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**Resale Price Maintenance: Consignment Agreements, Copyrighted
or Patented Products and the First Sale Doctrine**

Herbert Hovenkamp*

Agency

Throughout the history of resale price maintenance manufacturers have used a variety of devices to control the prices that intermediaries handling their products charged downstream customers.¹ Among these are the manufacturer's designating those handling its product as "agents" and authorizing them to convey its title in the goods directly to consumers² or, in the case of patented or copyrighted products, to "license" consumers to use the product for a "royalty" that the manufacturer specifies. Patent and copyright holders have also attempted to specify prices in a manner that purported to make transactions at lower prices infringements of the patent or copyright. Such efforts have been largely unsuccessful.

Let us put patented and copyrighted goods aside for the moment and begin with "ordinary" products, where the contract between the manufacturer and an intermediary designates the latter as the former's "agent," who promises to sell the manufacturer-owned goods for no less than a specified price. The reasonableness and legality of a contract so limiting the agent's pricing freedom is not automatically answered by the *Dr. Miles* rule governing contracts with "independent" businesspersons. After all,

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¹See also 8 Phillip E Areeda & Herbert Hovenkamp, *Antitrust Law* ¶¶1622-1627 (3d ed. 2010).

²Although the next downstream party need not be the ultimate consumer, it simplifies exposition to speak of "consumers" rather than to use more general or abstract descriptions.

employment contracts requiring employees to charge only those prices specified by their employer are lawful, notwithstanding their restraint of employees' freedom. That result is usually phrased in terms not of the reasonableness of the restraint but of the absence of any cognizable conspiracy.³ The employee is regarded as “inside the firm,” and thus the manager's and employee's “agreement” that the latter will charge a certain price is regarded as a unilateral act.

In sum, given that resale price maintenance is assessed under §1 of the Sherman Act, the legal issue can be phrased as one of the agent's capacity to conspire with its principal over prices to consumers. In all events, the existence of a cognizable conspiracy between principal and agent or its reasonableness depends upon policy judgments about whether and in what circumstances agents should be regarded as part of a principal's enterprise and thus as subject to internal direction about downstream pricing without regard to the *Dr. Miles* rule.

The law on this question seemed settled in 1926 when the Supreme Court held in *General Electric* that a manufacturer could lawfully fix the prices charged by its “agents.”⁴ That doctrine, however, was severely limited in 1964 by *Simpson*,⁵ which invoked the *Dr. Miles* condemnation notwithstanding the manufacturer's agency

³See Phillip E Areeda & Herbert Hovenkamp, *Antitrust Law* ¶¶1471-1472 (3d ed. 2010) (in press), which explore the issue in detail and consider possible exceptions to the text statement. See, e.g., *Valuepest.com of Charlotte, Inc. v. Bayer Corp.*, 561 F.3d 282 (4th Cir. 2009) (post-Leegin RPM decision; agency agreement did not create Sherman Act conspiracy).

⁴*United States v. General Electric Co.*, 272 U.S. 476 (1926). The Court was careful to point out that a patentee who manufactures the product protected by the patent and fails to retain its ownership in it cannot control the price at which it is resold. *Id.* at 489.

⁵*Simpson v. Union Oil Co.*, 377 U.S. 13 (1964). See also Jeffrey L. Harrison, *Dr. Miles' Orphans: Vertical Conspiracy and Consignment in the Wake of Leegin* (Working Paper, Feb. 20, 2010, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1556491).

arrangements with a “vast” number of intermediaries whom the Court deemed to be “independent businessmen.”

RPM and the First Sale Doctrine

When patented or copyrighted articles were made the subject of resale price maintenance agreements, manufacturers sometimes labeled the product with notices that stated that the dealers who bought them were “licensed” to resell only at specified prices. The manufacturers sued those who sold for less as infringers. Rather than obtaining or enforcing any contractual promise by dealers, as in *Dr. Miles*, manufacturers claimed that such notices defined the extent of the license they granted purchasers to use their patents or copyrights and that reselling for a lower price departed from that license and thus infringed the patent or copyright.^{5.1}

Such claims have been read very narrowly by the Supreme Court. In its 1908 *Bobbs-Merrill* decision, the Court held that a retailer who had sold a book for less than the specified price did not infringe the publisher's copyright, notwithstanding the publisher's notice declaring such a sale to be an infringement.⁶ Although the copyright

^{5.1} For fuller exploration of these issues, see Herbert Hovenkamp, Post-Sale Restraints and Competitive Harm, ___ NYU Annual Survey of American Law ___ (2010) (in press), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1540527 (Feb., 2010).

⁶ *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339 (1908). This decision, as well as others dealing with resale price maintenance where patents, copyrights, or other intellectual property are involved, are explored in Herbert Hovenkamp, Mark D. Janis, Mark A. Lemley, & Christopher R. Leslie, IP and Antitrust: An Analysis of Antitrust Principles Applied to Intellectual Property Law §§24.1c, 24.2d (2d ed. 2010). On copyright, the rationale of the first sale limitation is qualified if the underlying product is licensed rather than sold, and the license in question is worded and displayed in such a fashion that the purchaser can be said to have assented to it. See, e.g., *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996) (shrinkwrap license enforceable if purchaser/licensee of software had chance to read it before opening software package); *Microsoft Corp. v. Harmony Computers & Electronics*, 846 F. Supp. 208 (S.D.N.Y. 1994)

statute precluded others from publishing the book, it did not limit subsequent disposition of books published and sold by the copyright holder. To add to the publisher's "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."⁷

The Court did not then rule upon the enforceability of a contractual promise to charge a specified price, although it later did so in *Dr. Miles*. To be sure, patented or copyrighted articles might be distinguished from ordinary goods, but the Supreme Court has ruled since 1873 that patented articles pass outside the statutory monopoly once sold, and there are no grounds for giving greater power to copyright holders. In *Adams*, before the Sherman Act was passed, the plaintiff had rights under a patent to manufacture certain coffin lids within ten miles of Boston.⁸ He sold lids to the defendant undertaker, who used some of them outside the ten-mile limit. The Court found no infringement:

[I]n 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

("first sale" doctrine did not apply when Microsoft licensed software to a third party who re-licensed to plaintiff); *Vacco v. Microsoft Corp.*, 2000 WL 1683386 (Conn. Super. Ct. 2000), aff'd, 793 A.2d 1048 (Conn. 2002) (purchaser or computer from third party implicitly accepted license to Microsoft Windows that was bundled with the machine). Other decisions continue to follow its rationale. E.g., *Klocek v. Gateway*, 104 F. Supp. 2d 1332 (D. Kan. 2000) (purchaser not bound by terms of shrinkwrap license; discussing the split in decisions). See 17 U.S.C. §109. See Christina Bohannon, Copyright Preemption of Contract, 67 Md. L. Rev. 616 (2008); Mark A. Lemley, Beyond Preemption: The Law and Policy of Intellectual Property Licensing, 87 Cal. L. Rev. 111 (1999).

⁷*Bobbs-Merrill*, 210 U.S. at 351.

⁸*Adams v. Burke*, 84 U.S. 453 (1873).

parts with the right to restrict that use. The article, in the language of the court, passes without the limit of the [statutory patent] 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 use of the 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.⁹

Similarly, the *Keeler* Court found no infringement when a dealer knowingly purchased a patented product from a manufacturer licensed to make and sell it only in Michigan and then resold it in Massachusetts.¹⁰ The Court declared that

one who buys patented articles of manufacture from one authorized to sell them becomes possessed of an absolute property in such articles, unrestricted in time or place.... The conclusion reached does not deprive a patentee of his just rights, because no article can be unfettered from the claim of his monopoly without paying its tribute.¹¹

The principles of these early patent cases and of *Bobbs-Merrill* were followed when the Court dealt with alleged patent infringement by dealers reselling patented products at discounted prices. In *Bauer* a patentee-manufacturer “licensed” dealers to resell only

⁹Id. at 456.

¹⁰*Keeler v. Standard Folding Bed Co.*, 157 U.S. 659 (1895).

¹¹Id. at 666-667.

at specified prices, claiming that resale is a “use” of the patented article that is subject to the patentee's control because the patent grants the patentee “the exclusive right to make, use, and vend the invention.”¹² Discounted resale prices would then be an unlicensed use and thus an infringement. The Court disagreed, holding that “it is a perversion of terms to call the transaction in any sense a license to use the invention,”¹³ and quoting from *Adams* the proposition that selling the goods removes them from the patent monopoly.¹⁴

The Supreme Court found it equally easy to rebuff the more complicated scheme in the *Straus* case.¹⁵ The Court described the “license notice” attached to each patented machine as declaring

that only the right to use the machine “for demonstrating purposes” is granted to “distributors” (wholesale dealers), but that these “distributors” may assign a like right “to the public” or to “regularly licensed Victor dealers” (retailers) “at the dealers' regular discount royalty”; that the “dealers” may convey the “license to use the machine” only when a “royalty” of not less than \$200 shall have been paid, and upon the “consideration” that all of the conditions of the “license” shall have been observed; that the title to the machine shall remain in the plaintiff which shall have the right to repossess it

¹²*Bauer & Cie v. O'Donnell*, 229 U.S. 1 (1913).

¹³*Id.* at 16.

¹⁴*Id.* at 18.

¹⁵*Straus v. Victor Talking Machine Co.*, 243 U.S. 490 (1917).

upon breach of any of the conditions of the notice, by paying to the user the amount paid by him less five per cent for each year that the machine has been used.¹⁶

The Court noted that “the full price, called a ‘royalty,’ was paid before the [manufacturer] parted with the possession of it,”¹⁷ and concluded that this “scheme of distribution is not a system designed to secure to the plaintiff and to the public a reasonable use of its machines, within the grant of the patent laws, but is in substance and in fact a mere price-fixing enterprise.”¹⁸ Once again, the patent laws did not make price cutting an infringement. In the *Ethyl*¹⁹ and *Univis*²⁰ cases, patentees had issued licenses to wholesalers and retailers, setting the price at which each could sell to the next party in the chain. In both instances, the Supreme Court held that patent law did not protect the manufacturers and applied *Dr. Miles* to condemn the arrangement.

The Ethyl Company held a patent on an “anti-knock” fluid that the company made and sold to gasoline refiners, who incorporated it in their gas. The resulting mixture was also subject to Ethyl's patent. The refiners were restricted from selling to jobbers other than those licensed by Ethyl, and jobbers were restricted from selling to gasoline stations other than those approved by Ethyl. Although such customer restrictions might

¹⁶Id. at 494-495.

¹⁷Id. at 500.

¹⁸Id. at 501.

¹⁹*Ethyl Gasoline Corp. v. United States*, 309 U.S. 436 (1940). See Herbert Hovenkamp, Mark D. Janis Mark A. Lemley, and Christopher R. Leslie, *IP and Antitrust: An Analysis of Antitrust Principles Applied to Intellectual Property Law* §§24.1c, 24.2d(2d ed. 2010).

²⁰*United States v. Univis Lens Co.*, 316 U.S. 241 (1942).

be valid standing alone, the Court deemed them fatally contaminated by Ethyl's unlawful purpose: Ethyl withdrew or threatened to withdraw its approval or "licenses" from jobbers and retailers selling below certain prices.²¹ Controlling the jobbers' prices and distribution policies was held to fall outside Ethyl's patent, which, the Court declared, was "exhausted" no later than upon the refiners' sales of the patented mixture to jobbers.²²

Similarly, the Univis Company sold unfinished blank lenses to firms that ground and completed them before selling them to other dealers or to the public. The finished product was subject to Univis's patent. Univis purported to license each intermediary who finished the product or otherwise handled it and to fix their resale prices. The Court held 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 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. The reward he has demanded and received is for the article and the invention which it embodies and which his vendee is to practice upon it. He has thus parted with his right to assert the patent monopoly with respect to it and is no longer free to control the price at which it may be sold either in its unfinished or finished form. No

²¹*Ethyl Gasoline*, 309 U.S. at 452-454.

²²*Id.* at 457. The Court emphasized that Ethyl's business was selling patented fluid, and not the gasoline mixture.

one would doubt that if the patentee's licensee had sold the blanks to a wholesaler or finishing retailer, without more, the purchaser would not infringe by grinding and selling them. The added stipulation by the patentee fixing resale prices derives no support from the patent and must stand on the same footing under the Sherman Act as like stipulations with respect to unpatented commodities.²³

With the patent put aside, the arrangement violated *Dr. Miles'* prohibition of resale price maintenance.²⁴

The first sale, or patent “exhaustion,” doctrine operates only as a limitation on the rights created under the relevant intellectual property statutes; it does *not* independently create or modify antitrust liability. This distinction between removal of the intellectual property immunity and the creation of antitrust liability is particularly important in rule of reason cases. To illustrate, suppose that patentee General Electric licensed Westinghouse to manufacture light bulbs under GE's patent. The license agreement stipulated that (1) Westinghouse could not charge a wholesale price higher than \$1.00 each for the finished bulbs; and (2) resellers who purchased from Westinghouse could not sell the bulbs to consumers for a price higher than \$1.50. As interpreted in the

²³*Univis*, 316 U.S. at 250-251. Note that this language implies that Ethyl had exhausted its patent rights when it sold its patented fluid to the refiners; because such fluid had no use except to be combined with gasoline, the refiner would have an implied license to make the patented combination, just as those who purchase blanks from Univis do not infringe its patent over the finished product by grinding and finishing the blanks.

²⁴The *Univis* Court relied on *United States v. General Electric Co.*, 272 U.S. 476 (1926) and *Ethyl Gasoline Corp. v. United States*, 309 U.S. 436 (1940). See *Univis*, 316 U.S. at 251, 252, 254.

General Electric case,¹ the Patent Act itself authorizes the first agreement, stipulating the wholesale price charged by Westinghouse, and thus immunizes it from antitrust liability. However, under the exhaustion limitation, the Patent Act would create no immunity for the second agreement, setting the maximum retail price, for this agreement applies to a transaction beyond the original sale. Nevertheless, the loss of immunity does not itself create antitrust liability. In this case the arrangement in question imposes maximum resale prices. Such arrangements are treated under the rule of reason and are only rarely unlawful.²

In its 2008 *Quanta Computer* decision, the Supreme Court affirmed all aspects of the patent exhaustion rule (that is, the first sale doctrine) and held that it applies to method patents as well.³ Under that doctrine, a patentee who has sold a patented article gives up control over it and cannot take advantage of the patent laws to impose further restraints on it; as a result, someone who repurchases the article from the initial purchaser and who violates such a restriction cannot be guilty of patent infringement.

It has always been the case, however, that the IP right holder can enter into at least some contracts with either the first or the subsequent purchaser controlling the

¹ See 272 U.S. 476 .

² See 8 Antitrust Law ¶1635 (3d ed. 2010) (in press). Before the decision in *GTE Sylvania* that applied the rule of reason to vertical nonprice restraints, they were also illegal per se. During that period exhaustion was frequently applied so as to condemn vertical nonprice restraints involving intellectual property licenses. E.g., *American Industrial Fastener Corp. v. Flushing Enters.*, 362 F. Supp. 32, 38-39 (N.D. Ohio. 1973) (license to manufacturer restricted its sales to an assigned territory and required it to impose similar restraints upon its distributors; latter held not enforceable: “territorial restrictions beyond the first sale are not sanctioned by [35 U.S.C. §261](#)). Accord *Ansul Co. v. Uniroyal*, 448 F.2d 872, 879-880 (2d Cir. 1971). Cf. *Munters Corp. v. Burgess Indus.*, 450 F. Supp. 1195, 1207-1208 (S.D.N.Y. 1977) (concluding that even under *Sylvania* it was unlawful for patentee to impose field-of-use restriction on subsequent purchaser).

³ *Quanta Computer, Inc. v. LG Elecs., Inc.*, 128 S. Ct. 2109 (2008).

disposition or use of the protected good. The Copyright Act contemplates the first sale doctrine, and its legislative history contemplates the use of contracts to get around some of its limitations.⁴ In *Quanta* the Supreme Court refused to decide the issue with respect to the Patent Act, stating in a footnote:

We note that the authorized nature of the sale to Quanta [the indirect purchaser] does not necessarily limit LGE's [the patentee'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").⁵

There is no reason to think that *Quanta* upset the status quo on the contract issue.

Thus, a patent infringement action to enforce a resale price maintenance restriction

⁴ 17 U.S.C. §109; and see H.R. Rep. No. 94-1476, at 79 (1976), reprinted in 1976 U.S.C.C.A.N. 5659, 5693. See Christina Bohannon, Copyright Preemption of Contracts, 67 Maryland L. Rev. 616, 663 & nn. 220–221 (2008) ("although Congress intended to allow parties to contract around the first-sale doctrine, it would require that such waivers be enforced through breach of contract actions, not through copyright infringement actions.").

⁵*Quanta*, 128 S. Ct. at 2122 n. 7.

placed on a patented article could not be maintained once the patentee has sold the article. However, a contract entered into with the first or presumably any subsequent purchaser of a patented article and imposing a resale price would likely be enforceable unless it violated antitrust's rule of reason. Of course, all ordinary contract law requirements would apply, including privity of contract with the person against whom enforcement is sought. And the remedy for breach would be a contract remedy, not a cause of action for patent infringement.