Are You Exhausted by Your First Sale?

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Products protected by patents, copyrights, or trademarks sometimes lose those protections when they’re sold, leaving the holders of those IP rights with little recourse if those products are later resold.

In intellectual property (IP) law, “exhaustion” doesn’t mean weariness; it’s a legal term that describes the loss of certain rights normally held by the owner of a patent, copyright, or trademark. Those rights include the ability to control the use of a patented product, the distribution of a copyrighted product, and the sale of a trademarked product. Exhaustion, also known as the first-sale doctrine, promotes the resale of patented, copyrighted, and trademarked products through secondary markets. However, it’s sometimes difficult to know when the doctrine applies, and on 19 March 2013 the US Supreme Court issued a decision that expanded the doctrine and raised questions about its further application.

You’ve probably relied on the first-sale doctrine at one time or another. If you’ve bought a book, record, or CD and later sold or gave it to someone else, you’ve invoked it. If you’ve held a garage sale and sold items that were covered by patents, you’ve definitely invoked it. As long as you’ve lawfully acquired the item that you’re re-selling, the doctrine protects your ability to dispose of the item in any way that you want. This might make owners of IP such as patents, copyrights, or trademarks that cover the item unhappy, but they generally can’t do anything to stop it.

Economic arguments in support of the first-sale doctrine usually point to its many beneficiaries, including the original buyers who can recoup some of their purchase costs, and the businesses—both online and brick-and-mortar—that were established to handle the buying and selling of used items. However, an owner of the corresponding IP who wants tight control over the product’s distribution or its street pricing might have problems with the doctrine.

For an expanded discussion on this topic, visit the IEEE Computer Society’s website for the podcast that accompanies this column: http://www.computer.org/computing-and-the-law.

THE FIRST-SALE DOCTRINE FOR IP

The first-sale doctrine in the US as it applies to a patented, copyrighted, or trademarked item takes effect on each lawful and authorized initial sale of that item to a buyer. The doctrine eliminates restrictions on how the buyer can dispose of the item. The law supporting the doctrine, however, is different depending on whether you’re dealing with a patent, copyright, or trademark.

Patents

For patents, the doctrine is usually referred to as exhaustion. No statute defines patent exhaustion; it’s a legal concept that developed from common law, specifically through a series of US court decisions dating back to the 1800s.

A patent owner is granted the right to exclude others from making, using, selling, offering to sell, and importing the patented invention. Once the
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The patent owner sells a product covered by the patent, some of the owner’s rights to exclude others are generally exhausted. The patent owner typically can’t prohibit the buyer from using, selling, or offering to sell the purchased item. The patent owner can, however, prevent the buyer from making or importing another item. In fact, when it comes to self-replicating products, the US Supreme Court issued a decision on 15 May 2013 in Bowman v. Monsanto Co. et al. that patented soybean seeds once purchased, planted, and harvested couldn’t be replanted to grow a new crop without the patent owner’s authorization. Patent exhaustion wasn’t a defense because replanting was the same as making another item.

All of this might seem straightforward, but often it isn’t. For example, a patent owner might put restrictions on the item’s sale. One restriction limits the item to a single use only. Under this restriction, a buyer agrees to not refurbish and reuse the item—this has arisen in cases involving the refilling of inkjet cartridges and the remanufacturing of used medical devices. In Bowman, the patent owner restricted the planting of the seeds to just one growing season.

A related issue arises when the patent owner sells an incomplete item. Exhaustion applies to that sale if the incomplete item contains the essential features of what’s patented and could reasonably be used only to do what the patent describes. The US Supreme Court considered this in 2008 in Quanta Computer, Inc. v. LG Electronics, Inc. and concluded that LG couldn’t control Quanta’s use of LG microprocessors that Intel bought from LG and later resold to Quanta. LG imposed certain conditions on its sales to Intel, but the Supreme Court ruled that those conditions didn’t prevent the exhaustion of LG’s patent rights.

The decision in Quanta didn’t expressly overrule a 1992 decision by the US Court of Appeals for the Federal Circuit (a lower court) that permitted restrictions on resale. Because of this, it’s unclear whether, going forward, resale restrictions are valid and enforceable. It’s likely that a future dispute between a patent owner and a buyer will need to be litigated on facts broader than what were at issue in Bowman before this issue is settled.

Copyrights

Copyright owners have exclusive rights in their copyrighted material, including the right to control the reproduction, distribution, display, and performance of that material. The first-sale doctrine applies to copyrighted items by limiting the copyright owner’s distribution right. When a copyrighted item is first sold in a lawful and authorized manner, the buyer can freely dispose of it—by giving it away, throwing it away, reselling it, and so on—without worrying about being liable for infringement of the copyright owner’s exclusive distribution right.

The first-sale doctrine for copyrighted material is included in the copyright statute in Section 109 of Title 17 of the US Code. In addition to limiting the copyright owner’s exclusive distribution right, this section includes a provision that limits the exclusive display right. Specifically, the buyer of a copyrighted work is permitted to display the copyrighted material where the material is located—for example, the display of copyrighted photographs in a museum or gallery. However, the doctrine might not permit transmitting an image of the copyrighted item to a distant location.

It’s important to remember that the doctrine doesn’t apply until there’s a sale, and that something short of a sale, such as rental, lease, or loan, won’t invoke the doctrine. This is because the doctrine requires an actual and lawful change in ownership of the copyrighted material. Rentals, leases, and loans affect possession, which isn’t the same as ownership.

The ability to resell digital copies of copyrighted material legally, particularly songs in MP3 or other electronic formats, is unsettled. Much depends on the agreement between the original seller and original buyer. In some instances the agreement characterizes the initial transfer between these parties as a sale, which therefore might allow resale under the doctrine. In other instances the agreement characterizes the initial transfer as a license, which means that the transfer is more like a lease so the doctrine wouldn’t apply and resales wouldn’t be permitted.

There’s significant ongoing litigation regarding these issues, and it might be some time before there’s a clear resolution.

Trademarks

The purpose of a trademark is to identify the source of an item. Specific names, images, colors, and the like can be associated with items as trademarks so consumers, upon seeing the trademark, quickly recognize the item’s manufacturer—seeing a “swoosh” on athletic apparel, for example, would quickly make you conclude that Nike made that apparel. Trademark infringement usually occurs when someone uses a name, image, or color that’s similar
to another’s trademark on items that are similar to what the other sells. This creates a likelihood of confusion among consumers because it becomes difficult to identify the manufacturer of the similarly marked items.

Application of the first-sale doctrine to trademarked items is governed by the need to prevent this confusion. Reselling a trademarked item is usually permissible as long as it hasn’t been materially changed from the time of the original sale. Also, if the item has been repackaged for resale, the notice of repackaging must be adequate. The rationale for these limitations is clear—the reseller isn’t allowed to mislead or deceive consumers about the source or make of the item, and the trademark owner can be assured that its brand won’t be damaged by resales of inferior products.

**DOMESTIC VERSUS FOREIGN SALES**

On 19 March 2013, the US Supreme Court issued a decision in *Kirtsaeng v. John Wiley & Sons, Inc.* In that case, a student purchased textbooks in Thailand at prices that were much lower than the prices of those books in the US. The student had the textbooks shipped to the US and resold them at a profit while undercutting the US price. The publisher Wiley sued the student for copyright infringement, and the student claimed that the first-sale doctrine permitted his activities.

Two lower federal courts, the District Court for the Southern District of New York and the Court of Appeals for the Second Circuit, ruled that the doctrine didn’t apply when the resold goods were manufactured outside of the US, meaning that the student was liable for infringement. However, the Supreme Court reversed those decisions and ruled that the doctrine does indeed apply to foreign-made goods. In fact, the Supreme Court ruled that the doctrine applies to all lawful copies made anywhere, not just in the US. The student, therefore, was permitted to import the textbooks and resell them, and the publisher couldn’t prevent it under copyright law.

This decision will likely benefit consumers who want to purchase copyrighted items that are available outside of the US at reduced prices. However, it creates a dilemma for copyright owners who rely on pricing that’s different for different regions of the world. Multiple pricing models based on local economic factors might need to be replaced by uniform pricing. A shift to electronic distribution—using e-books, for example—might make this easier. But an open question, particularly in view of the current debate over the resale of digital copies of songs, is whether the doctrine would apply to electronic copies of the books.

The *Kirtsaeng* case raised questions about its further application to international patent exhaustion—that is, whether items lawfully made and sold outside of the US exhaust a US patent owner’s rights to exclude. Currently, there’s no international patent exhaustion based on a 2001 decision from the Court of Appeals for the Federal Circuit. In 2012, that court reiterated its position in *Ninestar Tech. Co. v. ITC*, which dealt with importing foreign manufactured inkjet cartridges to the US that infringed certain patents owned by Epson and Seiko Epson. Ninestar appealed the finding of infringement against it to the Supreme Court. Notwithstanding its ruling in the *Kirtsaeng* case, which permitted the resale of imported copyrighted items, the Supreme Court declined to hear the appeal. This means, at least for now, that buying a product outside the US that’s covered by a US patent and importing it into the US without authorization from the patent owner is still infringement.

**IS IT A SALE OR A LICENSE?**

Remember that the first-sale doctrine is triggered when there’s a lawful and authorized sale. Some products—software, for example—aren’t sold to consumers but are instead licensed to them. The theory is that by licensing the product, the owner is simply leasing it to the consumer. This framework is designed to let the owner maintain control and prevent the consumer from re-selling the software.

Whether a transfer of a product is done through a license or a sale has been the subject of many lawsuits. Each case is usually very fact-specific and involves a dissection and analysis of the agreements governing the transfer. If the agreements look like sales contracts because they don’t use the word “license” and don’t impose significant restrictions on the product’s use, courts have sometimes found that the transfer was an outright sale, which opens the door to re-sales through the application of the doctrine. If the objective is to have a transfer construed as a license, it’s imperative that the associated agreement be drafted very carefully.

The first-sale doctrine provides a powerful defense to some allegations of infringement, but it applies differently in patent, copyright, and trademark matters. It touches on many fast-moving areas of law, and its full scope is still evolving. Don’t assume that the doctrine will provide you with cover for your activities. Get competent legal advice first to avoid liability as an infringer.

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