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Innovation and Competition Policy, Ch. 10 (2d ed): Post-Sale and Related Distribution Restraints Involving IP Rights

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**INNOVATION AND COMPETITION POLICY, Ch. 10 (2d ed):
POST-SALE AND RELATED DISTRIBUTION RESTRAINTS INVOLVING IP
RIGHTS
Herbert Hovenkamp**

This book of CASES AND MATERIALS ON INNOVATION AND COMPETITION POLICY is intended for educational use. The book is free for all to use subject to an open source license agreement. It differs from IP/antitrust casebooks in that it considers numerous sources of competition policy in addition to antitrust, including those that emanate from the intellectual property laws themselves, and also related issues such as the relationship between market structure and innovation, the competitive consequences of regulatory rules governing technology competition such as net neutrality and interconnection, misuse, the first sale doctrine, and the Digital Millennium Copyright Act (DMCA). Chapters will be updated frequently. The author uses this casebook for a three-unit class in *Innovation and Competition Policy* taught at the University of Iowa College of Law and available to first year law students as an elective. The table of contents is as follows (click on chapter title to retrieve it):

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**INNOVATION AND COMPETITION POLICY:
CASES AND MATERIALS**

HERBERT HOVENKAMP

**CHAPTER TEN (2d ed)
POST-SALE AND RELATED DISTRIBUTION RESTRAINTS
INVOLVING IP RIGHTS**

**ADAMS v. BURKE
84 U.S. 453 (1873)**

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 considerations 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* to *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 the 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.

Mr. Justice BRADLEY (with whom concurred Justices SWAYNE and STRONG), dissenting:

The question raised in this case is whether an assignment of a patented invention for a limited district, such as a city, a county, or a State, confers upon the assignee the right to sell the patented article to be used outside of such limited district....

If it were a question of legislative policy, whether a patentee should be allowed to divide up his monopoly into territorial parcels, it might admit of grave doubt

whether a vendee of the patented article purchasing it rightfully, ought to be restrained or limited as to the place of its use. But the patent act gives to the patentee a monopoly of use, as well as of manufacture, throughout the whole United States; and the eleventh section of the act (of 1836) expressly authorizes not only an assignment of the whole patent, or any undivided part thereof, but a 'grant and conveyance of the exclusive right under any patent, to make and use, and to grant to others to make and use the thing patented within and throughout any specified part or portion of the United States.'

If an assignment under this clause does not confer the same rights within the limited district which the patentee himself previously had in the whole United States, and no more, it is difficult to know what meaning to attach to language however plain....

On the 13th day of March, 1865, Merrill & Horner, the patentees, by an assignment duly executed and recorded, did assign to 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. By necessary consequence (as it seems to me), the right thus assigned consisted of the exclusive right to make, use, and vend the improved coffin-lid within the limited territory described; but did not include any right to make, use, or vend the same outside of those limits. As the assigned right to make the lids was a restricted right, limited to the territory; so the assigned right to use them was a restricted right limited in the same manner. Each right is conveyed by precisely the same language. A different construction would defeat the intent of the parties. For if the assignees, after making any number of lids within the limited district, could use them or authorize others to use them outside of the district, the balance of the monopoly remaining in the hands of the patentees might be rendered of little value.

If it be contended that the right of vending the lids to others enables them to confer upon their vendees the right to use the lids thus sold outside of the limited district, the question at once arises, how can they confer upon their vendees a right which they cannot exercise themselves? The only consistent construction to be given to such an assignment is, to limit all the privileges conferred by it to the district marked out. It is an assignment of the manufacture and use of the patented article within that district, and within that district only.

Difficulties may, undoubtedly, be suggested in special cases. If the patented thing be an article of wearing apparel, sold by the assignee within his district, it is confidently asked, cannot the purchaser wear the article outside of the district? The answer to acute suggestions of this sort would probably be found (in the absence of all bad faith in the parties) in the maxim *de minimis non curat lex*.

On the other hand, the difficulties and the injustice which would follow from a contrary construction to that which I contend for, are very obvious. Take the electric telegraph, for example. Suppose Professor Morse had assigned his patent within and for the New England States. Would such an assignment authorize the vendees of his assignees to use the apparatus in the whole United States? Take the planing machine: would an assignment from Woodworth of his patent within and for the State of Vermont, authorize the assignees to manufacture machines *ad libitum*, and sell them to parties to be used in other States? So of Hoe's printing press, and a thousand other machines and inventions of like sort.

Such a doctrine would most seriously affect not only the assignor (as to his residuary right in his patent), but the assignee also. For if it be correct, there would be nothing to prevent the patentee himself, after assigning his patent within a valuable city or other locality, from selling the patent machine or article to be used within the assigned district. By this means, the assignment could be, and in numberless instances would be, rendered worthless. Millions of dollars have been invested by manufacturers and mechanics in these limited assignments of patents in our manufacturing districts and towns, giving them, as they have supposed, the monopoly of the patented machine or article within the district purchased. The decision of the court in this case will, in my view, utterly destroy the value of a great portion of this property.

NOTES AND QUESTIONS

1. The majority in *Adams* found that once a patented good is purchased lawfully, that *good* can be used anywhere. Further, "[t]he 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." Are the dissenters misunderstanding the issue, which is not whether a license can restrain where the licensee manufactures the product, but whether it can restrain the location whether a particular copy of a patented article is used after the sale?.

2. The first sale doctrine dates back to a series of decisions in which the Supreme Court was confronted with the problem of retroactive patent term extensions. The issue typically arose when a patentee sold a patented article subject to a use restriction intended (explicitly or implicitly) to apply for the balance of the patent term, but then Congress extended the term retroactively. The question was then whether the restriction still applied during the extension period. The position that the Supreme Court eventually reached was that once a patent article was sold the post-sale restriction did not apply *at all*, not even immediately after the sale. *See Mitchell v. Hawley*, 83 U.S. 544 (1872) ("but when [the patent owner has] made one or more of the things patented, and

have vended the same to others to be used, they have parted to that extent with their exclusive right"); *Wilson v. Rousseau*, 45 U.S. 646 (1846) (once the patent owner has sold "the thing patented" he no longer has any rights in the invention). For a brief history of the first sale doctrine and its application to the digital age, see Aaron Perzanowski & Jason Schultz, *Digital Exhaustion*, 58 UCLA L. REV. 889 (2011).

**GENERAL TALKING PICTURES CORP. v. WESTERN ELECTRIC CO., INC
305 U.S. 124 (1939)**

Mr. Justice BRANDEIS delivered the opinion of the Court.

... 1. Can the owner of a patent, by means thereof, restrict the use made of a device manufactured under the patent, after the device has passed into the hands of a purchaser in the ordinary channels of trade, and full consideration paid therefore?

2. Can a patent owner, merely by a 'license notice' attached to a device made under the patent, and sold in the ordinary channels of trade, place an enforceable restriction on the purchaser thereof as to the use to which the purchaser may put the device?

Upon further hearing we are of opinion that neither question should be answered. For we find that, while the devices embody the inventions of the patents in suit, they were not manufactured or sold 'under the patent(s)' and did not 'pass into the hands of a purchaser in the ordinary channels of trade.'

These are the relevant facts. Amplifiers embodying the invention here involved are useful in several distinct fields. Among these is (a) the commercial field of sound recording and reproducing, which embraces talking picture equipment for theatres, and (b) the private or home field, which embraces radio broadcast reception, radio amateur reception and radio experimental reception. For the commercial field exclusive licenses had been granted by the patent pool to Western Electric Company and Electrical Research Products, Inc. For the private or home field the patent pool granted non-exclusive licenses to about fifty manufacturers. Among these was American Transformer Company. It was licensed 'solely and only to the extent and for the uses hereinafter specified and defined * * * to manufacture * * *, and to sell * * * only for radio amateur reception, radio experimental reception and radio broadcast reception * * * licensed apparatus so manufactured by the Licensee. * * *'

The license provided further: 'Nothing herein contained shall be regarded as conferring upon the Licensee either expressly or by estoppel, implication or otherwise, a license to manufacture or sell, any apparatus except such as may be

manufactured by the Licensee in accordance with the express provision of this Agreement.'

Transformer Company, knowing that it had not been licensed to manufacture or to sell amplifiers for use in theatres as part of talking picture equipment, made for that commercial use the amplifiers in controversy and sold them to Pictures Corporation for that commercial use. Pictures Corporation ordered the amplifiers and purchased them knowing that Transformer Company had not been licensed to make or sell them for such use in theatres. Any use beyond the valid terms of a license is, of course, an infringement of a patent. Robinson on Patents, § 916. If where a patented invention is applicable to different uses, the owner of the patent may legally restrict a licensee to a particular field and exclude him from others, Transformer Company was guilty of an infringement when it made the amplifiers for, and sold them to, Pictures Corporation. And as Pictures Corporation ordered, purchased and leased them knowing the facts, it also was an infringer.

The question of law requiring decision is whether the restriction in the license is to be given effect. That a restrictive license is legal seems clear. *Mitchell v. Hawley*, 16 Wall. 544, As was said in *United States v. General Electric Co.*, 272 U.S. 476, 489, , the patentee may grant a license 'upon any condition the performance of which is reasonably within the reward which the patentee by the grant of the patent is entitled to secure.' The restriction here imposed is of that character. The practice of granting licenses for a restricted use is an old one, see *Providence Rubber Company v. Goodyear*, 9 Wall. 788, 799, 800; *Gamewall Fire-Alarm Telegraph Co. v. Brooklyn, C.C.*, 14 F. 255. So far as appears, its legality has never been questioned. The parties stipulated that 'it is common practice where a patented invention is applicable to different uses, to grant written licenses to manufacture under United States Letters Patents restricted to one or more of the several fields of use permitting the exclusive or non-exclusive use of the invention by the licensee in one field and excluding it in another field.'

As the restriction was legal and the amplifiers were made and sold outside the scope of the license, the effect is precisely the same as if no license whatsoever had been granted to Transformer Company. And as Pictures Corporation knew the facts, it is in no better position than if it had manufactured the amplifiers itself without a license. It is liable because it has used the invention without license to do so.

We have consequently no occasion to consider what the rights of the parties would have been if the amplifier had been manufactured 'under the patent' and 'had passed into the hands of a purchaser in the ordinary channels of trade.' Nor

have we occasion to consider the effect of a 'licensee's notice' which purports to restrict the use of articles lawfully sold.

Affirmed.

Mr. Justice BLACK, dissenting.

Almost a century ago, this Court asserted, and time after time thereafter it has reasserted, that when an article described in a patent is sold and 'passes to the hands of a purchaser, it is no longer within the limits of the monopoly. It passes outside of it, and is no longer under the protection of the act of Congress. * * * Contracts in relation to it are regulated by the laws of the State, and are subject to State jurisdiction.'

A single departure from this judicial interpretation of the patent statute was expressly overruled within five years, and this Court again reasserted that commodities-once sold-were not thereafter 'subject to conditions as to use' imposed by patent owners. In result, the judgment here is a second departure from the traditional judicial interpretation of the patent laws.

As a consequence of the return to the interpretation of the patent statutes previously repudiated and expressly overruled, petitioner is enjoined from making full use of, and must account in triple damages for using, tubes and amplifiers which he owns. He became the owner of the tubes by purchase from various retailers authorized by respondents to sell in the open market. He became the owner of the amplifiers by purchase from a manufacturer who-having the complete right to make them-had contracted to sell only for limited uses. The departure here permits the patentee-by virtue of his contract with the manufacturer-to restrict the uses to which this purchaser and owner may put his tubes and amplifiers.

Transformer Company was authorized by the patentee to make and to sell amplifiers. It did make such amplifiers-of a standard type usable in many fields, they became its property when made, were sold to and became the property of petitioner. The prior opinion in this case, both courts below and the opinion on this rehearing, all refer to the transaction between Transformer Company and petitioner as a sale. Even the very contract authorizing the Transformer Company to make and sell the amplifiers provided 'That for the purpose of this agreement all Licensed Apparatus shall be considered as 'sold' when the Licensed Apparatus has been billed out, or if not billed out, when it has been delivered, shipped, or mailed.'

Notice to the purchaser in any form could not-under the patent law-limit or restrict the use of the amplifiers after they were sold and knowledge by both

vendor and purchaser that the articles were purchased for use outside the 'field' for which the vendor had been given the right to sell, made the transaction between them no less a sale. Had petitioner-after making the purchase-decided not to use these amplifiers in the forbidden fields, or had they been destroyed prior to such use, certainly the mere state of mind of the parties at the time of sale would not have made them both infringers.

Indeed, petitioner could use the amplifiers at all only in combination with tubes which it purchased on the open market from retailers authorized by respondents to sell. Therefore, even if the state of mind of vendor and purchaser were material, Transformer Company could be considered an infringer only because it sold a commodity which might-depending on possible events after the sale-be . . . in infringing combination with another lawfully purchased commodity. The patent law was not intended to accomplish such result.

Petitioner has persistently contended throughout this litigation that no existing trade practice permits a patentee-under guise of a 'license'-to extend his monopoly to commodities after sale, and has not stipulated otherwise. Neither stipulation nor practice could justify extension of patent monopoly beyond the limits of legality fixed by Congress and recognized by this Court for over three-quarters of a century. 'The statutory authority to grant the exclusive right to 'use' a patented machine is precisely the same, as the authority to grant the exclusive right to 'vend' * * *.' A widespread practice of restricting the resale price of articles described in patents did not prevent this Court from holding that once the statutory right to vend has been exercised 'the added restriction is beyond the protection and purpose of the act. Similarly, a 'common practice * * * to grant written licenses * * * restricted to one or more * * * fields of * * * use' cannot prevent the application of 'that line of cases in which this court has from the beginning held that a patentee who has parted with a patented ** machine by passing title to a purchaser has placed the article beyond the limits of the monopoly secured by the patent act.'

NOTES AND QUESTIONS

1. Since the licensee both manufactured the product under the license and then sold it for a commercial use in violation of the field of use restriction the Supreme Court could not find that the sale was "unauthorized" except by finding first that the first sale doctrine did not apply to a manufacturing license. As a result the Court distinguished between sales of patented articles, to which the first sale rule applied, and patent licenses granted to a license to produce. In this case the first sale doctrine would not apply to the license to produce, although it would apply to any restriction placed on a patented good after it had been sold.

The same logic would apply to process, or “method,” patents. However, in the *Quanta Computer* decision, reprinted *infra*, the Supreme Court determined that the first-sale doctrine should be applied to a method patent, although it did not say how. Which rule makes more sense? One author argues that “a rule exempting method claims from exhaustion would, in practice, marginalize the entire doctrine by allowing patent applicants to easily preclude future adverse exhaustion defenses because virtually any invention can be cast as a method using simple claim drafting techniques. Thus, although method claims carry some drawbacks, their categorical exclusion from exhaustion would reduce the doctrine to a matter of preference and, as the Court recognized, “seriously undermine” it.” Andrew T. Dufresne, *The Exhaustion Doctrine Revived? Assessing the Scope and Possible Effects of the Supreme Court’s Quanta Decision*, 24 BERKELEY TECH. L. J. 11, 29-30 (2009). For a very different view, see F. Scott Kieff, *Quanta v. LG Electronics: Frustrating Patent Deals by Taking Contracting Options off the Table?*, 2008 CATO SUP. CT. REV. 315 (2008).

Consider this possibility: a patentee licenses another firm to manufacture its patent widget and sell it. However, the license provides that the licensee may manufacture (a) no more than 1000 units per year; and (2) that all of these must be sold in the state of New York; and (3) purchasers of the widget may use them only for personal, not business, use. Both quantity and territory restricted manufacturing licenses are routinely enforced, and territorial restrictions are expressly authorized by the Patent Act. See 35 U.S.C. §261, which permits the patentee to “grant and convey an exclusive right under his application for patent, or patents, to the whole or any specified part of the United States.” On quantity limitations, see *United States v. E.I. du Pont de Nemours & co.*, 118 F.Supp. 41, 225-226 (D.Del. 1953), *aff’d* on other grounds, 351 U.S. 377 (1956), which approved an arrangement that called for a stepped up royalty on production beyond a specified amount. See CHRISTINA BOHANNAN & HERBERT HOVENKAMP, *CREATION WITHOUT RESTRAINT: PROMOTING LIBERTY AND RIVALRY IN INNOVATION*, Ch. 13 (2011).

What if the patentee assigns the process patent, or gives another firm the *exclusive* right to manufacture, but also imposes the quantity or geographic restriction. Now it can be said that the patentee has given up ownership of all of the rights in the patent, just as the owner of a patent thing has given up all rights in that particular copy of the thing. Should the first sale doctrine apply in that case? The story is not as simple as it might first appear if there are competing alternative technologies and the patentee owns both of them. For example, the patentee might be

producing under Alpha technology, but it also owns Beta technology which is roughly as good but not being used. It then sells (assigns) the Beta technology to another firm, but since it is in competition with this technology it wants to limit either the number of units that Beta can make or the territories in which Beta can be sold. If the first sale doctrine precludes Beta by assignment, Alpha will probably simply give the other firm a nonexclusive right to Beta. If the first sale doctrine bars both the assignment and the nonexclusive license, the patentee will very likely refuse to grant any license at all. As a policy matter, which rule is best? Shouldn't competition (antitrust) policy be relevant, at least insofar as the Patent Act does not expressly authorize the action? We might prohibit either the quantity limitation or the geographic limitation, but that would conflict with long-standing practice. We could force the firm to license patent Beta, but that appears to conflict with the Patent Misuse Reform Act, 35 U.S.C. § 271(d), which states that a patentee may lawfully refuse to license.

2. Note that the law of real property does not have an equivalent to the first sale rule. Indeed, we permit restrictions to "run with the land" all the time. For example, if I sell a piece of property to you subject to a properly executed restriction that it not be used for commercial purposes I will be able to enforce that restriction not only against you, but against any subsequent purchaser who violates it. I will be able to do this even though I am not in privity of contract with these subsequent purchasers. By contrast, if I sell a patented computer subject to the restriction that it not be used for commercial purposes the restriction is generally unenforceable after the first sale occurs. What explains the difference in policy?

UNITED STATES v. UNIVIS LENS CO.

316 U.S. 241 (1942)

Mr. Chief Justice STONE delivered the opinion of the Court.

These cases come here on direct appeal and cross appeal from a judgment of the district court granting in part and denying in part the Government's prayer for an injunction restraining violations of §§ 1 and 3 of the Sherman Act....

Appellee, Univis Lens Company, was the owner of a number of patents and two trademarks relating to multifocal lenses. In 1931 it organized appellee, Univis Corporation.... [T]he Corporation then proceeded to set up and has since maintained the licensing system which the Government now assails.

The relevant features of the system are as follows: The Corporation licenses the Lens Company to manufacture lens blanks and to sell them to designated licensees of the Corporation, upon the Lens Company's payment to the Corporation of an agreed royalty of 50 cents a pair. The 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. Each blank is composed of two or more pieces of glass of different refractive power, of such size, shape, and composition and so disposed that when fused together in the blank it is said to conform to the specifications and claims of some one of the Corporation's patents.

The Corporation also issues three classes of licenses-licenses to wholesalers, to finishing retailers and to prescription retailers. The licenses to wholesalers authorize the licensees to purchase the blanks from the Lens Company, to finish them by grinding and polishing, and to sell them to prescription licensees only at prices fixed by the Corporation licensor. In finishing the lenses so as to make them an effective aid to vision of the prospective wearer, to whom the prescription retailer sells, it is necessary for the wholesaler, by grinding the blanks, to conform their curvatures to the prescription supplied by the retailer with his order. By the terms of the license the wholesalers are required to keep full accounts of all sales, showing the sales prices of lenses and the names of the purchasers, and to make them available to representatives of the Corporation.

The licenses to finishing retailers-who purchase the blanks from the Lens Company, grind and polish them and adjust the lenses, in frames or supports, to the eyes of the consumers-contain similar provisions. The retailers are licensed to purchase the blanks of the Lens Company and to sell them to their customers at prices prescribed by the Corporation licensor....

The licenses to prescription retailers, who are without facilities for grinding and finishing the lenses, but who prescribe and adjust glasses for their customers, are signed both by the Corporation and a licensor wholesaler, and grant to the retailer a 'franchise to prescribe and fit Univis lenses', in return for which the prescription retailer agrees to sell finished lenses only to consumers and only at prices prescribed by the Corporation.

All the licenses to wholesalers and retailers recite the Corporation's ownership of the lens patents and purport to confer on the licensee the privilege of selling the patented invention in the manner and to the extent stated. No royalties are exacted of any of the licensees other than the 50 cents collected by the Corporation for each pair of blanks sold by the Lens Company. The rewards of the corporate appellees for the exploitation of the patents and the patented

lenses are derived wholly from the sales by the Lens Company of the blanks, from the proceeds of which the 50 cent royalty is paid.....

For a time the Corporation licensed approximately 20 per cent of the retailers in a locality. It now licenses a larger percentage but not more than 50 per cent....

The district court found that the claims of each of these eight patents are for a finished lens and that consequently the wholesalers and finishing retailers, in grinding and polishing each lens, practice in part the patent, in conformity to which the Lens Company has manufactured the blanks which it supplies. The court thought that without the granted license the final step in finishing the lens would infringe the patent and concluded that for this reason the Corporation could condition its licenses upon the maintenance by the licensee of the prescribed retail price. See *United States v. General Electric Co.*, 272 U.S. 476. But it held that the prescription retailer licenses are unlawful because their restrictions upon the resale of the finished product are not within the patent monopoly and are proscribed by the Sherman Act....

The Government has not put in issue the validity of the lens patents, but argues that their scope does not extend beyond the structure of the lens blanks and consequently affords no basis for the Corporation's restrictions on the sale of the finished lenses which the wholesalers and finishing retailers fashion from blanks purchased from the Lens Company. It insists that the novel features of the invention do not include more than the combination of shape, size and arrangement of the described pieces of glass when they are fused into the blank; that the grinding and polishing of the blank involve no practice and add no feature not common to the finishing and 'fitting' of other types of multifocal lenses which are not covered by the patents; and that their scope cannot be lawfully extended to a procedure not in itself novel merely because it is applied to an article which embodies the only novel features of the alleged invention, and has by the sale become a lawful subject of commerce.....

As appellees concede, the invention of only a single lens patent is utilized in making each blank and finishing it as a lens. We therefore put to one side questions which might arise if the finisher of a particular lens blank utilized the invention of some patent other than the patent which was practiced in part by the manufacture of the blank. And we assume for present purposes, without deciding, that the patent is not fully practiced until the finishing licensee has ground and polished the blank so that it will serve its purpose as a lens. But merely because the licensee takes the final step in the manufacture of the patented product, by doing work on the blank which he has purchased from the patentee's licensee, it does not follow that the patentee can control the price at which the finished lens is sold.

Notwithstanding the assumption which we have made as to the scope of the patent, each blank, as appellees insist, embodies essential features of the patented device and is without utility until it is ground and polished as the finished lens of the patent. We may assume also, as appellees contend, that sale of the blanks by an unlicensed manufacturer to an unlicensed finisher for their completion would constitute contributory infringement by the seller.

But in any case it is plain that where the sale of the blank is by the patentee or his licensee—here the Lens Company—to a finisher, the only use to which it could be put and the only object of the sale is to enable the latter to grind and polish it for use as a lens by the prospective wearer. An incident to the purchase of any article, whether patented or unpatented, is the right to use and sell it, and upon familiar principles 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.... Sale of a lens blank by the patentee or by his licensee is thus in itself both a complete transfer of ownership of the blank, which is within the protection of the patent law, and a license to practice the final stage of the patent procedure. In the present case the entire consideration and compensation for both is the purchase price paid by the finishing licensee to the Lens Company. We have no question here of what other stipulations, for royalties or otherwise, might have been exacted as a part of the entire transaction, which do not seek to control the disposition of the patented article after the sale. The question is whether the patentee or his licensee, no longer aided by the patent, may lawfully exercise such control.

The declared purpose of the patent law is to promote the progress of science and the useful arts by granting to the inventor a limited monopoly, the exercise of which will enable him to secure the financial rewards for his invention.... The full extent of the monopoly is the patentee's 'exclusive right to make use, and vend the invention or discovery'. The patentee may surrender his monopoly in whole by the sale of his patent or in part by the sale of an article embodying the invention. His monopoly remains so long as he retains the ownership of the patented article. But sale of it exhausts the monopoly in that article and the patentee may not thereafter, by virtue of his patent, control the use or disposition of the article. Hence the patentee cannot control the resale price of patented articles which he has sold, either by resort to an infringement suit, or, consistently with the Sherman Act, by stipulating for price maintenance by his vendees....

We think that all the considerations which support these results lead to the conclusion 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 was 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 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.

Our decisions have uniformly recognized that 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. *Adams v. Burke*... The first vending of any article manufactured under a patent puts the article beyond the reach of the monopoly which that patent confers. Whether the licensee sells the patented article in its completed form or sells it before completion for the purpose of enabling the buyer to finish and sell it, he has equally parted with the article, and made it the vehicle for transferring to the buyer ownership of the invention with respect to that article. To that extent he has parted with his patent monopoly in either case, and has received in the purchase price every benefit of that monopoly which the patent law secures to him. If he were permitted to control the price at which it could be sold by others he would extend his monopoly quite as much in the one case as in the other, and he would extend it beyond the fair meaning of the patent statutes and the construction which has hitherto been given to them.

... Accordingly neither the Lens Company nor the Corporation, by virtue of the patents, could after the sale of the lens blank exercise any further control over the article sold.

The price fixing features of appellees' licensing system, which are not within the protection of the patent law, violate the Sherman Act... Agreements for price maintenance of articles moving in interstate commerce are, without more, unreasonable restraints within the meaning of the Sherman Act because they eliminate competition, and restrictions imposed by the seller upon resale prices of articles moving in interstate commerce...

Appellees stress the features of their licensing system by which it is said they protect the public interest and their own good will by the selection as licensees of those who are specially skilled and competent to render the service which they

undertake. But if we assume that such restrictions might otherwise be valid,.. these features are so interwoven with and identified with the price restrictions which are the core of the licensing system that the case is an appropriate one for the suppression of the entire licensing scheme even though some of its features, independently established, might have been used for lawful purposes... The injunction of the district court will therefore be continued....

NOTES AND QUESTIONS

1. As the previous notes have suggested, applying the "first sale" doctrine to a manufacturing license or method patent is conceptually difficult because regulating how a manufacturing license is used seems almost inherent in such licenses. As a result, quantity and locational limitations are routinely enforced. *Univis* represents the very interesting intermediate case of the sale of a good coupled with a process license to alter that particular copy of the good. In that case there are no additional limitations to specific that do not apply to the good itself, so the Supreme Court had little difficulty holding that the first sale doctrine applied. In this case the resale price maintenance restriction applied to the finished lens, not to the process that was used to finish it. Suppose that Univis had simply sold the lens blanks and separately licensed a process patent for its method of finishing blanks, but inserted in the process patent a restriction that lenses produced by the patented process could be sold only for \$25.00 each? Alternatively, suppose that Univis did not make the lenses at all but merely licensed a process patent providing that any lens produced with the patent be sold at \$25.00. Or suppose its process patent license stated that the licensing royalty was 10% of the sale price, which could not be less than \$25.00. Or alternatively, suppose that it simply provided that the royalty would be \$2.50 per lens produced, but that the only way a licensee could make a profit at that royalty rate was by charging at least \$25.00 per lens?

NOTE: RESALE PRICE MAINTENANCE

Resale price maintenance (RPM), sometimes known as vertical price fixing, is a type of vertical integration by contract in which a manufacturer or supplier regulates the price at which independent dealers resell a product. In 1911 the U.S. Supreme Court declared RPM to be unlawful per se under §1 the Sherman Act. *Dr. Miles Medical Co. v. John D. Park & Sons*, 220 U.S. 373 (1911). Dr. Miles Medical Company brought an equitable action seeking to enjoin the defendant from selling Dr. Miles products at a discounted rate. The Court concluded that restraint upon the sale of goods was invalid. Thereupon the Supreme Court engaged in nearly a century of management of RPM, creating

complex doctrine that was riddled with exceptions and largely economically incoherent, given that many instances of RPM are very likely not anticompetitive. The case law, much of which is now obsolete, is recounted in 8 PHILLIP E. AREEDA & HERBERT HOVENKAMP, *ANTITRUST LAW*, Ch. 16 (3d ed. 2010).

In 2007, the Court overturned *Dr. Miles* in its *Leegin* decision, concluding that RPM must be assessed under the rule of reason, which means that anticompetitive effects must be proven in each case. Writing for the majority, Justice Kennedy reasoned, "The justifications for vertical price restraints are similar to those for other vertical restraints. Minimum resale price maintenance can stimulate interbrand competition—the competition among manufacturers selling different brands of the same type of product—by reducing intrabrand competition—the competition among retailers selling the same brand. The promotion of interbrand competition is important because "the primary purpose of the antitrust laws is to protect [this type of] competition." A single manufacturer's use of vertical price restraints tends to eliminate intrabrand price competition; this in turn encourages retailers to invest in tangible or intangible services or promotional efforts that aid the manufacturer's position as against rival manufacturers. Resale price maintenance also has the potential to give consumers more options so that they can choose among low-price, low-service brands; high-price, high-service brands; and brands that fall in between." *Leegin Creative Leather Products, Inc. v. PSKS, Inc.* 551 U.S. 877, 890 (2007).

2, Was the Court in *Univis* making competition policy or patent policy? Note that the government brought the case under the Sherman Act as a challenge to unlawful resale price maintenance. However, the Court relied mainly on the first sale doctrine, which comes from patent rather than antitrust law. Would the Court have come out the same way had the restriction in question not been a per se antitrust violation such as RPM. For example, what if the restriction in *Univis* provided that each lens be sold with a set of detailed printed instructions describing how it is to be used? What purpose related to either patent policy or antitrust policy would require a court to condemn such a restriction?

**QUANTA COMPUTER, INC. v. LG ELECTRONICS, INC.
553 U.S. 617 (2008)**

Justice THOMAS delivered the opinion of the Court.

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.

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).

Frequently accessed data are generally stored in cache memory, which permits faster access than main memory and is often located on the microprocessor itself. 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. J. Handy, *Cache Memory Book* 124 (2d ed.1993). The '641 patent addresses this problem....

The '379 patent relates to the coordination of requests to read from, and write to, main memory. Processing all read requests first ensures speedy access, but may result in the retrieval of outdated data if a read request for a certain piece of data is processed before an outstanding write request for the same data. The '379 patent discloses an efficient method of organizing read and write requests while maintaining accuracy by allowing the computer to execute only read requests until it needs data for which there is an outstanding write request.... 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. It allows multiple devices to share the bus, giving heavy users greater access.

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....

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.” ...

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 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.

The longstanding doctrine of patent exhaustion provides that the initial authorized sale of a patented item terminates all patent rights to that item. This Court first applied the doctrine in 19th-century cases addressing patent extensions on the Woodworth planing machine. Purchasers of licenses to sell and use the machine for the duration of the original patent term sought to continue using the licenses through the extended term. The Court held that the extension of the patent term did not affect the rights already secured by purchasers who bought the item for use “in the ordinary pursuits of life.” *Bloomer v. McQuewan*, 14 How. 539, 549, (1853); see also *ibid.* (“[W]hen the machine passes to the hands of the purchaser, it is no longer within the limits of the monopoly”); *Bloomer v. Millinger*, 1 Wall. 340, 351, (1864). In *Adams v. Burke*, 17 Wall. 453, (1873), the Court affirmed the dismissal of a patent holder’s suit alleging that a licensee had violated postsale restrictions on where patented coffin-lids could be used. “[W]here a person ha[s] purchased a patented machine of the patentee or his assignee,” the Court held, “this purchase carrie[s] with it the right to the use of that machine so long as it [is] capable of use.”

Although the Court permitted postsale restrictions on the use of a patented article in *Henry v. A.B. Dick Co.*, 224 U.S. 1 (1912), that decision was short lived.

In 1913, the Court refused to apply A.B. Dick to uphold price-fixing provisions in a patent license. See *Bauer & Cie v. O'Donnell*, 229 U.S. 1, 14-17 (1913). Shortly thereafter, in *Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 243 U.S. 502, 518 (1917), the Court explicitly overruled A.B. Dick. In that case, a patent holder attempted to limit purchasers' use of its film projectors to show only film made under a patent held by the same company. The Court noted the "increasing frequency" with which patent holders were using A.B. Dick-style licenses to limit the use of their products and thereby using the patents to secure market control of related, unpatented items. 243 U.S., at 509, Observing that "the primary purpose of our patent laws is not the creation of private fortunes for the owners of patents but is 'to promote the progress of science and useful arts,' " *id.*, at 511 (quoting U.S. Const., Art. I, § 8, cl. 8), the Court held that "the scope of the grant which may be made to an inventor in a patent, pursuant to the [patent] statute, must be limited to the invention described in the claims of his patent." 243 U.S., at 511. Accordingly, it reiterated the rule that "the right to vend is exhausted by a single, unconditional sale, the article sold being thereby carried outside the monopoly of the patent law and rendered free of every restriction which the vendor may attempt to put upon it."

This Court most recently discussed patent exhaustion in *Univis*, 316 U.S. 241, on which the District Court relied. *Univis Lens Company*, the holder of patents on eyeglass lenses, licensed a purchaser to manufacture lens blanks by fusing together different lens segments to create bi- and tri-focal lenses and to sell them to other *Univis* licensees at agreed-upon rates. Wholesalers were licensed to grind the blanks into the patented finished lenses, which they would then sell to *Univis*-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 *Univis* under the Sherman Act, 15 U.S.C. §§ 1, 3, 15, alleging unlawful restraints on trade. *Univis* asserted its patent monopoly rights as a defense to the antitrust suit. The Court granted certiorari to determine whether *Univis*' patent monopoly survived the sale of the lens blanks by the licensed manufacturer and therefore shielded *Univis*' pricing scheme from the Sherman Act.

The Court assumed that the *Univis* 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 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.

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. In *Ethyl Gasoline Corp. v. United States*, 309 U.S. 436, 446, 457 (1940), for example, the Court held that the sale of a motor fuel produced under one patent also exhausted the patent for a method of using the fuel in combustion motors. Similarly, as previously described, *Univis* held that the sale of optical lens blanks that partially practiced a patent exhausted the method patents that were not completely practiced until the blanks were ground into lenses.

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.” *United States ex rel. Steinmetz v. Allen*, 192 U.S. 543, 559

(1904). 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." *Adams*, 17 Wall., at 457. We therefore reject LGE's argument that method claims, as a category, are never exhaustible.

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. If, as in *Univis*, patent rights are exhausted by the sale of the incomplete item, then LGE has no postsale right to require that the patents be practiced using only Intel parts. Quanta also argues that exhaustion doctrine will be a dead letter unless it is triggered by the sale of components that essentially, even if not completely, embody an invention. Otherwise, patent holders could authorize the sale of computers that are complete with the exception of one minor step--say, inserting the microprocessor into a socket--and extend their rights through each downstream purchaser all the way to the end user.

LGE, for its part, argues that *Univis* is inapplicable here for three reasons. First, it maintains that *Univis* should be limited to products that contain all the physical aspects needed to practice the patent. On that theory, the Intel Products cannot embody the patents because additional physical components are required before the patents can be practiced. Second, LGE asserts that in *Univis* there was no "patentable distinction" between the lens blanks and the patented finished lenses since they were both subject to the same patent. Brief for Respondent 14 (citing *Univis*, supra, at 248-252). In contrast, it describes the Intel Products as "independent and distinct products" from the systems using the LGE Patents and subject to "independent patents."...

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.” The lens blanks in *Univis* met this standard because they were “without utility until [they were] ground and polished as the finished lens of the patent.” *Ibid.* Accordingly, “the only object of the sale [was] to enable the [finishing retailer] to grind and polish it for use as a lens by the prospective wearer.” 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.” The essential, or inventive, feature of the *Univis* lens patents was the fusing together of different lens segments to create bi- and trifocal lenses. The finishing process performed by the finishing and prescription retailers after the fusing was not unique. As the United States explained: “The finishing licensees finish *Univis* lens blanks in precisely the same manner as they finish all other bifocal lens blanks. Indeed, appellees have never contended that their licensing system is supported by patents covering methods or processes relating to the finishing of lens blanks. Consequently, it appears that appellees perform all of the operations which contribute any claimed element of novelty to *Univis* lenses.” Brief for United States in *United States v. Univis Lens Co.*, O.T.1941, No. 855 etc., p. 10....

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. They control access to main and cache memory, practicing the ‘641 and ‘379 patents by checking cache memory against main memory and comparing read and write requests. They also control priority of bus access by various other computer components under the ‘733 patent. Naturally, the Intel Products cannot carry out these functions unless they are attached to memory and buses, but those additions are standard components in the system, providing the material that enables the microprocessors and chipsets to function.

The Intel Products were specifically designed to function only when memory or buses are attached; Quanta was not required to make any creative or inventive decision when it added those parts. Indeed, Quanta had no alternative but to follow Intel's specifications in incorporating the Intel Products into its computers because it did not know their internal structure, which Intel guards as a trade secret. Intel all but practiced the patent itself by designing its products to practice the patents, lacking only the addition of standard parts.

We are unpersuaded by LGE's attempts to distinguish *Univis*. First, there is no reason to distinguish the two cases on the ground that the articles in *Univis* required the removal of material to practice the patent while the Intel Products require the addition of components to practice the patent. LGE characterizes the lens blanks and lenses as sharing a "basic nature" by virtue of their physical similarity, while the Intel Products embody only some of the "patentably distinct elements and steps" involved in the LGE Patents. But we think that the nature of the final step, rather than whether it consists of adding or deleting material, is the relevant characteristic. In each case, the final step to practice the patent is common and noninventive: grinding a lens to the customer's prescription, or connecting a microprocessor or chipset to buses or memory. The Intel Products embody the essential features of the LGE Patents because they carry out all the inventive processes when combined, according to their design, with standard components.

With regard to LGE's argument that exhaustion does not apply across patents, we agree on the general principle: The sale of a device that practices patent A does not, by virtue of practicing patent A, exhaust patent B. But if the device practices patent A while substantially embodying patent B, its relationship to patent A does not prevent exhaustion of patent B. For example, if the Univis lens blanks had been composed of shatter-resistant glass under patent A, the blanks would nonetheless have substantially embodied, and therefore exhausted, patent B for the finished lenses. This case is no different. While each Intel microprocessor and chipset practices thousands of individual patents, including some LGE patents not at issue in this case, the exhaustion analysis is not altered by the fact that more than one patent is practiced by the same product. The relevant consideration is whether the Intel Products that partially practice a patent-by, for example, embodying its essential features-exhaust that patent.

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. *Univis*, 316 U.S., at 249.

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 (1938), and *General Talking Pictures Corp. v. Western Elec. Co.*, 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 postsale 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.

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 postsale 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.

It is so ordered.

NOTES AND QUESTIONS

1. About a year earlier the Government had argued in the *Leegin* case that the per se rule against RPM should be overruled and that all vertical contractual restrictions should be governed by antitrust's rule of reason. See *Brief of the United States as Amicus Curiae Supporting Petitioner*, 2007 WL 173650 (Jan. 2007), *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007). By contrast, in *Quanta* the Government submitted an amicus brief arguing for what amounts to a per se rule against post-sale restrictions on the sale of patented goods? See *Brief of the United States as Amicus Curiae Supporting Petitioners*, 2007 WL 3353102 (Nov. 2007), *Quanta Computer, Inc. v. LG Electronics, Inc.*, 553 U.S. 617 (2008). Are the two positions consistent? What policy goal other than *stare decisis* serves a first sale doctrine as broad as the Court held in *Quanta*? See CHRISTINA BOHANNAN & HERBERT HOVENKAMP, *CREATION WITHOUT RESTRAINT: PROMOTING LIBERTY AND RIVALRY IN INNOVATION*, ch. 13 (2011).

THE FIRST SALE DOCTRINE AND SELF-REPLICATING TECHNOLOGY

BOWMAN V. MONSANTO CO.

___ S.Ct. ___, 2013 WL 1942397 (May 13, 2013)

JUSTICE KAGAN delivered the opinion of the Court.

Under the doctrine of patent exhaustion, the authorized sale of a patented article gives the purchaser, or any subsequent owner, a right to use or resell that article. Such a sale, however, does not allow the purchaser to make new copies of the patented invention. The question in this case is whether a farmer who buys patented seeds may reproduce them through planting and harvesting without the patent holder's permission. We hold that he may not.

Respondent Monsanto invented a genetic modification that enables soybean plants to survive exposure to glyphosate, the active ingredient in many herbicides (including Monsanto's own Roundup). Monsanto markets soybean seed containing this altered genetic material as Roundup Ready seed. Farmers planting that seed can use a glyphosate-based herbicide to kill weeds without damaging their crops. Two patents issued to Monsanto cover various aspects of its Roundup Ready technology, including a seed incorporating the genetic alteration.

Monsanto sells, and allows other companies to sell, Roundup Ready soybean seeds to growers who assent to a special licensing agreement. That agreement permits a grower to plant the purchased seeds in one (and only one) season. He can then consume the resulting crop or sell it as a commodity, usually to a grain elevator or agricultural processor. But under the agreement, the farmer may not save any of the harvested soybeans for replanting, nor may he supply them to anyone else for that purpose. These restrictions reflect the ease of producing new generations of Roundup Ready seed. Because glyphosate resistance comes from the seed's genetic material, that trait is passed on from the planted seed to the harvested soybeans: Indeed, a single Roundup Ready seed can grow a plant containing dozens of genetically identical beans, each of which, if replanted, can grow another such plant—and so on and so on. The agreement's terms prevent the farmer from co-opting that process to produce his own Roundup Ready seeds, forcing him instead to buy from Monsanto each season.

Petitioner Vernon Bowman is a farmer in Indiana who, it is fair to say, appreciates Roundup Ready soybean seed. He purchased Roundup Ready each year, from a company affiliated with Monsanto, for his first crop of the season. In accord with the agreement just described, he used all of that seed for planting,

and sold his entire crop to a grain elevator (which typically would resell it to an agricultural processor for human or animal consumption).

Bowman, however, devised a less orthodox approach for his second crop of each season. Because he thought such late-season planting “risky,” he did not want to pay the premium price that Monsanto charges for Roundup Ready seed. He therefore 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.

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 doctrine of patent exhaustion limits a patentee’s right to control what others can do with an article embodying or containing an invention. Under the doctrine, “the initial authorized sale of a patented item terminates all patent rights to that item.” *Quanta Computer, Inc. v. LG Electronics, Inc.*, 553 U. S. 617, 625 (2008). And by “exhaust[ing] the [patentee’s] monopoly” in that item, the sale confers on the purchaser, or any subsequent owner, “the right to use [or] sell” the thing as he sees fit. *United States v. Univis Lens Co.*, 316 U. S. 241, 249–250 (1942). We have explained the basis for the doctrine as follows: “[T]he purpose of the patent law is fulfilled with respect to any particular article when the patentee has received his reward . . . by the sale of the article”; once that “purpose is realized the patent law affords no basis for restraining the use and enjoyment of the thing sold.”

Consistent with that rationale, the doctrine restricts a patentee’s rights only as to the “particular article” sold, *ibid.*; it leaves untouched the patentee’s ability to prevent a buyer from making new copies of the patented item. “[T]he purchaser of the [patented] machine . . . does not acquire any right to construct another machine either for his own use or to be vended to another.” *Mitchell v. Hawley*, 16 Wall. 544, 548 (1873); see *Wilbur-Ellis Co. v. Kuther*, 377 U. S. 422, 424 (1964) (holding that a purchaser’s “reconstruction” of a patented machine

“would impinge on the patentee’s right ‘to exclude others from making’ . . . the article” (quoting 35 U. S. C. §154 (1964 ed.)). Rather, “a second creation” of the patented item “call[s] the monopoly, conferred by the patent grant, into play for a second time.” *Aro Mfg. Co. v. Convertible Top Replacement Co.*, 365 U. S. 336, 346 (1961). That is because the patent holder has “received his reward” only for the actual article sold, and not for subsequent recreations of it. If the purchaser of that article could make and sell endless copies, the patent would effectively protect the invention for just a single sale. Bowman himself disputes none of this analysis as a general matter: He forthrightly acknowledges the “well settled” principle “that the exhaustion doctrine does not extend to the right to ‘make’ a new product.”

Unfortunately for Bowman, that principle decides this case against him. 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. Monsanto, although the patent holder, would have no business interfering in those uses of Roundup Ready beans. 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. . . . Because Bowman thus reproduced Monsanto’s patented invention, the exhaustion doctrine does not protect him.

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. *Univis*, 316 U. S., at 251. 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. 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. After buying beans for a single harvest, Bowman saved enough seed each year to reduce or eliminate the need for additional purchases. Monsanto still held its patent, but received no gain from Bowman’s annual production and sale of Roundup Ready soybeans. The exhaustion doctrine is limited to the “particular item” sold to avoid just such a mismatch between invention and reward.....

Bowman principally argues that exhaustion should apply here because seeds are meant to be planted. The exhaustion doctrine, he reminds us, typically prevents a patentee from controlling the use of a patented product following an authorized sale. And in planting Roundup Ready seeds, Bowman continues, he is merely using them in the normal way farmers do. Bowman thus concludes that allowing Monsanto to interfere with that use would “creat[e] an impermissible exception to the exhaustion doctrine” for patented seeds and other “self-replicating technologies.”

But it is really Bowman who is asking for an unprecedented exception—to what he concedes is the “well settled” rule that “the exhaustion doctrine does not extend to the right to ‘make’ a new product.” Reproducing a patented article no doubt “uses” it after a fashion. But as already explained, we have always drawn the boundaries of the exhaustion doctrine to exclude that activity, so that the patentee retains an undiminished right to prohibit others from making the thing his patent protects. See, e.g., *Cotton-Tie Co. v. Simmons*, 106 U. S. 89, 93–94 (1882) (holding that a purchaser could not “use” the buckle from a patented cotton-bale tie to “make” a new tie). That is because, once again, if simple copying were a protected use, a patent would plummet in value after the first sale of the first item containing the invention. The undiluted patent monopoly, it might be said, would extend not for 20 years (as the Patent Act promises), but for only one transaction. And that would result in less incentive for innovation than Congress wanted. Hence our repeated insistence that exhaustion applies only to the particular item sold, and not to reproductions....

Our holding today is limited—addressing the situation before us, rather than every one involving a self-replicating product. We recognize that such inventions are becoming ever more prevalent, complex, and diverse. In another case, the article’s self-replication might occur outside the purchaser’s control. Or it might be a necessary but incidental step in using the item for another purpose. Cf. 17 U. S. C. §117(a)(1) (“[I]t is not [a copyright] infringement for the owner of a copy of a computer program to make . . . another copy or adaptation of that computer program provide[d] that such a new copy or adaptation is created as an essential step in the utilization of the computer program”). We need not address here whether or how the doctrine of patent exhaustion would apply in such circumstances. In the case at hand, Bowman planted Monsanto’s patented soybeans solely to make and market replicas of them, thus depriving the company of the reward patent law provides for the sale of each article. Patent exhaustion provides no haven for that conduct. We accordingly affirm the judgment of the Court of Appeals for the Federal Circuit.

NOTES AND QUESTIONS

1. *The monopoly problem in the Bowman case.* One problem raised by self-replicating technologies is that they do in fact replicate themselves, with virtually infinite potential. Depending on the genetic characteristics of the patented portions and the geographic range over which fertilization occurs, self-replicating seeds might come to dominate a large region. As a result, a random purchase of locally produced seed is highly likely to contain the patented trait, as it did in this case. Doesn't this mean Monsanto is effectively forcing its seed on Farmer Bowman? Suppose you purchase a melon at the grocery store and, seeing the hundreds of seeds in it otherwise going to waste, plant a few in the back yard. If the melon contained one of Monsanto's protected genes you would be guilty of patent infringement. Under patent law it does not matter for basic infringement that you did not know about the patent, and neither does it matter that you are a consumer rather than commercial grower. Further, if the gene is robust you may find it difficult to find any melons in the area whose seed you could plant. Indeed, even if you found some "clean" seed and planted it, for many crops the cross-fertilization process is such that you would be forbidden from planting the second generation seed. Further, the principal value of Monsanto's technologically altered seed is that it is "Roundup Ready," which means that you can use Roundup herbicide to kill all the weeds and grass, leaving the genetically altered plants intact. But what if you are a true back-to-the earth organic gardener who wishes to purchase local seeds for planting and do not intend to use Roundup or any other herbicide at all. You are still guilty of patent infringement. Given that patent law now permits Monsanto to control the market in this fashion, can competition (antitrust) law be brought to bear on these practices?

Note that in the final portion of its opinion the Court limited its application, perhaps severely, stating that it does not even reach to every self-replicating product. The Court gives digital copyright as an example. Typically one installs or runs software from a medium such as a CD-ROM or DVD by making a copy. The Court states that it is taking no position on whether such self-replication is governed by the first sale doctrine. For example, suppose you purchase software on a CD-ROM and install it on your laptop computer. The first sale doctrine permits you to sell the CD-ROM (although under U.S. law a separate licensing requirement might forbid you from doing so). However, are you entitled to sell the laptop computer without first removing the installed copy of the program? Or suppose you burn songs from CD's to your iPod or similar digital music device. Can you now sell the iPod with the songs included, given that they are "replicas" of the songs on the CD's rather than the original CD itself? Note that these instances of self-replication do not raise the "monopoly" problem that Bowman does: there is little chance that the self-replicating songs

will spread through the entire neighborhood. But suppose the 300 students in a school form an organization in which they purchase CDs and then circulate them among their number, with each given a brief time to transfer the CD's contents to their iPods.

2. *The "repair-reconstruction" dichotomy and the first sale doctrine.* The *Bowman* decision discusses the repair/reconstruction dichotomy, suggesting that a second generation seed is certainly more than a "repair" of the original seed and more closely akin to a "reconstruction." As the first sale doctrine is usually stated, one who purchases a patented product has the right to "use," "resell" or "repair" the product without prohibition by the patentee via an infringement suit. See DONALD S. CHISUM, 5 CHISUM ON PATENTS §16.03[2] (a) (2013 Supp.). However, if the purchaser "reconstructs" the patented article without a licensing permitting it to do so, than it is reproducing or "practicing" the patent, and that would constitute infringement. So how does one tell the difference? Suppose I have purchased a patented bicycle with 25 parts and one of them breaks. If I replace it I am almost certainly "repairing." But what if 20 parts break and I replace all 20? Or what if my belt has two parts, a patented strap and a patented buckle. When the buckle breaks I replace it with an old buckle that I already own? See *Aro Mfg. Co. v. Convertible Top Replacement Co.*, 365 U.S. 336 (1961), which held that a purchaser's replacement of a single unpatented part in a patented mechanism for raising the top of a convertible automobile was a "repair," not "reconstruction." See also *Fuji Photo Film Co., Ltd. V. Int'l Trade Com'n*, 474 F.3d 1281 (Fed. Cir. 2007), which held that when a company refurbished used but patented cameras by putting new backs on them it was lawfully "repairing" them. Significantly, in both *Aro* and *Fuji* the courts emphasized that the parts that were being replaced were not separately patented. Accord *Surfco Hawaii Fin Control Sys.*, 264 F.3d 1062 (Fed. Cir. 2001) (replacement of broken fins on surfboard were a permissible "repair" when the fins were not covered by a separate patent. *Husky Injection Molding Sys. Ltd. V. R & D Tool Eng'g. Co.*, 291 F.3d 780 (Fed. Cir. 2002) (example: replacing all parts of a motor vehicle except its spark plugs would be "reconstruction").

COPYRIGHT PREEMPTION

KIRTSAENG v. JOHN WILEY & SONS, INC. 133 S.CT. 1351 (2013)

BREYER, J., delivered the opinion of the Court, in which ROBERTS, C.J., and THOMAS, ALITO, SOTOMAYOR, and KAGAN, JJ., joined.

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." These

rights are qualified, however, by the application of various limitations set forth in the...Act. Those sections...include, for example, the principle of "fair use" (§ 107), permission for limited library archival reproduction, (§ 108), and the doctrine at issue here, 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."...

I

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.

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. 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.

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.*" 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. A dissenting judge thought that the words "lawfully made under this title" do not refer "to a place of manufacture" but rather "focu[s] on whether a particular copy was manufactured lawfully under" America's copyright statute.

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." 654 F.3d, at 221–222....

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. We consequently conclude that Kirtsaeng's nongeographical reading is the better reading of the Act.

A

The language of § 109(a) read literally favors Kirtsaeng's nongeographical interpretation, namely, that "lawfully made under this title" means made "in accordance with" or "in compliance with" the Copyright Act. The language of § 109(a) says nothing about geography. The word "under" can mean "[i]n accordance with." 18 Oxford English Dictionary 950 (2d ed.1989). And a nongeographical interpretation provides each word of the five-word phrase with a distinct purpose. The first two words of the phrase, "lawfully made," suggest an effort to distinguish those copies that were made lawfully from those that were not, and the last three words, "under this title," set forth the standard of "lawful[ness]." Thus, the nongeographical reading is simple, it promotes a traditional copyright objective (combatting piracy), and it makes word-by-word linguistic sense.

The geographical interpretation, however, bristles with linguistic difficulties. It gives the word "lawfully" little, if any, linguistic work to do. (How could a book be *un*lawfully "made under this title"?) It imports geography into a statutory provision that says nothing explicitly about it. And it is far more complex than may at first appear....

In sum, we believe that geographical interpretations create more linguistic problems than they resolve. And considerations of simplicity and coherence tip the purely linguistic balance in Kirtsaeng's, nongeographical, favor.

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:

(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.” *Samantar v. Yousuf*, 130 S.Ct. 2278, 2289–2290, n. 13 (2010).

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:

“[If] a man be possessed of ... a horse, or of any other chattell ... and give or sell his whole interest ... therein upon condition that the Donee or Vendee shall not alien[ate] the same, the [condition] is voi[d], because his whole interest ... is out of him, so as he hath no possibilit[y] of a Reverter, and it is against Trade and Traffi[c], and bargaining and contracting betwee[n] man and man: and it is within the reason of our Author that it should ouster him of all power given to him.” 1 E. Coke, *Institutes of the Laws of England* § 360, p. 223 (1628).

A law that permits a copyright holder to control the resale or other disposition of a chattel once sold is similarly “against Trade and Traffi[c], and bargaining and contracting.” *Ibid.*

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. See, e.g., *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877, 886 (2007) (restraints with “manifestly anticompetitive effects” are *per se* illegal; others are subject to the rule of reason (internal quotation marks omitted)); 1 P. Areeda & H. Hovenkamp, *Antitrust Law* ¶ 100, p. 4 (3d ed. 2006)

("[T]he principal objective of antitrust policy is to maximize consumer welfare by encouraging firms to behave competitively").

D

Associations of libraries, used-book dealers, [and] technology companies 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 (presumably, many were first published in one of the nearly 180 copyright-treaty nations and enjoy American copyright protection); 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.

These examples...help explain *why* Lord Coke considered the “first sale” doctrine necessary to protect “Trade and Traffi[c], and bargaining and contracting,” and they help explain *why* American copyright law has long applied that doctrine.

[R]eliance upon the “first sale” doctrine is deeply embedded in the practices of those, such as booksellers, libraries, museums, and retailers, who have long relied upon its protection. Museums, for example, are not in the habit of asking their foreign counterparts to check with the heirs of copyright owners before sending, *e.g.*, a Picasso on tour. That inertia means a dramatic change is likely necessary before these institutions, instructed by their counsel, would begin to engage in the complex permission-verifying process that a geographical interpretation would demand. And this Court's adoption of the geographical interpretation could provide that dramatic change.

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.

III

Wiley and the dissent make several additional important arguments in favor of the geographical interpretation. *First*, they say that our *Quality King* decision strongly supports its geographical interpretation. In that case we asked whether the Act's “importation provision,” now § 602(a)(1), barred importation (without permission) of a copyrighted item (labels affixed to hair care products) where an American copyright owner authorized the first sale and export of hair care products with copyrighted labels made in the United States, and where a buyer sought to import them back into the United States without the copyright owner's permission. 523 U.S., at 138–139.

We held that the importation provision did *not* prohibit sending the products back into the United States (without the copyright owner's permission).

We pointed out that [§ 602(a)(1)] makes importation an infringement of the “exclusive right to distribute ... *under 106*.” We noted that § 109(a)'s “first sale” doctrine limits the scope of the § 106 exclusive distribution right. We took as given the fact that the products at issue had at least once been sold. And we held that consequently, importation of the copyrighted labels does not violate § 602(a)(1). 523 U.S., at 145.

In reaching this conclusion we endorsed *Bobbs–Merrill* and its statement that the copyright laws were not “intended to create a right which would permit the holder of the copyright to fasten, by notice in a book ... 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.” 210 U.S., at 349–350.

We also explained why we rejected the claim that our interpretation would make § 602(a)(1) pointless. Under *Quality King’s* interpretation, § 602(a)(1) would still forbid importing (without permission, and subject to the exceptions in § 602(a)(3)) copies lawfully made abroad, for example, where (1) a foreign publisher operating as the licensee of an American publisher prints copies of a book overseas but, prior to any authorized sale, seeks to send them to the United States; (2) a foreign printer or other manufacturer (if not the “owner” for purposes of § 109(a), *e.g.*, before an authorized sale) sought to send copyrighted goods to the United States; (3) “a book publisher transports copies to a wholesaler” and the wholesaler (not yet the owner) sends them to the United States; or (4) a foreign film distributor, having leased films for distribution, or any other licensee, consignee, or bailee sought to send them to the United States. These examples show that § 602(a)(1) retains significance.

Second, Wiley and the dissent argue...that the Act’s legislative history supports their interpretation. But the historical events to which it points took place more than a decade before the enactment of the Act and, at best, are inconclusive.

Third, Wiley and the dissent claim that a nongeographical interpretation will make it difficult, perhaps impossible, for publishers (and other copyright holders) to divide foreign and domestic markets. We concede that is so. A publisher may find it more difficult to charge different prices for the same book in different geographic markets. But we do not see how these facts help Wiley, for we can find no basic principle of copyright law that suggests that publishers are especially entitled to such rights.

The Constitution describes the nature of American copyright law by providing Congress with the power to “secur[e]” to “[a]uthors” “for limited [t]imes” the “*exclusive [r]ight to their ... [w]ritings.*” Art. I, § 8, cl. 8. The Founders, too, discussed the need to grant an author a limited right to exclude competition. Compare Letter from Thomas Jefferson to James Madison (July 31, 1788), in 13 Papers of Thomas Jefferson 440, 442–443 (J. Boyd ed. 1956) (arguing against any monopoly) with Letter from James Madison to Thomas Jefferson (Oct. 17, 1788), in 14 *id.*, at 16, 21 (J. Boyd ed. 1958) (arguing for a

limited monopoly to secure production). But the Constitution's language nowhere suggests that its limited exclusive right should include a right to divide markets or a concomitant right to charge different purchasers different prices for the same book, say to increase or to maximize gain. We have found no precedent suggesting a legal preference for interpretations of copyright statutes that would provide for market divisions.

To the contrary, Congress enacted a copyright law that (through the "first sale" doctrine) limits copyright holders' ability to divide domestic markets. And that limitation is consistent with antitrust laws that ordinarily forbid market divisions. Cf. *Palmer v. BRG of Ga., Inc.*, 498 U.S. 46, 49–50 (1990) (*per curiam*) ("[A]greements between competitors to allocate territories to minimize competition are illegal").

Fourth, the dissent and Wiley contend that our decision launches United States copyright law into an unprecedented regime of "international exhaustion." But they point to nothing indicative of congressional intent in 1976. The dissent also claims that it is clear that the United States now opposes adopting such a regime, but the Solicitor General as *amicus* has taken no such position in this case. In fact, when pressed at oral argument, the Solicitor General stated that the consequences of Wiley's reading of the statute (perpetual downstream control) were "worse" than those of Kirtsaeng's reading (restriction of market segmentation).

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.

It is so ordered.

[A concurring opinion by Justice KAGAN, Justice ALITO concurring, is omitted]

Justice GINSBURG, with whom Justice KENNEDY joins, and with whom Justice SCALIA joins except as to Parts III and V–B–1, dissenting.

... Instead of adhering to the Legislature's design, the Court today adopts an interpretation of the Copyright Act at odds with Congress' aim to protect copyright owners against the unauthorized importation of low-priced, foreign-made copies of their copyrighted works. The Court's bold departure from

Congress' design is all the more stunning, for it places the United States at the vanguard of the movement for "international exhaustion" of copyrights.

To justify a holding that shrinks to insignificance copyright protection against the unauthorized importation of foreign-made copies, the Court identifies several "practical problems." The Court's parade of horrors, however, is largely imaginary.

I

Because economic conditions and demand for particular goods vary across the globe, copyright owners have a financial incentive to charge different prices for copies of their works in different geographic regions. Their ability to engage in such price discrimination, however, is undermined if arbitrageurs are permitted to import copies from low-price regions and sell them in high-price regions.

In *Quality King Distributors, Inc. v. L'anza Research Int'l, Inc.*, 523 U.S. 135, 143–154 (1998), the Court held that a copyright owner's right to control importation under § 602(a)(1) is a component of the distribution right set forth in § 106(3) and is therefore subject to § 109(a)'s codification of the first sale doctrine. Important to the Court's holding, the copies at issue in *Quality King* had been "lawfully made under [Title 17]"—a prerequisite for application of § 109(a). Section 602(a)(1), the Court noted, would apply to "copies that were 'lawfully made' not under the United States Copyright Act, but instead, under the law of some other country."

As the District Court and the Court of Appeals concluded, application of the *Quality King* analysis to the facts of this case would preclude any invocation of § 109(a). Petitioner Supap Kirtsaeng imported and then sold at a profit over 600 copies of copyrighted textbooks printed outside the United States by the Asian subsidiary of respondent John Wiley & Sons, Inc. (Wiley). In the words the Court used in *Quality King*, these copies "were 'lawfully made' not under the United States Copyright Act, but instead, under the law of some other country." Section 109(a) therefore does not apply, and Kirtsaeng's unauthorized importation constitutes copyright infringement under § 602(a)(1).

II

The text of the Copyright Act demonstrates that Congress intended to provide copyright owners with a potent remedy against the importation of foreign-made copies of their copyrighted works. As the Court recognizes, this case turns on the meaning of the phrase "lawfully made under this title" in § 109(a). In my view, that phrase is most sensibly read as referring to instances in

which a copy's creation is governed by, and conducted in compliance with, Title 17 of the U.S. Code.

Section 109(a), properly read, affords Kirtsaeng no defense against Wiley's claim of copyright infringement. The Copyright Act, it has been observed time and again, does not apply extraterritorially. The printing of Wiley's foreign-manufactured textbooks therefore was not governed by Title 17. The textbooks thus were not "lawfully made under [Title 17]," the crucial precondition for application of § 109(a). And if § 109(a) does not apply, there is no dispute that Kirtsaeng's conduct constituted copyright infringement under § 602(a)(1).

Not only does the Court adopt an unnatural construction of the § 109(a) phrase "lawfully made under this title." Concomitantly, the Court reduces § 602(a)(1) to insignificance.

IV

Unlike the Court's holding, my position is consistent with the stance the United States has taken in international-trade negotiations. This case bears on the highly contentious trade issue of interterritorial exhaustion. The issue arises because intellectual property law is territorial in nature, which means that creators of intellectual property "may hold a set of parallel" intellectual property rights under the laws of different nations. Chiappetta, *The Desirability of Agreeing to Disagree: The WTO, TRIPS, International IPR Exhaustion and a Few Other Things*, 21 *Mich. J. Int'l L.* 333, 340–341 (2000). There is no international consensus on whether the sale in one country of a good incorporating protected intellectual property exhausts the intellectual property owner's right to control the distribution of that good elsewhere.

Even if the text and history of the Copyright Act were ambiguous on the answer to the question this case presents—which they are not, see Parts II–III—I would resist a holding out of accord with the firm position the United States has taken on exhaustion in international negotiations. While the Government has urged our trading partners to refrain from adopting international-exhaustion regimes that could benefit consumers within their borders but would impact adversely on intellectual-property producers in the United States, the Court embraces an international-exhaustion rule that could benefit U.S. consumers but would likely disadvantage foreign holders of U.S. copyrights.

V A

The Court asserts that its holding "is consistent with antitrust laws that ordinarily forbid market divisions." Section 602(a)(1), however, read as I do and as the Government does, simply facilitates copyright owners' efforts to impose

“vertical restraints” on distributors of copies of their works. See generally *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007) (discussing vertical restraints). We have held that vertical restraints are not *per se* illegal under § 1 of the Sherman Act because such “restraints can have procompetitive effects.” 551 U.S., at 881–882.¹

B

The Court sees many “horribles” following from a holding that the § 109(a) phrase “lawfully made under this title” does not encompass foreign-made copies. If § 109(a) excluded foreign-made copies, the Court fears, then copyright owners could exercise perpetual control over the downstream distribution or public display of such copies. A ruling in Wiley’s favor, the Court asserts, would shutter libraries, put used-book dealers out of business, cripple art museums, and prevent the resale of a wide range of consumer goods, from cars to calculators. Copyright law and precedent, however, erect barriers to the anticipated horrors.

1

Recognizing that foreign-made copies fall outside the ambit of § 109(a) would not mean they are forever free of the first sale doctrine. As earlier observed, the Court stated that doctrine initially in its 1908 *Bobbs–Merrill* decision. At that time, no statutory provision expressly codified the first sale doctrine. Instead, copyright law merely provided that copyright owners had “the sole liberty of printing, reprinting, publishing, completing, copying, executing, finishing, and vending” their works. Copyright Act of 1891, § 1, 26 Stat. 1107.

In *Bobbs–Merrill*, the Court addressed the scope of the statutory right to “ven[d].” In granting that right, the Court held, Congress did not intend to permit copyright owners “to fasten ... 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

¹ Despite the Court’s suggestion to the contrary, this case in no way implicates the *per se* antitrust prohibition against *horizontal* “[a]greements between competitors to allocate territories to minimize competition.” *Ante*, at — (quoting *Palmer v. BRG of Ga., Inc.*, 498 U.S. 46, 49 (1990) (*per curiam*)). Wiley is not requesting authority to enter into collusive agreements with other textbook publishers that would, for example, make Wiley the exclusive supplier of textbooks on particular subjects within particular geographic regions. Instead, Wiley asserts no more than the prerogative to impose *vertical* restraints on the distribution of its own textbooks. See Hovenkamp, *Post–Sale Restraints and Competitive Harm: The First Sale Doctrine in Perspective*, 66 N.Y.U. Ann. Survey Am. L. 487, 488 (2011) (“vertical restraints” include “limits [on] the way a seller’s own product can be distributed”).

price for it.” 210 U.S., at 349–350. “[O]ne who has sold a copyrighted article ... without restriction,” the Court explained, “has parted with all right to control the sale of it.”

Under the logic of *Bobbs–Merrill*, the sale of a foreign-manufactured copy in the United States carried out with the copyright owner’s authorization would exhaust the copyright owner’s right to “vend” that copy. The copy could thenceforth be resold, lent out, or otherwise redistributed without further authorization from the copyright owner. Thus, in accord with *Bobbs–Merrill*, the first authorized distribution of a foreign-made copy in the United States exhausts the copyright owner’s distribution right under § 106(3). After such an authorized distribution, a library may lend, or a used-book dealer may resell, the foreign-made copy without seeking the copyright owner’s permission.

[I]f Wiley, rather than Kirtsaeng, had imported into the United States and then sold the foreign-made textbooks at issue in this case, Wiley’s § 106(3) distribution right would have been exhausted under the rationale of *Bobbs–Merrill*. Purchasers of the textbooks would thus be free to dispose of the books as they wished without first gaining a license from Wiley.

2

Other statutory prescriptions provide further protection against the absurd consequences imagined by the Court. For example, § 602(a)(3)(C) permits “an organization operated for scholarly, educational, or religious purposes” to import, without the copyright owner’s authorization, up to five foreign-made copies of a non-audiovisual work—notably, a book—for “library lending or archival purposes.”

VI

To recapitulate, the objective of statutory interpretation is “to give effect to the intent of Congress.” *American Trucking Assns.*, 310 U.S., at 542. Here, two congressional aims are evident. First, in enacting § 602(a)(1), Congress intended to grant copyright owners permission to segment international markets by barring the importation of foreign-made copies into the United States. Second, as codification of the first sale doctrine underscores, Congress did not want the exclusive distribution right conferred in § 106(3) to be boundless. Instead of harmonizing these objectives, the Court subordinates the first entirely to the second. It is unsurprising that none of the three major treatises on U.S. copyright law embrace the Court’s construction of § 109(a). See 2 Nimmer § 8.12[B][6][c], at 8–184.34 to 8–184.35; 2 Goldstein § 7.6.1.2(a), at 7:141; 4 Patry §§ 13:22, 13:44, 13:44.10.

Rather than adopting the very international-exhaustion rule the United States has consistently resisted in international-trade negotiations, I would adhere to the national-exhaustion framework set by the Copyright Act's text and history. Under that regime, codified in § 602(a)(1), Kirtsaeng's unauthorized importation of the foreign-made textbooks involved in this case infringed Wiley's copyrights. I would therefore affirm the Second Circuit's judgment.

NOTE

The Supreme Court first applied the first-sale doctrine to copyright law in *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339 (1908). *Bobbs-Merrill* was a publishing company that sold Hallie Erminie Rives' *The Castaway*, a copyrighted novel, with a notice instructing vendors not to sell the novel for less than \$1. The defendants purchased a large number of the books wholesale and sold the individual books at 89 cents a copy. Publisher Bobbs-Merrill then brought suit. The Supreme Court held:

The precise question, therefore, in this case is, Does the sole right to vend . . . 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? . . . 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."

Note that *Bobbs-Merrill*, just as *Univis*, was a resale price maintenance case. In this case, however, the Supreme Court had not yet applied the antitrust laws to resale price maintenance. The *Dr. Miles* decision which declared RPM to be unlawful per se came three years later. The Court relied strictly on copyright law and borrowed from patent law's first sale doctrine.

This case established the notion that a copyright owner can control the initial sale of a work but cannot put further restraints on the work's use or transfer. It is important to note that the limitation of the first sale doctrine only applies to transfers to title. If a copyright holder leases his or her work, the mere possession does not fall under the first sale doctrine. Additionally, the limitation on restrictions does not extend to derivative works; the copyright holder still has the sole right to create derivative works. See Ivy Choderker, *The*

First Sale Doctrine Defense as a Limit on the Right of Publicity: Allison v. Vintage Sports Plaques, 19 LOY. L.A. ENT. L.J. 413 (1999). The holding in *Bobbs-Merrill* was codified in § 109(a) of the 1976 Copyright Act.

**VERNOR V. AUTODESK, INC.
621 F3d 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.

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.

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. 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 August 2007, Vernor brought a declaratory action against Autodesk to establish that his resales of used Release 14 software are protected by the first sale doctrine and do not infringe Autodesk's copyright. He also sought damages and injunctive relief....

Copyright is a federal law protection provided to the authors of “original works of authorship,” including software programs. 17 U.S.C. §§ 101-103. 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 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.

The Supreme Court articulated the first sale doctrine in 1908, holding that a copyright owner's exclusive distribution right is exhausted after the owner's first sale of a particular copy of the copyrighted work. See *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339, 350-51 (1908). In *Bobbs-Merrill*, the plaintiff-copyright owner sold its book with a printed notice announcing that any retailer who sold the book for less than one dollar was responsible for copyright infringement. Plaintiff sought injunctive relief against defendants-booksellers who failed to comply with the price restriction. The Supreme Court rejected the plaintiff's claim, holding that its exclusive distribution right applied only to first sales of copies of the work. The distribution right did not permit plaintiff to

dictate that subsequent sales of the work below a particular price were infringing. *Id.* The Court noted that its decision solely applied to the rights of a copyright owner that distributed its work without a license agreement. *Id.* at 350 (“There is no claim in this case of contract limitation, nor license agreement controlling the subsequent sales of the book.”).

Congress codified the first sale doctrine the following year. See 17 U.S.C. § 41 (1909). In its current form, it allows the “owner of a particular copy” of a copyrighted work to sell or dispose of his copy without the copyright owner's authorization....

[When] 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....

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.” ...

In *Wall Data, Inc. v. Los Angeles County Sheriff's Dept.*, 447 F.3d 769 (9th Cir. 2006), the 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....

[*Wall Data* and other decisions] 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.

The district court [held] that a first sale occurs whenever the transferee is entitled to keep the copy of the work. Since Autodesk does not require its customers to return their copies of Release 14, the district court found that Autodesk had sold Release 14 to CTA. It reasoned that thus, CTA and Vernor were successive "owner[s] of a copy" of the software and were entitled to resell it under the first sale doctrine. The district court also found that Vernor's customers' copying of software during installation was protected by the essential step defense.

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.

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....

Although unnecessary to our resolution of the case, we address the legislative history in order to address the arguments raised by the parties and amici. That legislative history supports our conclusion that licensees such as CTA are not entitled to claim the first sale doctrine. The House Report for § 109 underscores Congress' view that the first sale doctrine is available only to a person who has acquired a copy via an "outright sale". H.R.Rep. No. 94-1476, at 79 (1976), reprinted in 1976 U.S.C.C.A.N. 5659, 5693. The report also asserts that the first sale doctrine does not "apply to someone who merely possesses a copy or phonorecord without having acquired ownership of it." ...

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 ... 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.

VACATED AND REMANDED.

NOTES AND QUESTIONS

1. Compare with *Vernor, Apple, Inc. v. Psystar Corp.*, 658 F.3d 1150 (9th Cir. 2011), which held that the first sale doctrine did not protect a firm that purchased copies of the Apple operating system on DVDs and sold them to customers for installation on its own competing computers:

The DVD purchasers were licensees, not owners, of the software. The Mac OS X SLA, states that the software is "licensed, not sold, to [the customer] by Apple Inc. (Apple) for use only under the terms of this License." Thus the SLA provides that Apple "retain[s] ownership of the Apple Software itself." The SLA also imposes significant use and transfer restrictions, providing, *inter alia*, that a licensee may only run one copy and "may not rent, lease, lend, redistribute or sublicense the Apple Software." *Cf. Wall Data [Inc. v. Los Angeles County Sheriff's Dept.,]* 447 F.3d 769 at 785 [(9th Cir. 2006)] ("Generally, if the copyright owner makes it clear that she or he is granting only a license to the copy of software and imposes significant restrictions on the purchaser's ability to redistribute or transfer that copy, the purchaser is considered a licensee, not an owner, of the software."). The license thus satisfied Vernor's three factor test for demonstrating the existence of a licensor/licensee relationship.

2. European law now recognizes a "first download" doctrine, adopted by the European Court of Justice in 2012, in Case C-128/11, *UsedSoft GmbH v. Oracle International Corp.*, 2012 E.C.R. I-0000. Under that rule someone who purchases downloaded software for its full value and with no obligation to return it is legally entitled to transfer the software to another buyer. The clear implication is that the transferor at that point has no further right to use the software herself. The Court reasoned that the purposes of the first sale doctrine would be frustrated if a copyright holder could avoid it by selling downloaded software rather than software burned onto a tangible medium such as a CD-ROM.

The decision raises a number of interesting issues. *First*, digital software does not ordinary "pass" from seller to buyer; rather, one transfers it by making a *copy*. Of course, the seller can then independently delete it (or not). These verification problems do not normally exist when a protected good such as a book is transferred. *Second*, as it is articulated the first download doctrine seems easy to evade simply by calling the download a "license" and limiting its duration. However, in this case Oracle, the copyright holder, stated that it was giving away the software together with a fee-paid license to use it. The European Court did not buy that argument. *Third*, what about limited use licenses in which the copyright owner uses a digital key or counter to limit the number of times that a copy of downloaded software can be installed on a different computer. The court expressly held that the licensee did not have a right to sell his unused authorizations. *Id.* at §69. The limitation is interesting because it conflicts with the ordinary rules of appurtenant interests that permit measured, or corporeal uses, to be divided. For example, if someone acquires

the right to take 100 tons of sand annually from my riverbed, that right can be divided so long as the total demand does not exceed 100 tons.

What about media other than software? Should someone who purchases a Hollywood movie by download be able to resell the download? Should the owner of an iPod or similar device be able to sell the iPod with all of its songs? or the owner of an eBook reader?

One impact of a decision such as *UsedSoft* may be to increase the use of digital anticircumvention devices in order to restrict transfers or reassignments that the copyright owner may prefer not to make.