efforts to protect itself from hidden lawsuits. Either way, extending the patent rights beyond the first sale would clog the channels of commerce, with little benefit from the extra control that the patentees retain. And advances in technology, along with increasingly complex supply chains, magnify the problem.

This Court accordingly has long held that, even when a patentee sells an item under an express restriction, the patentee does not retain patent rights in that product. In *Boston Store of Chicago v. American Graphophone Co.*, for example, a manufacturer sold graphophones—one of the earliest devices for recording and reproducing sounds—to retailers under contracts requiring those stores to resell at a specific price. When the manufacturer brought a patent infringement suit against a retailer who sold for less, we concluded that there was “no room for controversy” about the result: By selling the item, the manufacturer placed it “beyond the confines of the patent law, [and] could not, by qualifying restrictions as to use, keep [it] under the patent monopoly.”

Two decades later, we confronted a similar arrangement in *Univis*. There, a company that made eyeglass lenses authorized an agent to sell its products to wholesalers and retailers only if they promised to market the lenses at fixed prices. The Government filed an antitrust lawsuit, and the company defended its arrangement on the ground that it was exercising authority under the Patent Act. We held that the initial sales “relinquish[ed] ... the patent monopoly with respect to the article[s] sold,” so the “stipulation ... fixing resale prices derive[d] no support from the patent and must stand on the same footing” as restrictions on unpatented goods.

It is true that *Boston Store* and *Univis* involved resale price restrictions that, at the time of those decisions, violated the antitrust laws. But in both cases it was the sale of the items, rather than the illegality of the restrictions, that prevented the patentees from enforcing those resale price agreements through patent infringement suits. And if there were any lingering doubt that patent exhaustion applies even when a sale is subject to an express, otherwise lawful restriction, our recent decision in *Quanta* settled the matter. In that case, a technology company—with authorization from the patentee—sold microprocessors under contracts requiring purchasers to use those processors with other parts that the company manufactured. One buyer disregarded the restriction, and the patentee sued for infringement. Without so much as mentioning the lawfulness of the contract, we held that the patentee could not bring an infringement suit because the “authorized sale ... took its products outside the scope of the patent monopoly.”

Turning to the case at hand, we conclude that this well-settled line of precedent allows for only one answer: Lexmark cannot bring a patent infringement suit against Impression Products to enforce the single-use/no-resale provision accompanying its Return Program cartridges. Once sold, the Return Program cartridges passed outside of the patent monopoly, and whatever rights Lexmark retained are a matter of the contracts with its purchasers, not the patent law.

B

The Federal Circuit reached a different result largely because it got off on the wrong foot. The “exhaustion doctrine,” the court believed, “must be understood as an interpretation of” the infringement statute, which prohibits anyone from using or selling a patented article “without authority” from the patentee. Exhaustion reflects a default rule that a patentee’s decision to sell an item “presumptively grant[s] ‘authority’ to the purchaser to use it and resell it.” But, the Federal Circuit explained, the patentee does not have to hand

over the full “bundle of rights” every time. If the patentee expressly withholds a stick from the bundle—perhaps by restricting the purchaser’s resale rights—the buyer never acquires that withheld authority, and the patentee may continue to enforce its right to exclude that practice under the patent laws.

The misstep in this logic is that the exhaustion doctrine is not a presumption about the authority that comes along with a sale; it is instead a limit on “the scope of the patentee’s rights.” *United States v. General Elec. Co.*, 272 U. S. 476, 489 (1926). The right to use, sell, or import an item exists independently of the Patent Act. What a patent adds—and grants exclusively to the patentee—is a limited right to prevent others from engaging in those practices. Exhaustion extinguishes that exclusionary power. As a result, the sale transfers the right to use, sell, or import because those are the rights that come along with ownership, and the buyer is free and clear of an infringement lawsuit because there is no exclusionary right left to enforce.

The Federal Circuit also expressed concern that preventing patentees from reserving patent rights when they sell goods would create an artificial distinction between such sales and sales by licensees. Patentees, the court explained, often license others to make and sell their products, and may place restrictions on those licenses. A computer developer could, for instance, license a manufacturer to make its patented devices and sell them only for non-commercial use by individuals. If a licensee breaches the license by selling a computer for commercial use, the patentee can sue the licensee for infringement. And, in the Federal Circuit’s view, our decision in *General Talking Pictures Corp. v. Western Elec. Co.*, 304 U. S. 175 (1938), established that—when a patentee grants a license “under clearly stated restrictions on post-sale activities” of those who purchase products from the licensee—the patentee can also sue for infringement those purchasers who knowingly violate the restrictions. If patentees can employ licenses to impose post-sale restrictions on purchasers that are enforceable through infringement suits, the court concluded, it would make little sense to prevent patentees from doing so when they sell directly to consumers.

The Federal Circuit’s concern is misplaced. A patentee can impose restrictions on licensees because a license does not implicate the same concerns about restraints on alienation as a sale. Patent exhaustion reflects the principle that, when an item passes into commerce, it should not be shaded by a legal cloud on title as it moves through the marketplace. But a license is not about passing title to a product, it is about changing the contours of the patentee’s monopoly: The patentee agrees not to exclude a licensee from making or selling the patented invention, expanding the club of authorized producers and sellers. Because the patentee is exchanging rights, not goods, it is free to relinquish only a portion of its bundle of patent protections.

A patentee’s authority to limit licensees does not, as the Federal Circuit thought, mean that patentees can use licenses to impose post-sale restrictions on purchasers that are enforceable through the patent laws. So long as a licensee complies with the license when selling an item, the patentee has, in effect, authorized the sale. That licensee’s sale is treated, for purposes of patent exhaustion, as if the patentee made the sale itself. The result: The sale exhausts the patentee’s rights in that item. A license may require the licensee to impose a restriction on purchasers, like the license limiting the computer manufacturer to selling for non-commercial use by individuals. But if the licensee does so—by, perhaps, having each customer sign a contract promising not to use the computers in business—the sale nonetheless exhausts all patent rights in the item sold. The purchasers might not

comply with the restriction, but the only recourse for the licensee is through contract law, just as if the patentee itself sold the item with a restriction.

General Talking Pictures involved a fundamentally different situation: There, a licensee “knowingly ma[de] ... sales ... outside the scope of its license.” We treated the sale “as if no license whatsoever had been granted” by the patentee, which meant that the patentee could sue both the licensee and the purchaser—who knew about the breach—for infringement. This does not mean that patentees can use licenses to impose post-sale restraints on purchasers. Quite the contrary: The licensee infringed the patentee’s rights because it did not comply with the terms of its license, and the patentee could bring a patent suit against the purchaser only because the purchaser participated in the licensee’s infringement. *General Talking Pictures*, then, stands for the modest principle that, if a patentee has not given authority for a licensee to make a sale, that sale cannot exhaust the patentee’s rights.

“if a patentee has not given authority for a licensee to make a sale, that sale cannot exhaust the patentee’s rights”

In sum, patent exhaustion is uniform and automatic. Once a patentee decides to sell—whether on its own or through a licensee—that sale exhausts its patent rights, regardless of any post-sale restrictions the patentee purports to impose, either directly or through a license.

Notes and Questions

1. *Post-sale restrictions.* Cases like *Mallinckrodt* and *Impression Products* revolve around the desire of a patent holder to impose restrictions on users of patented articles after their first sale. As a general matter, why do patent holders wish to impose such restrictions after they have been compensated for the sale of a patented article? Do you think this approach is more common in certain types of industries?
2. *Infringement versus breach of contract.* In many cases, patent holders who impose post-sale restrictions on purchasers of patented products seek to enforce these restrictions as a matter of patent law (i.e., the user who fails to comply is infringing the patent) rather than as a breach of contract. Why? What role does privity of contract play in this calculation?
3. *Choice of defendant.* In *Mallinckrodt*, the patent holder chose to sue the party who sterilized and reconditioned used UltraVent devices rather than the hospitals who used the devices in violation of the single-use restriction. Why? Would there be any advantages to suing the hospitals themselves?
4. *The smooth flow of commerce.* The Supreme Court in *Impression Products* reasons that the “smooth flow of commerce would sputter if companies that make the thousands of parts that go into a vehicle could keep their patent rights after the first sale.” What does this mean? Is this conclusion true with respect to all types of products and services, or is it specific to reusable items like printer ink cartridges?
5. *The end of post-sale restrictions?* Many commentators have questioned whether *Quanta*, and then *Impression Products*, effectively overrule *Mallinckrodt*, thus eliminating a patent holder’s ability to impose post-sale restrictions on patented products as a matter of patent law (i.e., disregarding the purely contractual restrictions discussed in footnote 7 of *Quanta*). What

do you think? Are there any post-sale restrictions that survive *Quanta*, and then *Impression Products*? Did *Impression Products* close any loopholes potentially left open by *Quanta*?

6. *Copyright versus patent*. How does the Supreme Court's reasoning in patent exhaustion cases like *Quanta* and *Impression Products* contrast with the lower courts' treatment of copyrighted works under cases such as *Bobbs-Merrill* and *Vernor*? Is the difference more about copyright versus patent law, or about the unusual evolution of the software distribution market?

23.6 INTERNATIONAL FIRST SALE, EXHAUSTION AND GRAY MARKETS

In the cases discussed so far, we have largely focused on patents and sales of patented products in the United States. As they usually do, things become more complicated once we introduce the international distribution of products into the mix. Yet, given the global nature of many product markets – from tennis shoes and designer handbags to films and recorded music to smartphones and microchips, a consideration of international issues is unavoidable in any conscientious treatment of exhaustion issues. International issues can arise with respect to all types of IP. In this chapter we will consider cases (one of which you have seen before) that have defined the law in this area.

23.6.1 *International First Sale and Copyrights*

Kirtsaeng v. John Wiley & Sons, Inc.

568 U.S. 519 (2013)

BREYER, JUSTICE

Section 106 of the Copyright Act grants “the owner of copyright under this title” certain “exclusive rights,” including the right “to distribute copies . . . of the copyrighted work to the public by sale or other transfer of ownership.” 17 U. S. C. §106(3). These rights are qualified, however, by the application of various limitations [including] the “first sale” doctrine (§109).

Section 109(a) sets forth the “first sale” doctrine as follows:

Notwithstanding the provisions of section 106(3) [the section that grants the owner exclusive distribution rights], 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. (Emphasis added.)

Thus, even though §106(3) forbids distribution of a copy of, say, the copyrighted novel *Herzog* without the copyright owner's permission, §109(a) adds that, once a copy of *Herzog* has been lawfully sold (or its ownership otherwise lawfully transferred), the buyer of *that copy* and subsequent owners are free to dispose of it as they wish. In copyright jargon, the “first sale” has “exhausted” the copyright owner's §106(3) exclusive distribution right.

What, however, if the copy of *Herzog* was printed abroad and then initially sold with the copyright owner's permission? Does the “first sale” doctrine still apply? Is the buyer, like the buyer of a domestically manufactured copy, free to bring the copy into the United States and dispose of it as he or she wishes?

To put the matter technically, an “importation” provision, §602(a)(1), says that

“[i]mportation into the United States, without the authority of the owner of copyright under this title, of copies ... of a work that have been acquired outside the United States is an infringement of the exclusive right to distribute copies ... *under section 106* ...” 17 U. S. C. §602(a)(1) (emphasis added).

Thus §602(a)(1) makes clear that importing a copy without permission violates the owner’s exclusive distribution right. But in doing so, §602(a)(1) refers explicitly to the §106(3) exclusive distribution right. As we have just said, §106 is by its terms “[s]ubject to” ... §109(a)’s “first sale” limitation. Do those same modifications apply—in particular, does the “first sale” modification apply—when considering whether §602(a)(1) prohibits importing a copy?

In *Quality King Distributors, Inc. v. L’anza Research Int’l, Inc.*, 523 U. S. 135, 145 (1998), we held that §602(a)(1)’s reference to §106(3)’s exclusive distribution right incorporates the later subsections’ limitations, including, in particular, the “first sale” doctrine of §109. Thus, it might seem that, §602(a)(1) notwithstanding, one who buys a copy abroad can freely import that copy into the United States and dispose of it, just as he could had he bought the copy in the United States.

But *Quality King* considered an instance in which the copy, though purchased abroad, was initially manufactured in the United States (and then sent abroad and sold). This case is like *Quality King* but for one important fact. The copies at issue here were manufactured abroad. That fact is important because §109(a) says that the “first sale” doctrine applies to “a particular copy or phonorecord lawfully made under this title.” And we must decide here whether the five words, “lawfully made under this title,” make a critical legal difference.

Putting section numbers to the side, we ask whether the “first sale” doctrine applies to protect a buyer or other lawful owner of a copy (of a copyrighted work) lawfully manufactured abroad. Can that buyer bring that copy into the United States (and sell it or give it away) without obtaining permission to do so from the copyright owner? Can, for example, someone who purchases, say at a used bookstore, a book printed abroad subsequently resell it without the copyright owner’s permission?

In our view, the answers to these questions are, yes. We hold that the “first sale” doctrine applies to copies of a copyrighted work lawfully made abroad.

I. A

Respondent, John Wiley & Sons, Inc., publishes academic textbooks. Wiley obtains from its authors various foreign and domestic copyright assignments, licenses and permissions—to the point that we can, for present purposes, refer to Wiley as the relevant American copyright owner. Wiley often assigns to its wholly owned foreign subsidiary, John Wiley & Sons (Asia) Pte Ltd., rights to publish, print, and sell Wiley’s English language textbooks abroad. Each copy of a Wiley Asia foreign edition will likely contain language making clear that the copy is to be sold only in a particular country or geographical region outside the United States.

For example, a copy of Wiley’s American edition says, “Copyright © 2008 John Wiley & Sons, Inc. All rights reserved ... Printed in the United States of America.” A copy of Wiley Asia’s Asian edition of that book says:

Copyright © 2008 John Wiley & Sons (Asia) Pte Ltd[.] All rights reserved. This book is authorized for sale in Europe, Asia, Africa, and the Middle East only and may be not exported out of these territories. Exportation from or importation of this book to another region without the Publisher's authorization is illegal and is a violation of the Publisher's rights. The Publisher may take legal action to enforce its rights ... Printed in Asia.

Both the foreign and the American copies say:

No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means ... except as permitted under Sections 107 or 108 of the 1976 United States Copyright Act.

The upshot is that there are two essentially equivalent versions of a Wiley textbook, each version manufactured and sold with Wiley's permission: (1) an American version printed and sold in the United States, and (2) a foreign version manufactured and sold abroad. And Wiley makes certain that copies of the second version state that they are not to be taken (without permission) into the United States.

Petitioner, Supap Kirtsaeng, a citizen of Thailand, moved to the United States in 1997 to study mathematics at Cornell University. He paid for his education with the help of a Thai Government scholarship which required him to teach in Thailand for 10 years on his return. Kirtsaeng successfully completed his undergraduate courses at Cornell, successfully completed a Ph.D program in mathematics at the University of Southern California, and then, as promised, returned to Thailand to teach. While he was studying in the United States, Kirtsaeng asked his friends and family in Thailand to buy copies of foreign edition English-language textbooks at Thai book shops, where they sold at low prices, and mail them to him in the United States. Kirtsaeng would then sell them, reimburse his family and friends, and keep the profit.

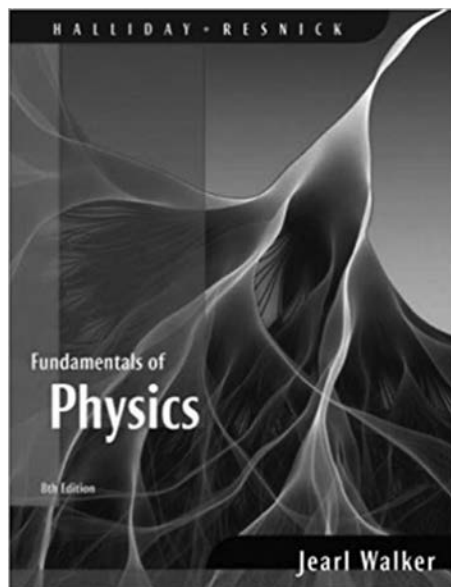


FIGURE 23.8 J. Walker, *Fundamentals of Physics* (Wiley, 8th ed. (US), 2008) – one of the textbooks at issue in *Kirtsaeng v. Wiley*.

B

In 2008 Wiley brought this federal lawsuit against Kirtsaeng for copyright infringement. Wiley claimed that Kirtsaeng's unauthorized importation of its books and his later resale of those books amounted to an infringement of Wiley's §106(3) exclusive right to distribute as well as §602's related import prohibition. Kirtsaeng replied that the books he had acquired were "lawfully made" and that he had acquired them legitimately. Thus, in his view, §109(a)'s "first sale" doctrine permitted him to resell or otherwise dispose of the books without the copyright owner's further permission.

The District Court held that Kirtsaeng could not assert the "first sale" defense because, in its view, that doctrine does not apply to "foreign-manufactured goods" (even if made abroad with the copyright owner's permission). The jury then found that Kirtsaeng had willfully infringed Wiley's American copyrights by selling and importing without authorization copies of eight of Wiley's copyrighted titles. And it assessed statutory damages of \$600,000 (\$75,000 per work).

On appeal, a split panel of the Second Circuit agreed with the District Court. It pointed out that §109(a)'s "first sale" doctrine applies only to "the owner of a particular copy ... *lawfully made under this title.*" (emphasis added). And, in the majority's view, this language means that the "first sale" doctrine does not apply to copies of American copyrighted works manufactured abroad.

We granted Kirtsaeng's petition for certiorari to consider this question in light of different views among the Circuits.

II

We must decide whether the words "lawfully made under this title" restrict the scope of §109(a)'s "first sale" doctrine geographically. The Second Circuit, the Ninth Circuit, Wiley, and the Solicitor General (as amicus) all read those words as imposing a form of geographical limitation. The Second Circuit held that they limit the "first sale" doctrine to particular copies "made in territories in which the Copyright Act is law," which (the Circuit says) are copies "manufactured domestically," not "outside of the United States." Wiley agrees that those five words limit the "first sale" doctrine "to copies made in conformance with the [United States] Copyright Act where the Copyright Act is applicable," which (Wiley says) means it does not apply to copies made "outside the United States" and at least not to "foreign production of a copy for distribution exclusively abroad." Similarly, the Solicitor General says that those five words limit the "first sale" doctrine's applicability to copies "'made subject to and in compliance with [the Copyright Act],'" which (the Solicitor General says) are copies "made in the United States." And the Ninth Circuit has held that those words limit the "first sale" doctrine's applicability (1) to copies lawfully made in the United States, and (2) to copies lawfully made outside the United States but initially sold in the United States with the copyright owner's permission.

Under any of these geographical interpretations, §109(a)'s "first sale" doctrine would not apply to the Wiley Asia books at issue here. And, despite an American copyright owner's permission to make copies abroad, one who buys a copy of any such book or other copyrighted work—whether at a retail store, over the Internet, or at a library sale—could not resell (or otherwise dispose of) that particular copy without further permission.

Kirtsaeng, however, reads the words "lawfully made under this title" as imposing a non-geographical limitation. He says that they mean made "in accordance with" or "in compliance with" the Copyright Act. In that case, §109(a)'s "first sale" doctrine would

apply to copyrighted works as long as their manufacture met the requirements of American copyright law. In particular, the doctrine would apply where, as here, copies are manufactured abroad with the permission of the copyright owner.

In our view, §109(a)'s language, its context, and the common-law history of the "first sale" doctrine, taken together, favor a non-geographical interpretation. We also doubt that Congress would have intended to create the practical copyright-related harms with which a geographical interpretation would threaten ordinary scholarly, artistic, commercial, and consumer activities. See [Part II–D](#), *infra*. We consequently conclude that Kirtsaeng's nongeographical reading is the better reading of the Act.

B

[W]e normally presume that the words "lawfully made under this title" carry the same meaning when they appear in different but related sections. But doing so here produces surprising consequences. Consider:

- (1) Section 109(c) says that, despite the copyright owner's exclusive right "to display" a copyrighted work (provided in §106(5)), the owner of a particular copy "lawfully made under this title" may publicly display it without further authorization. To interpret these words geographically would mean that one who buys a copyrighted work of art, a poster, or even a bumper sticker, in Canada, in Europe, in Asia, could not display it in America without the copyright owner's further authorization.
- (2) Section 109(e) specifically provides that the owner of a particular copy of a copyrighted video arcade game "lawfully made under this title" may "publicly perform or display that game in coin-operated equipment" without the authorization of the copyright owner. To interpret these words geographically means that an arcade owner could not ("without the authority of the copyright owner") perform or display arcade games (whether new or used) originally made in Japan.
- (3) Section 110(1) says that a teacher, without the copyright owner's authorization, is allowed to perform or display a copyrighted work (say, an audiovisual work) "in the course of face-to-face teaching activities"—unless the teacher knowingly used "a copy that was not lawfully made under this title." To interpret these words geographically would mean that the teacher could not (without further authorization) use a copy of a film during class if the copy was lawfully made in Canada, Mexico, Europe, Africa, or Asia.

C

A relevant canon of statutory interpretation favors a nongeographical reading. "[W]hen a statute covers an issue previously governed by the common law," we must presume that "Congress intended to retain the substance of the common law."

The "first sale" doctrine is a common-law doctrine with an impeccable historic pedigree. In the early 17th century Lord Coke explained the common law's refusal to permit restraints on the alienation of chattels: A law that permits a copyright holder to control the resale or other disposition of a chattel once sold is ... "against Trade and Traffi[c], and bargaining and contracting."

With these last few words, Coke emphasizes the importance of leaving buyers of goods free to compete with each other when reselling or otherwise disposing of those goods. American law too has generally thought that competition, including freedom to resell, can work to the advantage of the consumer.

The “first sale” doctrine also frees courts from the administrative burden of trying to enforce restrictions upon difficult-to-trace, readily movable goods. And it avoids the selective enforcement inherent in any such effort. Thus, it is not surprising that for at least a century the “first sale” doctrine has played an important role in American copyright law. See *Bobbs-Merrill Co. v. Straus*, 210 U. S. 339 (1908).

The common-law doctrine makes no geographical distinctions; nor can we find any in *Bobbs-Merrill* (where this Court first applied the “first sale” doctrine) or in §109(a)’s predecessor provision, which Congress enacted a year later. Rather, as the Solicitor General acknowledges, a straightforward application of *Bobbs-Merrill* would not preclude the “first sale” defense from applying to authorized copies made overseas. And we can find no language, context, purpose, or history that would rebut a “straightforward application” of that doctrine here.

D

Associations of libraries, used-book dealers, technology companies, consumer-goods retailers, and museums point to various ways in which a geographical interpretation would fail to further basic constitutional copyright objectives, in particular “promot[ing] the Progress of Science and useful Arts.” U. S. Const., Art. I, §8, cl. 8.

The American Library Association tells us that library collections contain at least 200 million books published abroad; that many others were first published in the United States but printed abroad because of lower costs; and that a geographical interpretation will likely require the libraries to obtain permission (or at least create significant uncertainty) before circulating or otherwise distributing these books.

How, the American Library Association asks, are the libraries to obtain permission to distribute these millions of books? How can they find, say, the copyright owner of a foreign book, perhaps written decades ago? They may not know the copyright holder’s present address. And, even where addresses can be found, the costs of finding them, contacting owners, and negotiating may be high indeed. Are the libraries to stop circulating or distributing or displaying the millions of books in their collections that were printed abroad?

Used-book dealers tell us that, from the time when Benjamin Franklin and Thomas Jefferson built commercial and personal libraries of foreign books, American readers have bought used books published and printed abroad. The dealers say that they have “operat[ed] ... for centuries” under the assumption that the “first sale” doctrine applies. But under a geographical interpretation a contemporary tourist who buys, say, at Shakespeare and Co. (in Paris), a dozen copies of a foreign book for American friends might find that she had violated the copyright law. The used-book dealers cannot easily predict what the foreign copyright holder may think about a reader’s effort to sell a used copy of a novel. And they believe that a geographical interpretation will injure a large portion of the used-book business.

Technology companies tell us that “automobiles, microwaves, calculators, mobile phones, tablets, and personal computers” contain copyrightable software programs or packaging. Many of these items are made abroad with the American copyright holder’s permission and then sold and imported (with that permission) to the United States. A geographical interpretation would prevent the resale of, say, a car, without the permission

of the holder of each copyright on each piece of copyrighted automobile software. Yet there is no reason to believe that foreign auto manufacturers regularly obtain this kind of permission from their software component suppliers, and Wiley did not indicate to the contrary when asked. Without that permission a foreign car owner could not sell his or her used car.

Retailers tell us that over \$2.3 trillion worth of foreign goods were imported in 2011. American retailers buy many of these goods after a first sale abroad. And, many of these items bear, carry, or contain copyrighted “packaging, logos, labels, and product inserts and instructions for [the use of] everyday packaged goods from floor cleaners and health and beauty products to breakfast cereals.” The retailers add that American sales of more traditional copyrighted works, “such as books, recorded music, motion pictures, and magazines” likely amount to over \$220 billion. A geographical interpretation would subject many, if not all, of them to the disruptive impact of the threat of infringement suits.

Art museum directors ask us to consider their efforts to display foreign-produced works by, say, Cy Twombly, René Magritte, Henri Matisse, Pablo Picasso, and others. A geographical interpretation, they say, would require the museums to obtain permission from the copyright owners before they could display the work—even if the copyright owner has already sold or donated the work to a foreign museum. What are the museums to do, they ask, if the artist retained the copyright, if the artist cannot be found, or if a group of heirs is arguing about who owns which copyright?

Neither Wiley nor any of its many amici deny that a geographical interpretation could bring about these “horribles”—at least in principle. Rather, Wiley essentially says that the list is artificially invented. It points out that a federal court first adopted a geographical interpretation more than 30 years ago. Yet, it adds, these problems have not occurred. Why not? Because, says Wiley, the problems and threats are purely theoretical; they are unlikely to reflect reality.

[T]he fact that harm has proved limited so far may simply reflect the reluctance of copyright holders so far to assert geographically based resale rights. They may decide differently if the law is clarified in their favor. Regardless, a copyright law that can work in practice only if unenforced is not a sound copyright law. It is a law that would create uncertainty, would bring about selective enforcement, and, if widely unenforced, would breed disrespect for copyright law itself.

Thus, we believe that the practical problems that petitioner and his amici have described are too serious, too extensive, and too likely to come about for us to dismiss them as insignificant—particularly in light of the ever-growing importance of foreign trade to America. The upshot is that copyright-related consequences along with language, context, and interpretive canons argue strongly against a geographical interpretation of §109(a).

IV

For these reasons we conclude that the considerations supporting Kirtsaeng’s nongeographical interpretation of the words “lawfully made under this title” are the more persuasive. The judgment of the Court of Appeals is reversed, and the case is remanded for further proceedings consistent with this opinion.

Notes and Questions

1. *Statutory interpretation.* Justice Breyer's analysis in *Kirtsaeng* focuses in excruciating detail on the language of Section 109(a) of the Copyright Act – the statutory codification of the first sale doctrine. Yet Chief Justice Roberts hardly considers statutory language at all in *Impression Products*. Why is there such a difference in approach as between copyright and patent law with respect to international exhaustion?

23.6.2 International Patent Exhaustion

Impression Products, Inc. v. Lexmark International, Inc.

137 S. Ct. 1523 (2017)

ROBERTS, CHIEF JUSTICE

[The case background and a discussion of exhaustion, generally, are contained in [Section 23.5](#).]

Our conclusion that Lexmark exhausted its patent rights when it sold the domestic Return Program cartridges goes only halfway to resolving this case. Lexmark also sold toner cartridges abroad and sued Impression Products for patent infringement for “importing [Lexmark’s] invention into the United States.” 35 U. S. C. §154(a). Lexmark contends that it may sue for infringement with respect to all of the imported cartridges—not just those in the Return Program—because a foreign sale does not trigger patent exhaustion unless the patentee “expressly or implicitly transfer[s] or license[s]” its rights. The Federal Circuit agreed, but we do not. An authorized sale outside the United States, just as one within the United States, exhausts all rights under the Patent Act. This question about international exhaustion of intellectual property rights has also arisen in the context of copyright law. Under the “first sale doctrine,” which is codified at 17 U. S. C. §109(a), when a copyright owner sells a lawfully made copy of its work, it loses the power to restrict the purchaser’s freedom “to sell or otherwise dispose of . . . that copy.” In *Kirtsaeng v. John Wiley & Sons, Inc.*, we held that this “‘first sale’ [rule] applies to copies of a copyrighted work lawfully made [and sold] abroad.” We began with the text of §109(a), but it was not decisive: The language neither “restrict[s] the scope of [the] ‘first sale’ doctrine geographically,” nor clearly embraces international exhaustion. What helped tip the scales for global exhaustion was the fact that the first sale doctrine originated in the common law’s refusal to permit restraints on the alienation of chattels. That common-law doctrine makes no geographical distinctions. The lack of any textual basis for distinguishing between domestic and international sales meant that “a straightforward application” of the first sale doctrine required the conclusion that it applies overseas.

Applying patent exhaustion to foreign sales is just as straightforward. Patent exhaustion, too, has its roots in the antipathy toward restraints on alienation, and nothing in the text or history of the Patent Act shows that Congress intended to confine that borderless common law principle to domestic sales. In fact, Congress has not altered patent exhaustion at all; it remains an unwritten limit on the scope of the patentee’s monopoly. And differentiating the patent exhaustion and copyright first sale doctrines would make little theoretical or practical sense: The two share a “strong similarity . . . and identity of purpose,” and many

everyday products—“automobiles, microwaves, calculators, mobile phones, tablets, and personal computers”—are subject to both patent and copyright protections, see *Kirtsaeng*, 568 U.S., at 545. There is a “historic kinship between patent law and copyright law,” and the bond between the two leaves no room for a rift on the question of international exhaustion.

Lexmark sees the matter differently. The Patent Act, it points out, limits the patentee’s “right to exclude others” from making, using, selling, or importing its products to acts that occur in the United States. 35 U. S. C. §154(a). A domestic sale, it argues, triggers exhaustion because the sale compensates the patentee for “surrendering [those] U. S. rights.” A foreign sale is different: The Patent Act does not give patentees exclusionary powers abroad. Without those powers, a patentee selling in a foreign market may not be able to sell its product for the same price that it could in the United States, and therefore is not sure to receive “the reward guaranteed by U. S. patent law.” Absent that reward, says Lexmark, there should be no exhaustion. In short, there is no patent exhaustion from sales abroad because there are no patent rights abroad to exhaust.

The territorial limit on patent rights is, however, no basis for distinguishing copyright protections; those protections “do not have any extraterritorial operation” either. Nor does the territorial limit support the premise of Lexmark’s argument. Exhaustion is a separate limit on the patent grant, and does not depend on the patentee receiving some undefined premium for selling the right to access the American market. A purchaser buys an item, not patent rights. And exhaustion is triggered by the patentee’s decision to give that item up and receive whatever fee it decides is appropriate “for the article and the invention which it embodies.” *Univis*, 316 U. S., at 251. The patentee may not be able to command the same amount for its products abroad as it does in the United States. But the Patent Act does not guarantee a particular price, much less the price from selling to American consumers. Instead, the right to exclude just ensures that the patentee receives one reward—of whatever amount the patentee deems to be “satisfactory compensation,” *Keeler*, 157 U. S., at 661—for every item that passes outside the scope of the patent monopoly.

This Court has addressed international patent exhaustion in only one case, *Boesch v. Gräff*, decided over 125 years ago. All that case illustrates is that a sale abroad does not exhaust a patentee’s rights when the patentee had nothing to do with the transaction. *Boesch*—from the days before the widespread adoption of electrical lighting—involved a retailer who purchased lamp burners from a manufacturer in Germany, with plans to sell them in the United States. The manufacturer had authority to make the burners under German law, but there was a hitch: Two individuals with no ties to the German manufacturer held the American patent to that invention. These patentees sued the retailer for infringement when the retailer imported the lamp burners into the United States, and we rejected the argument that the German manufacturer’s sale had exhausted the American patentees’ rights. The German manufacturer had no permission to sell in the United States from the American patentees, and the American patentees had not exhausted their patent rights in the products because they had not sold them to anyone, so “purchasers from [the German manufacturer] could not be thereby authorized to sell the articles in the United States.” 133 U. S. 697, 703 (1890).

Our decision did not, as Lexmark contends, exempt all foreign sales from patent exhaustion. Rather, it reaffirmed the basic premise that only the patentee can decide whether to make a sale that exhausts its patent rights in an item. The American patentees did not do so with respect to the German products, so the German sales did not exhaust their rights.

Finally, the United States, as an amicus, advocates what it views as a middle-ground position: that “a foreign sale authorized by the U. S. patentee exhausts U. S. patent rights unless those rights are expressly reserved.” Its position is largely based on policy rather than principle. The Government thinks that an overseas “buyer’s legitimate expectation” is that a “sale conveys all of the seller’s interest in the patented article,” so the presumption should be that a foreign sale triggers exhaustion. But, at the same time, lower courts long ago coalesced around the rule that “a patentee’s express reservation of U.S. patent rights at the time of a foreign sale will be given effect,” so that option should remain open to the patentee.

The theory behind the Government’s express-reservation rule also wrongly focuses on the likely expectations of the patentee and purchaser during a sale. Exhaustion does not arise because of the parties’ expectations about how sales transfer patent rights. More is at stake when it comes to patents than simply the dealings between the parties, which can be addressed through contract law. Instead, exhaustion occurs because, in a sale, the patentee elects to give up title to an item in exchange for payment. Allowing patent rights to stick remora-like to that item as it flows through the market would violate the principle against restraints on alienation. Exhaustion does not depend on whether the patentee receives a premium for selling in the United States, or the type of rights that buyers expect to receive. As a result, restrictions and location are irrelevant; what matters is the patentee’s decision to make a sale.

The judgment of the United States Court of Appeals for the Federal Circuit is reversed, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

JUSTICE GINSBURG, concurring in part and dissenting in part.

I concur in the Court’s holding regarding domestic exhaustion—a patentee who sells a product with an express restriction on reuse or resale may not enforce that restriction through an infringement lawsuit, because the U.S. sale exhausts the U.S. patent rights in the product sold. I dissent, however, from the Court’s holding on international exhaustion. A foreign sale, I would hold, does not exhaust a U.S. inventor’s U.S. patent rights. Patent law is territorial. When an inventor receives a U.S. patent, that patent provides no protection abroad. A U.S. patentee must apply to each country in which she seeks the exclusive right to sell her invention.

Because a sale abroad operates independently of the U.S. patent system, it makes little sense to say that such a sale exhausts an inventor’s U.S. patent rights. U.S. patent protection accompanies none of a U.S. patentee’s sales abroad—a competitor could sell the same patented product abroad with no U.S.-patent-law consequence. Accordingly, the foreign sale should not diminish the protections of U.S. law in the United States.

The majority disagrees, in part because this Court decided, in *Kirtsaeng v. John Wiley & Sons, Inc.*, 568 U. S. 519, 525 (2013), that a foreign sale exhausts U. S. copyright protections. Copyright and patent exhaustion, the majority states, “share a strong similarity.” I dissented from our decision in *Kirtsaeng* and adhere to the view that a foreign sale should not exhaust U.S. copyright protections.

But even if I subscribed to *Kirtsaeng*’s reasoning with respect to copyright, that decision should bear little weight in the patent context. Although there may be a “historical kinship” between patent law and copyright law, the two “are not identical twins”. The Patent Act contains no analogue to 17 U.S.C. §109(a), the Copyright Act first-sale provision analyzed in *Kirtsaeng*. More importantly, copyright protections, unlike patent protections,

are harmonized across countries. Under the Berne Convention, which 174 countries have joined, members “agree to treat authors from other member countries as well as they treat their own.” The copyright protections one receives abroad are thus likely to be similar to those received at home, even if provided under each country’s separate copyright regime.

For these reasons, I would affirm the Federal Circuit’s judgment with respect to foreign exhaustion.



FIGURE 23.9 Justice Ruth Bader Ginsburg dissented in both *Kirtsaeng* and *Impression Products*.

Notes and Questions

1. *Copyright versus patent*. Despite the difference in approach discussed in Note 1, Chief Justice Roberts relies in his reasoning in *Impression Products* on the “historical kinship” between patent law and copyright law. Justice Ginsburg, dissenting, argues that the two “are not identical twins.” What is the crux of this disagreement between the justices? Which view of the relationship between patent and copyright law do you consider to be stronger?

23.6.3 International Trademark Exhaustion and the Gray Market

As discussed in Section 23.3, “genuine” trademarked goods may be resold without the authorization of the trademark owner. This is also the case internationally. An overseas purchaser of an authorized marked product may import it into the United States so long as the foreign product is “genuine,” or manufactured under authority of the mark owner. Take the example of Nike athletic shoes. Nike may authorize a manufacturer in Thailand to manufacture a particular type of branded shoe. Under its contract with Nike, the Thai manufacturer may then sell those shoes for \$20 per pair to Nike’s authorized wholesalers, who distribute them to retailers in the United States who sell them to consumers for \$150 per pair. But suppose that the Thai manufacturer makes a few extra shoes and sells them at \$30 per pair to discount Nike retailers in the United States, who then sell them to consumers for \$50 per pair? It is possible that the Thai manufacturer is violating its contract with Nike, but can Nike prevent the sale of the shoes by the discount retailers in the United States under trademark law if they are the exact same shoes that authorized resellers are selling for \$150? This scenario illustrates what is called the “gray market” for trademarked goods.



FIGURE 23.10 Flow of goods in the “gray market.”

You will note the similarities in this scenario to those described in *Kirtsaeng* and *Impression Products*. Yet trademark law was the first place in which international exhaustion was recognized – long before the Supreme Court intervened in the copyright and patent areas.

The key question in international trademark exhaustion cases¹¹ is whether the imported goods are, in fact, “genuine,” as trademark law does not extend to the sale of genuine goods. But as the Third Circuit explained in *Iberia Foods Corp. v. Romeo*, 150 F.3d 298, 303 (3d Cir. 1998), where imported goods are marketed under identical marks but are materially different, the alleged infringer’s goods are considered “non-genuine” and the sale of the goods constitutes infringement. This leads, naturally, to the question of what constitutes a “material difference” for purposes of international trademark exhaustion. The question has attracted significant attention and is addressed in detail in the following case.

Societe Des Produits Nestle, S.A. v. Casa Helvetia, Inc.

982 F.2d 633 (1st Cir. 1992)

SELYA, CIRCUIT JUDGE

This bittersweet appeal requires us to address the protection that trademark law affords a registrant against the importation and sale of so-called “gray goods,” that is, trademarked goods manufactured abroad under a valid license but brought into this country in derogation of arrangements lawfully made by the trademark holder to ensure territorial exclusivity. As we explain below, the scope of protection turns on the degree of difference between the product authorized for the domestic market and the allegedly infringing product. In the case before us, the difference is sufficiently marked that the domestic product warrants protection.

I. Background

PERUGINA chocolates originated in Italy and continue to be manufactured there. They are sold throughout the world and cater to a sophisticated consumer, a refined palate, and an indulgent budget. Societe Des Produits Nestle, S.A. (Nestle S.P.N.) owns the PERUGINA trademark.

¹¹ This section focuses on the treatment of international trademark exhaustion under US law. Of course, every country can approach the issue slightly differently. For a summary and comparison of approaches in other jurisdictions see Irene Calboli, *The Relationship between Trademark Exhaustion and Free Movement of Goods: A Review of Selected Jurisdictions and Regional Organizations* in *The Cambridge Handbook of International and Comparative Trademark Law* 589 (Irene Calboli & Jane C. Ginsburg, eds., Cambridge, Univ. Press, 2020).



FIGURE 23.11 Nestlé sought to prevent its former distributor from importing Venezuelan Perugina-branded chocolates into Puerto Rico.

For many years, defendant-appellee Casa Helvetia, Inc. was the authorized distributor of PERUGINA chocolates in Puerto Rico. On November 28, 1988, however, Nestle S.P.N. forsook Casa Helvetia and licensed its affiliate, Nestle Puerto Rico, Inc. (Nestle P.R.), as the exclusive Puerto Rican distributor.

At this point, the plot thickened. Nestle S.P.N. had previously licensed an independent company, Distribuidora Nacional de Alimentos La Universal S.A. (Alimentos), to manufacture and sell chocolates bearing the PERUGINA mark in Venezuela. The Venezuelan sweets differ from the Italian sweets in presentation, variety, composition, and price. In March 1990, without obtaining Nestle S.P.N.'s consent, Casa Helvetia began to purchase the Venezuelan-made chocolates through a middleman, import them into Puerto Rico, and distribute them under the PERUGINA mark.

This maneuver drew a swift response. Charging that Casa Helvetia's marketing of the Venezuelan candies infringed both Nestle S.P.N.'s registered trademark and Nestle P.R.'s right of exclusive distributorship, Nestle S.P.N. and Nestle P.R. (hereinafter collectively "Nestle") sued under the Lanham Act. They claimed that Casa Helvetia's use of the PERUGINA label was "likely to confuse consumers into the mistaken belief that the Venezuelan chocolates are the same as the Italian chocolates and are authorized by Nestle for sale in Puerto Rico." And, they asserted that, because the PERUGINA name in Puerto Rico is associated with Italian-made chocolates, the importation of materially different Venezuelan chocolates threatened to erode "the integrity of the PERUGINA trademarks as symbols of consistent quality and goodwill in Puerto Rico."

The district court consolidated the hearing on preliminary injunction with the hearing on the merits, and, after taking testimony, ruled in the defendants' favor. It held that the differences between the Italian-made and Venezuelan-made candies did not warrant injunctive relief in the absence of demonstrated consumer dissatisfaction, harm to plaintiffs' good will, or drop-off in product quality. This appeal followed.

II. The Lanham Act Claims

Two amaranthine principles fuel the Lanham Act. One aims at protecting consumers. The other focuses on protecting registrants and their assignees. These interlocking principles, in turn, are linked to a concept of territorial exclusivity.

1. *Animating Principles*. Every product is composed of a bundle of special characteristics. The consumer who purchases what he believes is the same product expects to receive those special characteristics on every occasion. Congress enacted the Lanham Act to realize this expectation with regard to goods bearing a particular trademark. The Act's prophylaxis operates not only in the more obvious cases, involving the sale of inferior goods in derogation of the registrant's mark, but also in the less obvious cases, involving the sale of goods different from, although not necessarily inferior to, the goods that the customer expected to receive. By guaranteeing consistency, a trademark wards off both consumer confusion and possible deceit.

The system also serves another, equally important, purpose by protecting the trademark owner's goodwill. Once again, this protection comprises more than merely stopping the sale of inferior goods. Even if an infringer creates a product that rivals or exceeds the quality of the registrant's product, the wrongful sale of the unauthorized product may still deprive the registrant of his ability to shape the contours of his reputation.

2. *Territoriality*. In general, trademark rights are congruent with the boundaries of the sovereign that registers (or recognizes) the mark. Such territoriality reinforces the basic goals of trademark law. Because products are often tailored to specific national conditions, see *Lever Bros. Co. v. United States*, 877 F.2d 101, 108 (D.C. Cir. 1989), a trademark's reputation (and, hence, its goodwill) often differs from nation to nation. Because that is so, the importation of goods properly trademarked abroad but not intended for sale locally may confuse consumers and may well threaten the local mark owner's goodwill. It is not surprising, then, that the United States Supreme Court long ago recognized the territoriality of trademark rights.

Of course, territoriality only goes so far. By and large, courts do not read [prior cases] to disallow the lawful importation of identical foreign goods carrying a valid foreign trademark. See, e.g., *NEC Elecs., Inc. v. Cal Circuit Abco*, 810 F.2d 1506 (9th Cir.), *cert. denied*, 484 U.S. 851 (1987). Be that as it may, territorial protection kicks in under the Lanham Act where two merchants sell physically different products in the same market and under the same name, for it is this prototype that impinges on a trademark holder's goodwill and threatens to deceive consumers. Indeed, without such territorial trademark protection, competitors purveying country-specific products could exploit consumer confusion and free ride on the goodwill of domestic trademarks with impunity. Such a scenario would frustrate the underlying goals of the Lanham Act, the "plain language and general sweep" of which "undeniably bespeak an intention to protect domestic trademark holders." *Lever Bros.*, 877 F.2d at 105. Thus, where material differences exist between similarly marked goods, the Lanham Act honors the important linkage between trademark law and geography.

In this case ... liability necessarily turns on the existence *vel non* of material differences between the products of a sort likely to create consumer confusion. Because the presence or absence of a material difference – a difference likely to cause consumer confusion – is the pivotal determinant of Lanham Act infringement in a gray goods case, the lower court's insistence on several other evidentiary showings was inappropriate.

III. The Materiality Threshold

When a trial court misperceives and misapplies the law, remand may or may not be essential. Here, a final judgment under the correct rule of law requires only the determination of whether reported differences between the Venezuelan and Italian products are material.

It follows, then, that we must examine the legal standard for materiality before deciding whether to remand.

Under the Lanham Act, only those appropriations of a mark that are likely to cause confusion are prohibited. Ergo, when a product identical to a domestic product is imported into the United States under the same mark, no violation of the Lanham Act occurs. In such a situation, consumers get exactly the bundle of characteristics that they associate with the mark and the domestic distributor can be said to enjoy in large measure his investment in goodwill. By the same token, using the same mark on two blatantly different products normally does not offend the Lanham Act, for such use is unlikely to cause confusion and is, therefore, unlikely to imperil the goodwill of either product.

The probability of confusion is great, however, when the same mark is displayed on goods that are not identical but that nonetheless bear strong similarities in appearance or function. Gray goods often fall within this category. Thus, when dealing with the importation of gray goods, a reviewing court must necessarily be concerned with subtle differences, for it is by subtle differences that consumers are most easily confused. For that reason, the threshold of materiality must be kept low enough to take account of potentially confusing differences – differences that are not blatant enough to make it obvious to the average consumer that the origin of the product differs from his or her expectations.

There is no mechanical way to determine the point at which a difference becomes “material.” Separating wheat from chaff must be done on a case-by-case basis. Bearing in mind the policies and provisions of the Lanham Act as they apply to gray goods, we can confidently say that the threshold of materiality is always quite low in such cases. See *Lever Bros.*, 877 F.2d at 103, 108 (finding minor differences in ingredients and packaging between versions of deodorant soap to be material); *Ferrero*, 753 F. Supp. at 1241–49, 1247 (finding a one-half calorie difference in chemical composition of breath mints, coupled with slight differences in packaging and labeling, to be material); *PepsiCo Inc. v. Nostalgia*, 18 U.S.P.Q.2d (BNA) at 1405 (finding “differences in labeling, packaging and marketing methods” to be material); *PepsiCo v. Giraud*, 7 U.S.P.Q.2d (BNA) at 1373 (finding differences not readily apparent to the consumer – container volume, packaging, quality control, and advertising participation – to be material); *Dial Corp.*, 643 F. Supp. at 952 (finding differences in formulation and packaging of soap products to be material).

We conclude that the existence of any difference between the registrant’s product and the allegedly infringing gray good that consumers would likely consider to be relevant when purchasing a product creates a presumption of consumer confusion sufficient to support a Lanham Act claim. Any higher threshold would endanger a manufacturer’s investment in product goodwill and unduly subject consumers to potential confusion by severing the tie between a manufacturer’s protected mark and its associated bundle of traits.

The alleged infringer, of course, may attempt to rebut this presumption, but in order to do so he must be able to prove by preponderant evidence that the differences are not of the kind that consumers, on average, would likely consider in purchasing the product.

“the existence of any difference between the registrant’s product and the allegedly infringing gray good that consumers would likely consider to be relevant when purchasing a product creates a presumption of consumer confusion sufficient to support a Lanham Act claim.”

The alleged infringer, of course, may attempt to rebut this presumption, but in order to do so he must be able to prove by preponderant evidence that the differences are not of the kind that consumers, on average, would likely consider in purchasing the product.

IV. Materiality in This Case

Having fashioned the standard of materiality and examined the record in light of that standard, we are drawn to the conclusion that remand is not required. The district court determined that the products are different but that the differences are not material. Although this determination is tainted by a misunderstanding of the applicable legal principles, the court's subsidiary findings are, nonetheless, reasonably explicit and subject to reuse. Hence, we proceed to take the lower court's supportable findings of fact, couple them with other, uncontradicted facts, and, using the rule of law articulated above, determine for ourselves whether the admitted differences between the Venezuelan-made chocolates and the Italian-made chocolates are sufficiently material to warrant injunctive relief.

A Catalog of Differences.

The district court identified numerous differences between the competing products. Because the record supports these findings and the parties do not contest their validity, we accept them. We add, however, other potentially significant distinctions made manifest by the record.

1. **Quality Control.** Although Nestle and Casa Helvetia each oversees the quality of the product it sells, the record reflects, and Casa Helvetia concedes, that their procedures differ radically. The Italian PERUGINA leaves Italy in refrigerated containers which arrive at Nestle's facility in Puerto Rico. Nestle verifies the temperature of the coolers, opens them, and immediately transports the chocolates to refrigerated rooms. The company records the product's date of manufacture, conducts laboratory tests, and destroys those candies that have expired. It then transports the salable chocolates to retailers in refrigerated trucks. Loading and unloading is performed only in the cool morning hours.

On the other hand, the Venezuelan product arrives in Puerto Rico via commercial air freight. During the afternoon hours, airline personnel remove the chocolates from the containers in which they were imported and place them in a central air cargo cooler. The next morning, employees of Casa Helvetia open random boxes at the airport to see if the chocolates have melted. The company then transports the candy in a refrigerated van to a warehouse. Casa Helvetia performs periodic inspections before delivering the goods to its customers in a refrigerated van. The record contains no evidence that Casa Helvetia knows or records the date the chocolates were manufactured.

2. **Composition.** The district court enumerated a number of differences in ingredients. The Italian BACI candies have five percent more milk fat than their Venezuelan counterparts, thus prolonging shelf life. Furthermore, the Italian BACI chocolates contain Ecuadorian and African cocoa beans, fresh hazelnuts, and cooked sugar syrup, whereas the corresponding Venezuelan candies are made with domestic beans, imported hazelnuts, and ordinary crystal sugar.
3. **Configuration.** The district court specifically noted that the Italian chocolates in the Maitre Confiseur and Assortment collections come in a greater variety of shapes than the Venezuelan pieces.
4. **Packaging.** The district court observed differences in the "boxes, wrappers and trays" between the Italian and Venezuelan versions of the various chocolate assortments. For example, the packages from Italy possess a glossy finish and are either silver, brown, or gold in color. The Venezuelan boxes lack the shiny finish. They are either blue, red,

or yellow in color. While the Italian sweets sit in gold or silver trays, their Venezuelan counterparts rest on white or transparent trays. The Italian boxes depict the chocolates inside and describe the product in English, French, and Italian. The Venezuelan packages describe the contents only in Spanish and English. Moreover, only the BACI box illustrates what is inside.

5. Price. The district court pointed out that while the Venezuelan and Italian BACI collections contain the same quantity of chocolate (8 oz.), the Italian BACI sells for \$12.99 and the Venezuelan BACI costs \$7.50. The record also reflects that the Italian version of the Assortment collection (14.25 oz. for \$26.99) weighs less and is more expensive than the Venezuelan version (15.6 oz. for \$22.99).

Applying the Standard

Applying the legal standard discussed in [Part III](#), *supra*, to the record at bar, it is readily apparent that material differences exist between the Italian and Venezuelan PERUGINA. These differences – which implicate quality, composition, packaging, and price – if not overwhelming, are certainly relevant. We run the gamut.

Differences in quality control methods, although not always obvious to the naked eye, are nonetheless important to the consumer. The precautions a company takes to preserve a food product's freshness are a prime example. Here, the parties' quality control procedures differ significantly. Even if Casa Helvetia's quality control measures are as effective as Nestle's – a dubious proposition on this record – the fact that Nestle is unable to oversee the quality of the goods for the entire period until they reach the consumer is significant in ascertaining whether a Lanham Act violation exists. Regardless of the offending goods' actual quality, courts have issued Lanham Act injunctions solely because of the trademark owner's inability to control the quality of the goods bearing its name. Thus, the substantial variance in quality control here creates a presumption of customer confusion as a matter of law.

The differences in presentation of the candies are also material. Although the district court dismissed the differences in packaging as “subtle,” subtle differences are, as we have said, precisely the type that heighten the presumption of customer confusion. Consumers are more likely to be confused as to the origin of different goods bearing the same name when both goods are substantially identical in appearance. Furthermore, the differences in presentation and chocolate shape strike us as more than subtle. Glossy veneers, gold and silver wraps, and delicate sculpting add to the consumer's perception of quality. In the market for premium chocolates, often purchased as gifts, an elegant-looking package is an important consideration. The cosmetic differences between the Italian-made and the Venezuelan-made PERUGINA, therefore, might well perplex consumers and harm Nestle's goodwill.

We are also hesitant to dismiss as trivial the differences in ingredients. While the district court may be correct in suggesting that “the ultimate consumer is [not] concerned about the country of origin of cocoa beans and hazelnuts,” the measure of milk fat in the chocolates is potentially significant. Certainly, consumers care about the expected shelf life of food products.

Price, without doubt, is also a variable with which purchasers are concerned. To the consumer (perhaps a gift buyer) who relishes a higher price for its connotation of quality and status, as well as to the chocolate aficionado who values his wallet more than his image, a difference of nearly five and a half dollars (or, put another way, 73 percent) on a

half-pound box of chocolate is a relevant datum. Furthermore, the fact that consumers are willing to pay over five dollars more for the Italian-made chocolate than for its Venezuelan counterpart may suggest that consumers do care about the other differences between the two products. Afforded perfect information, consumers indifferent between the two would presumably not be willing to pay more for one than for the other.

We need go no further. Given the low threshold of materiality that applies in gray goods cases, we find the above dissimilarities material in the aggregate. The use of the same PERUGINA label on chocolates manifesting such differences is presumptively likely to cause confusion. Casa Helvetia could, of course, have offered evidence to rebut this presumption – but it has not done so. There is no proof that retailers explain to consumers the differences between the Italian and Venezuelan products. The record is likewise devoid of any evidence that consumers are indifferent about quality control procedures, packaging, ingredients, or price. Because the differences between the Italian and Venezuelan PERUGINA chocolates are material, the district court erred in denying plaintiffs' trademark infringement and unfair competition claims.

Reversed and remanded for the entry of appropriate injunctive relief and for further proceedings not inconsistent herewith.

Notes and Questions

1. *A low threshold.* As the court notes in *Nestle*, there is a low threshold of materiality that applies in gray goods cases. Why is the threshold so low? Is there any limiting principle that could be applied to the types of details that could constitute a material difference between imported and domestic products?
2. *Price?* One of the most surprising holdings of *Nestle* was that differences in price alone could support a finding that an imported product was materially different than a domestic product, even if the products were otherwise identical. If this is the case, would the discount retailers of Thai-manufactured Nike athletic shoes discussed in the introduction to this section be liable for trademark infringement? Is this outcome consistent with the purpose of the trademark exhaustion doctrine?
3. *Consumer preferences.* The court in *Nestle* observes that "The record is ... devoid of any evidence that consumers are indifferent about quality control procedures, packaging, ingredients, or price." What if the defendant had conducted consumer taste tests and surveys demonstrating that most consumers could not tell the difference between the Italian and Venezuelan chocolates, and didn't really care about the other factors? Would the result have changed?
4. *An international difference.* As shown in the *Kirtsaeng* and *Impression Products* cases, the tests for exhaustion of copyrighted and patented products do not change depending on whether the product originates domestically or abroad (those cases largely considering whether international exhaustion should exist at all). In trademark cases, however, the tests for exhaustion are somewhat different for domestic and international products. Consider that the Venezuelan PERUGINA chocolates found to be infringing in *Nestle* were unaltered when distributed in Puerto Rico. They were the exact products manufactured by Nestle's authorized Venezuelan producer, Alimentos. Unlike the refurbished surgical instrument in *Surgi-Tech* or the watches in *Rolux*, Casa Helvetia made no changes at all to the candies produced

and packaged by Alimentos. So why was Casa Helvetia liable for trademark infringement when reselling these authorized goods in Puerto Rico?

5. *Cure by labeling?* Professor Irene Calboli notes that “several countries allow importers and/or national distributors to cure these differences [in imported products] by affixing disclaimers to the goods clearly notifying that these goods have been imported by third parties and may be of a different quality.”¹² Would such a label notification have addressed any potential consumer confusion in *Nestle*? Should the United States allow parallel imports of slightly different products so long as consumers are warned?

¹² Calboli, *supra* note 11, at 605.