

VIRGINIA LAW REVIEW ONLINE

VOLUME 103

APRIL 2017

1-17

ESSAY

COMMON LAW VS. STATUTORY BASES OF PATENT EXHAUSTION

*John F. Duffy and Richard M. Hynes**

*The pending Supreme Court case *Lexmark v. Impression Products* reveals the full breadth of disagreement about the exhaustion doctrine in patent law. In practical terms, the doctrine could mean almost everything—a mandatory rule applicable to all domestic and international sales of patented goods—or almost nothing—an optional rule applicable only to domestic sales that patentees can easily avoid by contract. This essay shows that this breadth of disagreement arises from a more fundamental disagreement over the legal basis for the doctrine, with judges, lawyers and academics deeply divided over whether the doctrine is based on judicially fabricated common law or a specific statute. The essay reiterates and further clarifies our position, first advanced in our prior article, that the doctrine is based on statutory interpretation and is designed to avoid broad constructions of intellectual property rights that would interfere with the vast and complex body of common law rules and statutory provisions governing commercial transactions. The essay also replies to two prior responses to our original article and concludes with a modest hope for what we think is a first necessary step toward clarity in this area: we hope that*

* John F. Duffy is the Samuel H. McCoy II Professor of Law and the Elizabeth D. and Richard A. Merrill Professor of Law at the University of Virginia School of Law. Richard M. Hynes is the John Allan Love Professor of Law at the University of Virginia School of Law. © 2017.

the Supreme Court will identify the legal basis for the exhaustion doctrine.

INTRODUCTION

THE pending Supreme Court case, *Impression Products v. Lexmark* (set for argument on March 21, 2017), poses two very important questions about the patent exhaustion doctrine: (1) whether the exhaustion doctrine is a mandatory restriction on patent rights that bars resort to infringement suits to enforce restrictions on use or resale imposed through a “conditional sale” of patented goods, and (2) whether foreign sales exhaust U.S. patent rights. Yet despite the significance of those questions, the most noteworthy feature of the litigation is that the parties, the amici, the government, and even the judges of the court below cannot agree on the most fundamental question about the doctrine: where does patent exhaustion come from? More specifically, is the doctrine a common law rule based on judicial assessments of good public policy, or is it based on an interpretation of a particular statute?

Identifying the legal basis for a doctrine seems like a natural first step in deciding disputes about the doctrine, and *Impression Products* presents the Supreme Court with a perfect opportunity to take that step. The en banc Federal Circuit clearly raised and addressed the issue whether patent exhaustion is based on judge-made common law or on statutory interpretation.¹ As our prior article makes clear,² we believe that the latter view is correct, as did the Federal Circuit. Unfortunately, as explained below, the Federal Circuit identified the wrong statutory basis for the doctrine and thus reached the wrong conclusions about its application.

In Part I of this short essay, we explain the issues in *Impression Products* and what’s at stake in the case. Part II addresses a response to our article written by Professors Katz, Perzanowski, and Rub (“the KPR essay”);³ Part III replies to a separate response by Professor Hovenkamp.⁴

¹ *Lexmark Int’l, Inc. v. Impression Prods., Inc.*, 816 F.3d 721, 750–52 (Fed. Cir. 2016).

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

³ Ariel Katz, Aaron Perzanowski & Guy A. Rub, *The Interaction of Exhaustion and the General Law: A Reply to Duffy And Hynes*, 102 Va. L. Rev. Online 8 (2016) [hereinafter KPR Essay].

I. Impression Products v. Lexmark: Theoretical Uncertainty in the Dock

Although the litigation in *Impression Products v. Lexmark* highlights an astounding degree of uncertainty about the legal foundation for patent exhaustion, the specific legal issues and facts of the case are quite straightforward.

The first issue in the case—the “conditional sale” issue—is whether exhaustion doctrine is a mandatory doctrine preventing patentees from using infringement actions to enforce restrictions placed on goods sold through so-called “conditional sales.”⁵ Lexmark sells some of its patented ink cartridges as “Return Program Cartridges,” which sell for a discount of about 20% off the price of “Regular Cartridges” but are subject to two restrictions: the depleted cartridges (1) cannot be refilled or reused and (2) cannot be transferred to anyone but Lexmark (the purchaser can dispose of the cartridges or return them for recycling). Regular Cartridges are subject to no restrictions concerning reuse or resale. Lexmark and Impression stipulated, for purposes of litigation, that the reduced price of Return Program Cartridges “reflects the value of the property interest and use rights conveyed to the purchaser under the express terms of the conditional sale contract and conditional single-use license.”⁶

Impression Products purchases, refurbishes, and resells depleted Lexmark cartridges, including Return Program Cartridges. Because the restrictions imposed on those cartridges expressly prohibit resale, Lexmark sued Impression on the theory, supported by the Federal Circuit’s precedent *Mallinckrodt, Inc. v. Medipart, Inc.*,⁷ that Impression’s resales are unauthorized and thus infringe Lexmark’s exclusive patent

⁴ Herbert Hovenkamp, Patent Exhaustion and Federalism: A Historical Note, 102 Va. L. Rev. Online 25 (2016).

⁵ As we explain in our article, the phrase “conditional sale” described a forerunner of the modern security interest, and the Uniform Commercial Code now deems such a sale to be a sale subject to a security interest. See Duffy & Hynes, *supra* note 2, at 62–63; see also Lynn M. LoPucki et al., Commercial Transactions: A Systems Approach 837 (5th ed. 2012) (“The consequence [of a conditional sale] is that the buyer becomes the owner of the goods and the seller becomes a secured creditor for the price of the goods.”); Donald H. Partington, Note, Effect of the Uniform Commercial Code on Virginia Commercial Law: Conditional Sales and Article 9, 20 Wash. & Lee L. Rev. 286, 286 (1963) (“The conditional sale is one of several common law and statutory security devices merged into what is called a security interest under the secured transactions article of the Uniform Commercial Code.”).

⁶ *Lexmark Int’l*, 816 F.3d at 727–728 (internal quotation marks omitted).

⁷ 976 F.2d 700 (Fed. Cir. 1992).

rights to control sales of its patented invention. In response, Impression argued that Lexmark's original sales—even if conditioned—exhausted Lexmark's patent rights and thus bar any patent infringement actions concerning subsequent uses or sales of the goods. Impression expressly concedes that “[l]ike all other market participants, patentees may use non-patent mechanisms to restrict resale or reuse of goods,”⁸ so the issue in the case is only whether Lexmark can use patent infringement actions to enforce the restrictions placed on the original sales.

The second legal issue—the international exhaustion issue—is whether foreign sales exhaust U.S. patent rights. Lexmark sells its patented ink cartridges (both Return Program and Regular Cartridges) in foreign countries and has never authorized those foreign cartridges to be imported into, or sold in, the United States. Lexmark sued Impression on the theory, supported by the Federal Circuit's precedent *Jazz Photo Corp. v. International Trade Commission*,⁹ that Impression's resales into the U.S. market of cartridges originally sold outside the United States were unauthorized acts of patent infringement. Impression argued that Lexmark's foreign sales exhausted even the U.S. patent rights in the cartridges and thus subsequent importation, sales, and uses of the cartridges do not infringe Lexmark's patent rights.

Adhering to its prior decisions in *Mallinckrodt* and *Jazz Photo*, the Federal Circuit sided with Lexmark on both issues.¹⁰ The en banc court even extended the *Mallinckrodt* decision, which held infringement suits could be used to enforce restrictions on subsequent *use* imposed by conditional sales, so that restrictions on subsequent *alienation* could also be enforced by infringement actions.

As we previously stated in our article,¹¹ we believe that *Mallinckrodt* was decided incorrectly and *Jazz Photo* correctly, and thus, not surprisingly, we think the Supreme Court is likely to reverse the en banc court on the conditional sale issue and affirm on the international exhaustion issue. On one initial and crucial point, however, the Federal Circuit was completely correct.

⁸ Brief for Petitioner at 11 n.2, *Impression Prods., Inc v. Lexmark Int'l, Inc.*, No. 15-1189 (U.S. filed Jan. 17, 2017).

⁹ 264 F.3d 1094 (Fed. Cir. 2001).

¹⁰ *Lexmark Int'l*, 816 F.3d at 726–27.

¹¹ See Duffy & Hynes, *supra* note 2, at 55–58, 47–53.

Just a few pages into its legal analysis, the Federal Circuit directly addressed whether the exhaustion doctrine is based on statutory interpretation or judge-made common law. Merely raising and discussing the issue is, in our view, a hugely positive development. Modern scholarly discussions of the doctrine have tended to provide substantive policy reasons as the basis for the doctrine, with the assumption that federal judges can fabricate legal doctrine from substantive policies as a supplement to statutory law.¹² As the Federal Circuit recognized, that assumption seems wrong because, once Congress has legislated in an area, the task of the federal courts is generally “to interpret and apply statutory law, not to create common law.”¹³ That general reluctance to fabricate judge-made common law in an area controlled by statute is based ultimately on separation-of-powers considerations.¹⁴ Such a fundamental jurisprudential commitment should not be cavalierly disregarded, and patent law—an area comprehensively controlled by an entire title of the U.S. Code (Title 35)—seems like an exceptionally poor place for federal courts to begin asserting a new-found power to supplement (or even supplant) federal statutory law with judge-made common law.

That’s our compliment to the Federal Circuit—now some criticism. Although correct in holding that exhaustion must be a statutory doctrine, the court chose the wrong statute as the basis for the doctrine. It chose the statute defining patent infringement, 35 U.S.C. § 271, which generally imposes liability on anyone who “without authority makes, uses, offers to sell, or sells” or “imports into the United States” any patented invention.¹⁵ To the Federal Circuit, the “exhaustion doctrine in the Patent Act must be understood as an interpretation of § 271(a)’s ‘without authority’ language” such that “some sales confer authority on the purchaser to take certain actions—such as selling or using the purchased article in the United States or importing it into the United States— that would otherwise be infringing acts.”¹⁶ Because “without authority” means “without consent or permission” from the patentee, the Federal

¹² See, e.g., KPR Essay, *supra* note 3, at 24 (listing a variety of policy factors by which the “scope [of exhaustion] should ideally be set”).

¹³ *Lexmark Int’l*, 816 F.3d at 734 (quoting *Nw. Airlines, Inc., v. Transp. Workers Union of Am.*, 451 U.S. 77, 95 n.34 (1981)).

¹⁴ See *City of Milwaukee v. Illinois*, 451 U.S. 304, 315 (1981).

¹⁵ 35 U.S.C. § 271(a) (2012).

¹⁶ *Lexmark Int’l*, 816 F.3d at 734.

Circuit reasoned that sales made subject to conditions—for example, conditions forbidding refilling or reselling—could not be viewed as granting any kind of “authority,” “consent,” or “permission” to violate the conditions of the sale, for “a patentee does not grant authority by denying it.”¹⁷

Yet Supreme Court case law never grounded the exhaustion doctrine in the phrase “without authority” but instead justified it as based on the limited domain or scope of the statutory grant of patent rights, which currently is in 35 U.S.C. § 154. Thus, in the highly important case of *Keeler v. Standard Folding Bed Co.*, the Court clearly identified the statutory basis for its decision by quoting, in the first sentence of the opinion, Revised Statutes § 4884¹⁸—the predecessor statute of modern § 154. The Court’s holding was also directly based on the limited scope of the rights granted by § 4884, with the Court embracing the view that a patented product, once sold by the patentee, is “discharged of all the rights . . . attached to it, or impressed upon it, by *the act of Congress under which the patent was granted.*”¹⁹

Similarly, in the equally important case of *Motion Picture Patents Co. v. Universal Film Manufacturing Co.*, the Court began its legal analysis by stating that the case:

requires that we shall determine the meaning of Congress when in Rev. Stats., § 4884, it provided that “Every patent shall contain . . . a grant to the patentee, his heirs or assigns, for the term of seventeen years, *of the exclusive right to make, use, and vend the invention or discovery* throughout the United States, and the Territories thereof.”²⁰

¹⁷ Id. at 742.

¹⁸ See 157 U.S. 659, 661 (1895) (quoting Rev. Stat. § 4884); see also 35 U.S.C. § 154 note (2012) (noting lineage from § 4884). A recent analysis of the historical origins of patent exhaustion identifies *Keeler* as important in the development of “[m]odern exhaustion.” Sean M. O’Connor, *Origins of Patent Exhaustion: Jacksonian Politics, “Patent Farming,” and the Basis of the Bargain* 44–47 (Mar. 7, 2017), <https://perma.cc/WZ6C-QQY8>.

¹⁹ See *Keeler*, 157 U.S. at 661 (emphasis added) (internal quotation marks omitted).

²⁰ 243 U.S. 502, 509 (1917).

The *Motion Picture Patents* Court repeatedly referred to its task as identifying the proper “meaning” of the statute granting exclusive patent rights.²¹

Despite this criticism of the Federal Circuit’s opinion, we have to commend the court for attempting to ground the exhaustion doctrine in statutory law, for the court’s effort will hopefully spur the Supreme Court into clarifying the exact statutory basis of the doctrine. As demonstrated by the briefing in the case, there is currently massive uncertainty on this point. The chart below²² shows the set of possible bases for exhaustion advanced by various actors in the litigation and the effect that the legal basis has on the two issues in the case: (1) whether the doctrine is an optional or mandatory restriction on patent rights, and (2) whether foreign sales trigger the exhaustion of U.S patent rights.

²¹ See *id.* at 510, 513–14 (asserting that the “meaning [of the statutory words] would seem not to be doubtful if we can avoid reading into them that which they really do not contain” and asserting that the result in the case was based on the “plain meaning of the statute”).

²² The briefs submitted in the case are located at American Bar Association, Preview of United States Supreme Court Cases, <https://perma.cc/WE3M-UX4U>

Court/Party/ Amici advancing position:	Exhaustion is based on:	(1) Exhaustion is:	(2) Do foreign sales exhaust U.S. rights?
Federal Circuit	§ 271(a)	Optional	No
Respondent	§ 271(a) (partly) and § 154(a)(1) (partly)	Optional except for parts based on § 154	No
Duffy & Hynes amici brief	§ 154(a)(1)	Mandatory	No
Solicitor General	“Doctrine” (ambiguous as to whether that doctrine is common law or statutory)	Mandatory	No (if patentee reserves U.S. rights at time of foreign sale)
Petitioner and most of petitioner’s amici	Common law or judge-made doctrine justified by particular policy views	Mandatory	Yes
Some of respondent’s amici	“Doctrine” based on judicial assessments of policy	Optional	No

Not surprisingly, the legal basis for the exhaustion doctrine matters. Most obviously, if the doctrine is based on § 271(a) as the Federal Circuit held, then it would be hard to argue that sales with contractual restrictions provide the “authority” or permission necessary to violate the very restrictions imposed in the sale. In other words, the exhaustion doc-

trine would be just a default rule meaning almost nothing if patentees want it so.

Alternatively, if the doctrine (in whole or in part) is based on inferred limits on the scope of patent rights granted under § 154(a)(1), then it would be quite easy to hold (as the Supreme Court did in *Keeler* and *Motion Picture Patents*) that the enforcement of restrictions imposed during sales of patented goods is simply “outside” patent law. In other words, the doctrine (or at least those parts of doctrine based on § 154(a)(1)) should be mandatory, but it should not affect non-patent causes of action. Interestingly, the Respondent’s brief accepts that the *Motion Picture Patents* case is based on the limited scope of § 154 and that, with respect to that portion of the doctrine (the portion of the doctrine grounded in a statutory “delimit[ing]” of the patent rights granted “in § 154”), a patentee cannot opt out by withholding “authority” under § 271(a) because “the patentee cannot withhold ‘authority’ that it never had, like authority to set resale prices.”²³

Finally, if the doctrine is pure federal common law, a variety of different results are possible depending on the Justices’ assessments of good public policy. For example, if the doctrine is based on an “affirmative policy” of federal patent law favoring “the free movement of all patented goods” (as some of Petitioner’s amici allege²⁴), then the doctrine should not only be mandatory but might also render post-sale restrictions on use and resale unenforceable more generally, not merely unenforceable through infringement actions. On the other hand, the opposite result—a merely optional or “presumptive” doctrine (escapable through clear contractual language)—could be supported if the Justices agree with some of Respondent’s amici that the exhaustion doctrine serves “multiple policy objectives” including the policy of permitting patentees to “craft customized usage terms for downstream partners in the commercialization process” and to enforce those terms through infringement actions.²⁵ Or policy factors might point to the Solicitor General’s posi-

²³ Brief of Respondent at 14, *Impression Prods., Inc. v. Lexmark Int’l, Inc.*, No. 15-1189 (U.S. filed Feb. 16, 2017) (emphasis omitted).

²⁴ See Brief of Amici Curiae Intellectual Property Professors and American Antitrust Institute in Support of Petitioner at 3, 6, *Impression Prods., Inc. v. Lexmark Int’l, Inc.*, No. 15-1189 (U.S. filed Jan. 24, 2017) [hereinafter IP and Antitrust Amici].

²⁵ See Brief of 44 Law, Economics and Business Professors as Amici Curiae in Support of Respondent at 3, *Impression Prods., Inc. v. Lexmark Int’l, Inc.*, No. 15-1189 (U.S. Feb. 23, 2017) [hereinafter Law, Economics and Business Amici].

tion, with a mandatory doctrine applied to U.S. sales but an optional or presumptive approach applied to foreign sales. The multitude of potential outcomes should, of course, be expected with a common law approach because everything turns on a judicial assessment of complex policy considerations.

Such a huge range of possible legal bases for the doctrine does not, to put it mildly, contribute to doctrinal clarity, and if the Supreme Court fails to specify a single legal basis for the doctrine, uncertainty and litigation over the issue are likely to continue.

II. The KPR Essay: Mistakes about the Common Law and Exhaustion

Responding to the KPR essay is challenging because the essay is frequently incorrect in its presentation of our views. For example, at the very beginning of its first part, the essay poses an important question and then answers it incorrectly: “Did the common law play a role in the emergence of exhaustion? Duffy and Hynes vigorously argue it did not.”²⁶ The KPR essay provides no quote, paraphrase or citation to support that passage, and our article did not argue that position.

As we stated in the introduction to our article, our thesis is that “[t]he legal doctrine in the area pursues not common law policies disfavoring encumbrances or restraints on alienation, but instead the more nuanced goal of limiting the scope or domain of IP statutes to avoid displacing the law in other fields, such as general contract, property, and antitrust law.”²⁷ The exhaustion doctrine is not itself common law and does not itself pursue substantive common law policies. But that does not mean that the common law played no role in the development of exhaustion. The *existence* of common law (and later statutory law)—with intricate and variable rules concerning the enforceability of restraints on alienation and encumbrances on personal property—*was* important to the development of exhaustion. As we said, the “nuanced goal” of the exhaustion doctrine is to protect other areas of law, including “general contract, property, and antitrust law.”²⁸ And surely, the general law of contracts and property encompasses a great deal of common law.

²⁶ KPR Essay, *supra* note 3, at 10.

²⁷ Duffy & Hynes, *supra* note 2, at 7.

²⁸ *Id.*

The KPR essay does, however, afford us the welcome opportunity to explain some background about our thesis and thereby to clarify a crucial point about the relationship between the exhaustion doctrine and common law. An earlier draft of our article—indeed the version we presented in a workshop to the University of Virginia law faculty—was entitled “Common Law Conformity and the Commercial Law of Intellectual Property,” and it was expressly built around the idea that the exhaustion doctrine developed as an outgrowth of the much-maligned canon that statutes in derogation of the common law should be construed narrowly—the very canon cited by the KPR essay.²⁹ That version of our paper included the central insight that the exhaustion doctrine was trying to avoid displacing large swaths of commercial law, but it also suffered from three weaknesses that ultimately led us to rewrite the paper substantially.

The first and most important weakness is the ambiguity in a thesis tying the development of exhaustion to the common law. Such a thesis could mean that judges limited the scope of IP rights because they did not want to displace certain common law principles with overly broad interpretations of IP rights. But it could also mean that judges developed the exhaustion doctrine as federal common law to reach certain substantive goals, such as a supposed “affirmative policy” favoring the “free movement of all patented goods.”³⁰

Both of those theses might be described as positing that exhaustion has common law origins. To us, however, they are quite different. The first thesis is close to our thesis (with the important caveat, discussed below, that judges might also be trying to avoid displacing vast bodies of *statutory* law too). The second thesis is quite clearly what we are rejecting. Indeed, we view the two theses as incompatible because, to the extent that exhaustion is trying to advance federal policies about the free movement of goods, it risks interfering with the common law of any state that would permit restrictions on the free movement of goods through complex contractual structures³¹ or personal property encum-

²⁹ KPR Essay, *supra* note 3, at 10–11.

³⁰ IP and Antitrust Amici, *supra* note 24, at 3, 6.

³¹ As an example, our article cited Qualcomm’s contracting structures, which undoubtedly restrict the free movement of goods even if patent rights are exhausted after a first sale. Our article remained agnostic about whether such contracts would be enforceable under state contract law, legal under federal antitrust law, or sensible from a standpoint of economic ef-

branches.³² The KPR essay demonstrates the ambiguity about the different possible meanings of asserting that exhaustion has common law origins: the essay asserts both that exhaustion is based on the canon favoring preservation of the common law,³³ but also that exhaustion might sometimes “preempt” state law governing contracts and private property.³⁴

A second problem is that the “common law” thesis in the earlier version of our paper did not fit especially well with what the foundational cases said. The Supreme Court cases framed their holdings as statutory interpretation but did not rely on the canon about construing narrowly statutes in derogation of the common law. *Bobbs-Merrill Co. v. Straus* said that the case presented “purely a question of statutory construction” and mentioned the common law only to emphasize that any common law rights to copyright *were* displaced by the federal copyright statute.³⁵ *Keeler v. Standard Folding Bed Co.* began its opinion by quoting in full the statutory text defining the scope of the patent grant, never mentioned the common law, and sharply distinguished between the law of contracts and “the inherent meaning and effect of the patent laws.”³⁶ *Motion Picture Patents Co. v. Universal Film Manufacturing Co.* also quoted the statutory text defining the scope of the patent grant, highlighted in italics certain words in that statute, and described its task as “interpreting *this* language of the statute.”³⁷ In sum, the more we carefully focused on the foundational cases rather than modern scholarship, the more statutory

efficiency. Prior scholarship, however, has set forth reasons why Qualcomm’s contracts may serve positive economic functions by controlling each step in the productive “value chain.” See Sean M. O’Connor, IP Transactions as Facilitators of the Globalized Innovation Economy, in *Working Within the Boundaries of Intellectual Property: Innovation Policy for the Knowledge Society* 203, 212–28 (Rochelle C. Dreyfuss et al. eds., 2010) (describing Qualcomm’s contracts as desirable “value chain licensing”).

³² See Duffy & Hynes, *supra* note 2, at 60 (explaining that security interests under the Uniform Commercial Code can secure obligations generally and noting that the common law of some states might also permit so-called “personal property servitudes” to enforce obligations on subsequent purchasers).

³³ KPR Essay, *supra* note 3, at 10–11, 14–15.

³⁴ *Id.* at 22.

³⁵ 210 U.S. 339, 346–50 (1908) (discussing authors’ rights at common law but concluding that those “common-law rights are lost” upon publication).

³⁶ 157 U.S. 659, 666 (1895).

³⁷ 243 U.S. 502, 509–10 (1917) (emphasis added).

interpretation took center stage and the common law took on a lesser role.

The case law applying the exhaustion doctrine does sometimes refer to the common law's hostility to restraints on the use or alienation of chattels, as our original article acknowledged.³⁸ Such passages do not pose a problem for our thesis because judges restricting the domain of a statute might be expected to discuss the bodies of law that are being preserved by interpreting the relevant statute narrowly. Thus, in *FDA v. Brown & Williamson Tobacco Corp.*, the Supreme Court discussed the vast body of federal and state law regulating the distribution and sale of cigarettes.³⁹ The Court did so not to prove that the statute at issue there—the Food, Drug and Cosmetics Act—was a law regulating the sale of cigarettes, but to prove the contrary.

A third and perhaps obvious problem with justifying exhaustion as a doctrine for preserving the common law is that the doctrine also preserves the domains of state and federal statutory law regulating contracts, competition, personal property encumbrances, and insolvency. To focus on the common law is myopic. Thus, in the final version of our article, we scrupulously referred to the “general commercial law” as the body of law being protected by exhaustion. That phraseology was designed to be more comprehensive—to include both common law and statutory law. It was not designed to establish, as the KPR essay inaccurately states (again without supporting citations), a “stark dichotomy” between general commercial law and the common law.⁴⁰

One final point: the KPR essay also accuses us of attacking straw men—that there are few if any (1) exhaustion skeptics arguing for “complete freedom to contract around exhaustion,” or (2) exhaustion proponents viewing “the doctrine as a ‘free ranging power’ to ‘allow or forbid a particular transaction.’”⁴¹ Yet both *Impression Products* and the writings of the authors of the KPR essay demonstrate the reality of these positions and the degree of divergence between them.

As correctly recognized by the IP Professors' brief filed in *Impression Products* (and signed by both Professors Katz and Perzanowski), the majority of the judges on the Federal Circuit held that the “exhaustion

³⁸ Duffy & Hynes, *supra* note 2, at 51–52.

³⁹ 529 U.S. 120, 143–59 (2000).

⁴⁰ KPR Essay, *supra* note 3, at 21.

⁴¹ *Id.* at 17 (citations omitted).

doctrine is merely a default arrangement that a patentee can change with contract terms.”⁴² And it’s not just Federal Circuit judges. A group of scholars (including Professor Rub, the third author of the KPR essay) is urging the Supreme Court to affirm the Federal Circuit to “enable innovators and users to waive exhaustion by contract.”⁴³

On the other side of the debate, scholars such as Professor Katz have expressly endorsed a “strong formulation” of the exhaustion doctrine under which “attempting to work around exhaustion rules” should be “invalidated in the absence of a compelling case-specific explanation as to why the work around should be upheld.”⁴⁴ Indeed, the KPR essay itself expressly acknowledges that “[e]xhaustion cannot be a doctrine that is purely designed to preserve other laws, such as contract and private property, if it might also preempt some of those other arrangements.”⁴⁵ That really is a key point of our disagreement with the KPR essay, for the exhaustion doctrine should not be preempting or invalidating non-IP legal mechanisms if, as the foundational Supreme Court cases assert, the doctrine is based on the idea that sold patented goods pass “outside” the scope of the federal statute.⁴⁶

III. Hovenkamp and Federalism

Most of Professor Hovenkamp’s response is devoted to a “modest historical revision” of our thesis, arguing that “[the] exhaustion doctrine developed as a creature of federalism.”⁴⁷ We agree with Professor Hovenkamp that federalism played a part in the development of exhaustion doctrine in the United States. In early U.S. cases now viewed as cases on exhaustion, the courts spoke in terms of dividing areas gov-

⁴² IP and Antitrust Amici, *supra* note 24, at 2.

⁴³ Law, Economics and Business Amici, *supra* note 25, at 31–32; see also *id.* at 7 (arguing that exhaustion should be “generally” inapplicable to sales “made subject to conditions that are expressly communicated and otherwise lawful”).

⁴⁴ Ariel Katz, *The First Sale Doctrine and the Economics of Post-Sale Restraints*, 2014 *BYU L. Rev.* 55, 63 (2014); see also *id.* at 74, 101 (endorsing the “strong” version of the doctrine and arguing that contracting around the doctrine should be “presumptively invalid” and that courts should refuse to enforce contract terms limiting resales unless the IP owner “can demonstrate that the restraint is necessary and superior to other means to achieve efficiency”).

⁴⁵ KPR Essay, *supra* note 3, at 22.

⁴⁶ *Keeler*, 157 U.S. at 661; *Bloomer v. McQuewan*, 55 U.S. 539, 549 (1852).

⁴⁷ Hovenkamp, *supra* note 4, at 26.

erned by the federal law of patents and the state law of contracts and property. Even now, intellectual property law is primarily federal law, and commercial law is primarily state law. State law was even more dominant in commercial matters in the nineteenth century,⁴⁸ so any doctrine limiting the scope of federal IP rights to preserve commercial law would necessarily protect state law and thereby preserve interests in federalism.

To Hovenkamp's modest historical revision, however, we add two modest caveats. First, even though the U.S. exhaustion doctrine developed primarily as protective of state law, the theory developed in the case law was more general—and was thus able to prevent intellectual property law from unduly encroaching not only on state law, but also on areas of federal law such as bankruptcy and antitrust.

For example, without any exhaustion doctrine, a patentee who sells goods on credit could substantially increase its rights in bankruptcy by supplementing a commercial law security interest with a non-transferable license to continue using the goods that is conditioned on the purchaser making the required payments. The Bankruptcy Code grants courts explicit powers to restructure secured loans,⁴⁹ changing the payment schedule, interest rate, and sometimes even the principal amount,⁵⁰ but it does not give courts similar powers to restructure executory contracts like patent licenses.⁵¹ Worse still, not only would the now-bankrupt purchaser lack the power to assign the license so that another firm could use the goods, but most circuits that have examined the issue prohibit the bankrupt entity from assuming patent licenses without the

⁴⁸ Today, federal law governs some commercial law issues such as security interests in maritime vessels (46 U.S.C. § 31301 et seq. (2012)) and aircraft (49 U.S.C.A. § 44108 (2015)). More significantly, federal bankruptcy law often alters commercial rights, but the United States did not have a lasting bankruptcy act until 1898. See David A. Skeel, Jr., *Debt's Dominion: A History of Bankruptcy Law in America* 23 (2001); Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 *Am. Bankr. Inst. L. Rev.* 5, 6, 23 (1995).

⁴⁹ See 11 U.S.C. § 1123(b)(5) (2012) (allowing the court to approve a plan of reorganization that modifies the rights of secured creditors).

⁵⁰ See *id.* § 506 (allowing the court to reduce the amount of a secured claim to the value of the underlying collateral); *id.* § 1129(b)(2)(A) (allowing a court to approve a plan based on a judicial valuation of the promised payments to the secured creditor).

⁵¹ See *id.* § 365 (granting the trustee in bankruptcy, acting on behalf of the bankrupt entity, certain limited powers to assume or reject executory contracts but not granting any power to modify such contracts without the consent of the counterparty).

patentee's consent.⁵² Thus, after bankruptcy occurs, perhaps no one—not even the original purchaser—could use the goods without the patentee's consent. Although the license would not give the patentee the right to repossess the goods, the patentee would have quite a bit of leverage to control or prevent the normal restructuring of claims in bankruptcy because it could prevent anyone from using the goods unless the patentee receives payment in full.

Second, although federalism was important to the development of exhaustion in this country, exhaustion also developed (and still exists) in many countries that lack federalism.⁵³ Our original article provides a possible explanation: limiting the scope of a specialized statute is a sensible reaction to legislative specialization, for it “avoid[s] imposing substantive policies not resolved through the structured, democratic process that is the legislature.”⁵⁴ In short, the doctrine helps keep order, so that different areas of specialized law governing topics such as IP, security interests, bankruptcy, and antitrust remain distinct.

CONCLUSION

The KPR essay concludes that our thesis would “significantly narrow[] the perspective of what exhaustion is and what it should be.”⁵⁵ To this we plead: guilty. We believe that a narrower and more precise explanation of “what exhaustion is” would be a huge positive, for it would help the doctrine better perform its primary function of preventing IP rights from interfering with other complex areas of law.

By contrast, the KPR essay argues that, in determining “the socially desirable scope of IP exhaustion,” scholars (and possibly courts) “should explore the justifications for exhaustion, examine how strong and applicable they are nowadays and going forward, study the effects it has on initial and secondary markets for copyrighted goods, and yes—consider

⁵² See, e.g., *N.C.P. Mktg. Grp., Inc. v. BG Star Prods., Inc.*, 556 U.S. 1145, 1146 (2009) (statement of Kennedy, J., respecting the denial of certiorari) (noting that most circuits will not allow the bankrupt entity to assume executory contracts that are not assignable).

⁵³ See Christopher Stothers, 16th Annual Conference on Intellectual Property Law and Policy of Fordham University School of Law, Patent Exhaustion: the UK Perspective (Mar. 27–28, 2008), <https://perma.cc/7XMN-Q5ZP> (noting that “[i]n most jurisdictions patent rights cannot be used to prevent genuine products which were put on the domestic market from being resold within that jurisdiction”).

⁵⁴ Duffy & Hynes, *supra* note 2, at 32.

⁵⁵ KPR Essay, *supra* note 3, at 24.

other legal (as well as non-legal) ways to regulate those markets.”⁵⁶ And on top of all those factors, the essay is also willing to blend together “common law and statutory interpretation”⁵⁷ without any clear framework of where one begins and the other ends. That approach seems hard to reconcile with the Supreme Court’s general jurisprudential approach to restricting the power of judges to fashion federal common law in areas controlled by federal statutes.⁵⁸ But perhaps even more importantly, it is a recipe for continued confusion in an area of law notorious for its incoherence.

As discussed in the beginning of this response, the *Impression Products* case is a poster child for that incoherence, and we hope that the Supreme Court takes the opportunity to provide a bit of theoretical clarity to the area. Specifically, we hope that the Supreme Court’s ultimate opinion includes a sentence stating something like: “The patent exhaustion doctrine is based on _____.” Of course, we would like to see that blank filled in with “an interpretation of the limited scope of the federal patent rights granted in 35 U.S.C. § 154(a)(1).” But our overarching point is that we really hope that the Supreme Court puts something in that blank.

⁵⁶ *Id.*

⁵⁷ *Id.* at 10.

⁵⁸ See *Lexmark Int’l, Inc. v. Impression Prods., Inc.*, 816 F.3d 721, 734 (Fed. Cir. 2016).