

Intellectual Property: IP and Parallel Importation—Should the U.S., Through IP Laws and Other Means, Protect Businesses from “Gray Goods” Imported Without Manufacturers’ Authorization?

2:00 p.m. - 3:30 p.m.

Grand Ballroom - Overflow: Chinese Room

Prof. F. Scott Kieff, Professor of Law, The George Washington University Law School and Senior Fellow, Hoover Institution, Stanford University

Prof. David S. Olson, Assistant Professor of Law, Boston College Law School

Mr. David Salmons, Bingham McCutchen LLP

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Moderator: Hon. Randall R. Rader, U. S. Court of Appeals, Federal Circuit

Mayflower Hotel
Washington, DC

P-R-O-C-E-E-D-I-N-G-S

JUDGE RADER: I'm with the Court of Appeals for the federal circuit, and with me, I have some magnificent professorial and academic colleagues. We're going to discuss exhaustion, a very demanding topic.

Just a week ago, I was in Tokyo, Japan with my whole court, the first time any court has met with another court in a joint judicial conference anywhere in the world. It was a rather historic meeting, and I could get all excited about that event. We had a mock hearing at that proceeding. The Japanese court heard a case and we heard the identical case, which was chosen by the Chief Judge of the Federal Circuit, and it involved exhaustion. At that hearing, we picked the best lawyers from both countries, and one of those lawyers started with the following hypothetical that I'm going to hit these colleagues with:

I'm in Japan on a trip with my court and I notice that I don't have a watch, and I need one to keep the court running on time. I buy a watch at the local store. Unbeknownst to me, it has is infringing chip in it.

Now, Brethren, when I return to the United States, am I an infringer? Moreover, a year later when I notice that it's running slow and I take it in

for repairs, have I infringed a second time?
Maybe that's kind of an intriguing little hypothetical that'll get us started.

What we're going to do is give each of our panelists five to seven minutes to introduce their take on this issue, and then it will be a free-for-all, which will include you. I hope that as soon as they finish, I see six hands and we'll have an open conversation here.

We're going to start with Professor Kieff. Scott is a magnificent professor at George Washington Law School. He's also a senior fellow at Stanford University Hoover Institution. I remember him most fondly as one of the last clerks to Circuit Judge Giles Rich, one of the legends of my court, I can tell you, Scott made marvelous contributions to our jurisprudence as well as those he's made since his professorial activities.

Professor Kieff.

PROFESSOR KIEFF: Thank you very much. Thank you very much, Chief, for those kind words and for the great hypothetical. I think that the hypothetical does ask us to ask the hard question. It does ask us to dig deep.

As we think about digging deep, let me hit back another hypothetical. You, in the United States, descend from a tribe of people who have populated North America since human beings walked on North America, and you dig down deep into your

land that you own in fee-simple, as your ancestors have owned since human beings walked here. And I'm making the best case for ownership of stuff, clearest chain of title. And you don't go to the library and you don't have access to the inter-webs and you don't talk to other people, but you're really smart.

You dig down into this land you own, and using your own ingenuity, you assemble something; let's call it a widget. If I happen to have a patent on that widget, you infringe. It doesn't matter how clean your title is to the stuff and it doesn't matter how independent your origination is, patent law in the United States and in most of the rest world is designed to say the patentee has a right to exclude you from doing what is covered by the patent, and your access to the information and your access to the stuff are totally irrelevant to the question of whether you infringe.

Either the patent is valid or not, and you infringe or not, but the infringement question is unrelated to the ownership question, even in the best case of ownership and even in the best case of independent creation. So, if that is the answer domestically, and if that is the answer in the best case for your ownership, then it must be the answer when you buy something overseas. That has nothing to do with the patents in the United States or in any other countries where you might encounter a patent. And yes, when you bring the thing into the

second country, you now have an infringing article.

My next response would be, who cares? There are massive numbers of infringements that occur in this country, large numbers of low-value acts of infringement, and our society does not grind to a halt because of it. Cats and dogs don't live together. Government continues to operate. The world continues to turn. And life moves on. Markets and property rights can be totally robust without having them so perfectly enforced that the transaction costs and the hold-up problems and the 'two bites at the apple' or 'four bites at the apple' problem that many people will talk about later today problems don't actually creep in, even though there are acts of infringement.

The bigger issue is, can commercial players arbitrage and game a system of intellectual property rights in multiple countries by buying at a low price and selling at a high price? If you allow that, and that's what many of these cases are about, big commercial players arbitraging different pricing systems, then what you do is you stop price discrimination.

We, in our progressive, pluralist society, are totally correct in being quite skeptical about many forms of discrimination, but we happen to be totally delighted with most forms of price discrimination. Many of you flew here on an airplane, and you could look at the seat, look at the person

sitting in the seat next to you on the flight and compare your price tickets, and I bet you did not pay the same price and yet you got the same rather modest service. You arrived the same one hour late. You sat on the tarmac for the same extra hour. And they said 'thank you' in the same way. Price discrimination is something that we view as quite constructive because it increases access to whatever is being sold, and in fact, it does so in a way that is generally thought to be quite efficient.

So "exhaustion", which is a funny term I'll talk about in a second, and "international exhaustion" are terms that, the way they get used, interfere with something everyone should like, which is productive, efficiency-enhancing price discrimination. International exhaustion should make no sense as a matter of doctrine because IP rights are national in scope, so you're not using your US patent in Japan when you sell a product in Japan, and when the product comes to the US, it now should encounter the US patent. So adding the word "international" to exhaustion is just a distraction.

But don't worry. That's okay because exhaustion is itself a distraction, and here's why. A patent is a right to exclude, so when a patentee sells her product, she is not using her patent. She is using a whole lot of other things, her property interest in whatever she's selling. But what she's not using is her patent. A patent is a right to exclude. So if

you're not using your patent when you sell your patented product, how are you using it up? "Exhaustion" means you've used it up. So the exhaustion doctrine is itself a misnomer.

Now that doesn't mean that the doctrine is baseless. The doctrine really has a totally productive rooting, and the root of the exhaustion doctrine is its alternative name. The alternative name is "first sale", and "first sale" really is a doctrine about what licensing terms get implied into contracts over stuff bought from IP owners. That doctrine says, if you buy something from a patentee, you probably thought you were also buying a license to use whatever you bought. So "first sale" is about implied rights to use what you've bought. But we all know how to get around implication, and that's to be explicit. So, when people are clear that they are not buying a license, courts should not impose licenses.

Thank you.

JUDGE RADER: Thank you, Professor Keiff.

Our next speaker is Dave Salmons, Chair of the Bingham McCutcheon appellate practice group. David was an assistant solicitor general of the United States, where he argued 14 cases before the United States Supreme Court. Let's hear from him.

MR. SALMONS: Thank you, Judge.

Well, I'm going to focus on a couple of Supreme Court cases that many of you will be familiar with. One is the *Quanta*

v LG Electronics case and the other is the *Costco v Omega* case from this last term. I'm going to talk a little bit about the issues that have arisen related to the first sale doctrine or the doctrine of the exhaustion, which are mirror images of one another, in those phases and tell you a little bit about what I think, how they play out in the cases that are still developing in this area. I'm going to bring a more generalist's perspective, more of a practitioner's perspective, because that's what I am.

I think it's important to start with the realization that these issues related to the so-called gray goods arise because there is tremendous potential value to manufacturers and producers of patented and copyrighted works in seeking to control the secondary markets for their products. At the same time, there is tremendous value to consumers, distributors, retailers, and others, perhaps most notably e-commerce in today's age, in ensuring the free alienability of goods in secondary markets. To date, the law has generally disfavored attempts by producers and manufacturers to control those secondary markets through doctrines such as patent exhaustion and the first sale doctrine and copyright. These doctrines, as described, hold that intellectual property interests of the producer entitle it to control the terms of the first sale of the patented or copyrighted work, but that after that first

sale, it's the property rights of the purchaser that become paramount. And the purchaser could sell or dispose of the product in any subsequent transaction without regard to the interests of the producer.

Now, at least in the *Quanta* case, the Supreme Court was very wary of limiting the doctrine of patent exhaustion in a way that would allow its application to turn on a factor that producers have substantial control over, on the fear that producers will manipulate the doctrine and render it largely meaningless. Thus, in *Quanta*, the Court rejected an argument that exhaustion principles should be limited to an apparatus patents and should not apply to method patents. The Court noted that in many instances the line between the two forms of patents was very blurry and that "patentees seeking to avoid patent exhaustion could simply draft their patent claims to describe a method rather than an apparatus." The Court rejected a construction that could lead to an end-run around the exhaustion doctrine.

In *Costco v Omega*, the Court was confronted with a similar problem involving the first sale doctrine under the Copyright Act. Now, as a technical legal matter, the question presented in that case was how to construe Section 109(a) of the Copyright Act, which codifies the first sale doctrine. It states that "the owner of a particular copy or phono record

lawfully made under this Title, or any person authorized by such owner, is entitled without the authority of the copyright owner to sell or otherwise dispose of the possession of the copy or phono record." The dispute was whether the phrase "lawfully made under this Title" carried with it a geographic limitation that excluded copies made outside the jurisdiction of the United States. The manufacturer in that case, Omega argued, and the Ninth Circuit agreed, that because the Copyright Act only applies and has force in the United States, a copy is only lawfully made under the Act if it's made in the United States. The reseller argued that "legally made under the Act" means only that the copy did not violate the Act and the language imposes no geographic limitation at all. It also pointed out that there's no conceivable purpose in Congress favoring goods manufactured abroad and giving them a greater right to control secondary markets than is granted domestically produced goods.

So the Supreme Court took up the case and split 4-4, with Justice Kagan recusing herself because the case was pending in the Solicitor General's Office during her tenure. There were a variety of textual arguments that can be and were made related to how to construe the phrase "lawfully made" under this title based on everything from dictionary definitions to legislative history to how to same phrase is used in other parts of the Act, as well as how the first sale doctrine in Section 109 overlaps

and interacts with the importation provisions of Section 106. Thankfully, I'm not going to go through all those today.

This is what lawyers are paid to fight about, and these are important arguments in the often-unsatisfying search for congressional intent. But there's another important principle that I think is worth keeping in mind, and that is what I want to conclude with today. That is, it's the one that the Court identified in *Quanta*. Namely, that, given the incentives for manufacturers and producers to seek to control secondary and downstream markets, you ought not to construe those important limiting doctrines in a way that would have them turn on a factor that is substantially in the control of the producer, lest you risk an end run around the limitation.

Un *Quanta*, that factor that was subject to manipulation was whether the patentee's claims described a method or an apparatus patent. In copyright, in the *Costco* case, that this factor was the place of manufacture, and the ability to manipulate that factor brings with it the added risk that you create yet another incentive for manufacturers and producers to produce their goods overseas, thus potentially negatively impacting not only secondary markets but the economy more generally.

I submit that it is very difficult to believe that Congress intended to create such an incentive, especially

through a simple reference to copies being lawfully made under the Act. That's especially true because the Copyright Act has a long history of disfavoring goods that were made abroad. And at the same time Congress added the phrase "lawfully made under this Act," it phased out an express place of manufacture provision that discriminated against books that were produced overseas.

These issues continue to work their way through the courts. A divided panel of the Second Circuit recently joined the Ninth Circuit in reading a place of manufacture element in the Copyright Act's first sale doctrine. The Second Circuit panel was troubled with the result, emphasized how close a statutory construction question it was, and all but pleaded with Congress to clear it up once and for all. Perhaps Congress will, but in the meantime, we'll just have to wait for an appropriate case, perhaps this Second Circuit case, and see what Justice Kagan has to say about it.

Thank you.

JUDGE KAGAN: Our third speaker will be Professor David Olson. Professor Olson is an assistant professor at Boston College. Before entering academia, he was a practicing patent litigator at the rather prominent firm of Kirkland & Ellis.

PROFESSOR OLSON: Thank you, Judge. It's great to be

here.

I'm going to dive in a little bit, say some general things, and then get into some specifics, after the issues have already started to be lined up by the first two speakers.

First, at a general level, to me, it seems there are three main questions we're thinking about today for this panel. First, is price discrimination good? Or can it be good? Or when is it good? If it's always bad, then we shouldn't facilitate restrictions on parallel importation rights. So that is the first question, and Scott already spoke to that some. Secondly, if it is good in some cases, how do we allow it in patent and copyright and trademark law? How do we do it currently? How could we do it better? Third, what should the limits on any ability to internationally price discriminate be? I think there is a couple of main worries, one of notice and fairness, and secondly, antitrust concerns. So those are the areas I want to talk about.

Just to add to what Scott was saying about price discrimination, a quick example from the cases that David talked about, one example of price discrimination from the *L'Anza v Quality King* case, is a US manufacture manufactures shampoo in the US, sells it with a lovely botanical label on the bottle, that label gets to be copyrighted, the shampoo, of course, is not operated nor is it patented -- anyone could copy the shampoo

formula and sell it. But anyway, L'Anza sells the shampoo for high price in the US, doing lots of marketing to pump up demand for that but also says, hey, we could sell some in Europe for a lower price, and it's still above our marginal cost; why not do that? So L'Anza sells some in Europe. Then jobbers, people in Europe, figure out they can pick up the shampoo at the price, reimport it into the US, sell it at a medium price, and make profit. Of course, L'Anza doesn't like that at all because it wants to sell only at the high price in the US. The question here is, should L'Anza be able to stop that from happening or should it not?

Another example would be watchmakers. Someone makes a watch, let's say, this time in Switzerland, sells it again for a high price in the US where there's a lot of demand for that brand of watch, sells it, say, for a lower price in Europe; again, someone imports it I don't know, say, Costco starts selling in the US for a cheap price or a medium price. And in this case, the watch manufacturer, again, doesn't like this. One response to this would be, well, too bad you don't like it; raise your prices if you don't like it. But what we should recall, especially we think about intellectual property law and the subsequent copyright patent, what the court used to call monopolies, that goes with that is that what we're trying to do is incentivize innovation and creation of expressive works, and

the way we do this is by giving an exclusive right. Usually, I'd say most economists, not all, but most economists agree, once you've given someone monopoly power, it's good to let them then utilize the monopoly power in the most efficient way possible. Often, the most efficient way possible is to price-discriminate.

So, if we say, you can keep people from parallel importation -- from bringing in these watches or this shampoo at these prices -- then L'Anza or Omega will go ahead and sell the goods at the two different prices. L'Anza or Omega will make more money, but also, consequently, lower-valued users now get to buy this lovely shampoo with the botanical label on it, or the purchasers of watches, which, of course -- in the *Omega* case, what was the IP? It wasn't the watch; it wasn't a patent. It was, if you took the watch off and you looked on the back, there was a little Omega symbol (this isn't an Omega watch; I wasn't able to make it Costco in time to afford one, so this is different.) But, you know, it's this little symbol. And people are just using copyright as the hook to allow this kind of parallel importation. So, in some ways, a critique would be, wait a minute; these aren't people getting their full return for copyrighted good; they're just using it as a hook to prevent parallel importation. Nevertheless, there is a lot to be said for the benefits of price discrimination. Particularly if you

care about wealth inequality, if you care about poor people globally, then maybe you should really like price discrimination because it means we can charge high prices for drugs for US citizens, and we can provide them for cheap or even free to other places in the world without worries that they'll then be reimported back and destroy the profits that can be made here. So those are some thoughts on that.

How does the IP law facilitate international price discrimination? Patent law is territorial, so, if you have a Japanese patent, you have a US patent, you can license someone to sell and make under the Japanese patent and not on the US patent and, therefore, try to prevent some parallel importation copyright law. As David was just pointing out, Section 602(a) gives explicit right to control importation, and of course, the question in Costco v Omega and others is how that conflicts with the first sale doctrine. I think the case was probably rightly decided by the Ninth Circuit and Second Circuit, although the statute is a mess. Congress needs to rewrite because it's ambiguous and unclear. But both of these doctrines serve purposes. Then, when we ask, what should the limitations on them -- I'm running out of time -- but I think what we should look at is, well, when we have worries about notice issues or fairness issues? That's what should shape our limitations. Or, when are manufacturers or others using these for antitrust,

anticompetitive purposes? In which case, antitrust law can come in.

So, now, to answer the Judge's question in the minute I have left, I think, when the Judge buys a watch in Japan, and let's say it's patented or maybe it's copyrighted; maybe it has a lovely face. Either way, there's a patent, let's say, in this case. If it's a Japanese patent, he should have bought it with an implied license to have all rights to use it under that patent. He could get it repaired in Japan. Then he brings back to the US. That's what makes this question tricky. Say there's a separate US patent. There shouldn't be any implication that he bought it with a right to use it under the US law. So I think, in that case, we could argue that it is infringing when he enters the country, and when he gets it repaired. It's infringing every day he wears around because he's using it.

This is little troubling; right? This raises the issue of notice you probably didn't have any notice of this and so that might worry us and we might want to have some restrictive doctrines. On the other hand, as Scott pointed out, I'm not really worried that people are going to try to come out and try to sue the individual consumer who will be out there wearing the watch. What they're going to try to do is, if someone is importing and letting Costco distribute the watches, that is who they're going to go after. So, as a practical

matter, maybe the problem disappears.

JUDGE KAGAN: Thank you.

Our last speaker is Sherwin Sly, who is the Deputy Legal Director at the Public Knowledge Foundation, where he focuses on emerging copyright issues.

Sherwin.

MR. SLY: Thank you.

I focus mostly on popular issues, as you heard, and so I want to focus on the first sale doctrine as it appears in copyright law.

I do want to respond a little bit to some of what my other fellow panelists said first before continuing with my introductory remarks. I think it's interesting. When you look at the questions we are facing here, when I look at the first sale doctrine, my question is what it does for copyright law and why it has its place in copyright law. It's not necessarily a question of, are we concerned with wealth distribution or access to goods? Are we concerned with allowing price discrimination? These are broader questions. But the question behind copyright law really is about incentivizing creation. It's not about incentivizing creation of goods in general. It's about incentivizing the creation of creative works and creative expression.

I don't think that reading the first sale doctrine in

the way that it's been read in *Costco v Omega* leads to that incentivizing of that creation, and maybe it increases the amount of value you can extract out of transactions with a watch. But the watch wasn't the copyrighted object; it was symbol on it. The value in an Omega watch isn't a logo on it. The value in a bottle shampoo isn't the label on it. The goods itself.

So, if you want to be able to allow perfect price discrimination by a producer, copyright law is not the way you want to go about doing that. One of the reasons that you don't want that to happen is because using the first sale doctrine in this way doesn't just allow price discrimination, it actually prevents alienability, and it's not just for that first importer or for that first seller because, if we look at the way exhaustion works in copyright, the question isn't merely about licenses.

The point is, as it was pointed out earlier, a sale of a patented work might not itself be using that work. But by definition, in the statute of copyright law, a distribution of a copyrighted work is a use under Section 106, and that use can be enjoined, can be actionable under the copyright law. So any transfer of any copyrighted work, absent the application of first sale, becomes an infringement automatically. So, by taking goods that are manufactured outside of this country

beyond the scope of that, to say that the first sale doctrine doesn't supply, doesn't just mean somebody can't import a series of textbooks and then resell them. It also means that Judge Rader can't sell his watch that he bought in Japan if it has a copyrighted logo in it. It means not just that he can't sell it; he can't even give it away or loan it or rent it or lease it. That seems very strange and actually, to me, very wrong. So, if you want to find a means for better price discrimination, this isn't the way to go.

I think that, really, what the first sale doctrine does in copyrightable -- it's funny because the "first sale" in copyright law is the misnomer, and exhaustion might actually be more appropriate because the question isn't about where that first sale occurred. The way the statute is framed certainly is, was this copy of this work made lawfully? And the question of whether it says "lawfully made under this Title," does that mean lawfully made under the laws of Title 17? Doesn't mean it would have been lawful if it is made in another country? Does it mean it was lawfully made in this country only. And we can get to the questions of that interpretation in panel discussions in the future.

I think what the first sale doctrine does, what exhaustion does, is it creates a way of dealing with the intersection between copyrights and the rights in personal

property. Because copyrights are so pervasive, they last so long, and they're involved in so many transactions of goods, that without carving out these personal property rights, you would actually have much higher friction transactions and you do see lawsuits against small players along these lines.

The origin story of the first sale doctrine is usually told as *Bobbs-Merrill Co v Straus*. A publisher has a book that they insist must be sold for a dollar or more. They actually have a legend inside it saying that this book must be sold for a dollar. No dealer is licensed to sell it at a lower price. Macy's sells it for 89 cents and they're sued for copyright infringement. And that's the origins of why we have the first sale doctrine -- because the Supreme Court said, you don't want to have this sort of control of chattels by the manufacturer throughout its entire lifetime as it passes from hand to hand. We don't want there to be this control by the manufacturer. We don't want there to be this transaction cost every single time you buy something that contains a copyrighted work. Are you going to want to have to trace that chain of title, gain the permission of the copyright-holder? That, absent the first sale doctrine, is what you would have to do.

A lot of people like to look at the first sale doctrine as just an exception or a limitation applying to the distribution rights of copyrighted works. It's true that it is

that, but it's rooted in much more than that. And there are pre-*Bobbs-Merrill* cases from 1894, from 1901, and so on that involve slightly different fact patterns. For example, somebody buys a bunch of scrap paper, a bunch of waste paper that was damaged in a fire at a book warehouse, and they reassemble these pages into actual books and then sell them. The Court finds that that's okay. They've bought these goods and bought the title to the goods, and they have the right to repair them. This happened with children's books that were water-damaged. In that case, the Seventh Circuit actually found that it was fine for them to recreate the covers of the books as well. And there have been other cases, as well, where people would buy comics off the shelf, compile them, and sell them as double comics.

And so I think this shows us that there's something more at work here. And this was before the first sale doctrine as we now know it was codified in 1909 Act and then recodified again in the '76 Act. But at the root of the first sale doctrine is not just a neat sort of carve-out in the distribution right, but a real understanding that once I've bought a thing, once I've bought a book, this copy of that is mine to do with as I please, and I shouldn't let the hand of the copyright owner reach across however many transactions for before and stop my dealing with it.

So it's important for us to understand not just what

our broader policy goals might be in commerce, but also what our broad policy goals are in copyright and the purpose of the laws we're trying to use to accomplish these goals.

There's one last thing I want to touch on and then I did want to mention a couple of cases. I won't go into too many details. But a big question that keeps coming up is, what happens with copyrights and software? Because, every time you use a piece of software, a copy of it is made into the memory of your computer. As a reproduction not distribution, it's not dealt with in Section 109's first sale doctrine. There is a separate provision in the law, Section 117, that says, if you buy a piece of software, if you're the owner of that copy, you can make all of the copies that are that are necessary to use that program. Now what happens in pretty much every single piece of software that's ever sold is you have this long end-user license agreement that comes along with it, and in that fine print is also a statement that, says you're merely licensing the software; you are not buying it. And that, according to the Ninth Circuit Court in *Vernor v Autodesk* and *MDY v Blizzard* controls what the characteristics of that transaction were.

It doesn't matter what I thought when I walked into a store, picked a box off the shelf, put it on the register and paid for it. Even if I think that's a transaction, that is, a

sale, that makes me the owner of this copy -- not of the copyrights in the disk but of the disk itself -- regardless of what I think, that means that whatever I do, any time I use that piece of software, I'm infringing copyrights unless I obey all of the terms of that end-user license agreement. Now this is a means by which you can escalate what would be a simple purchase contract into a copyright violation.

And again, I think what you're seeing here is a particular set of laws and rules in copyright that are fairly ubiquitous but, because they're ubiquitous, can be used to affect a purpose that they weren't intended to.

Thanks.

JUDGE RADER: Let's do this. Let's go through each speaker again and give them two minutes to respond to each other and give their additional thoughts, and then we'll go to you with questions, or I have a couple.

Professor Kieff?

PROFESSOR KIEFF: Thank you very much. I greatly enjoyed the comments from the other panelists.

I guess one session I would ask is, when you buy a very expensive watch or camera or other device and it has a logo on it, my guess would be that if you brought it into a repair shop owned by the company who is associated with that logo and they told you, well, you don't have exactly the right logo and

so we will not stand by the wonderful iron-clad, solid gold warranty you expect, take your watch and good luck, you'd be quite annoyed. Those logos actually are terribly important. It's nice to trivialize them, except everybody realizes they matter a ton.

When you buy a very expensive piece of equipment, you're buying not just what you think you get when it arrives on your doorstep but the whole set of service and quality that will last after that point and the relationship between the intellectual copyright and the control, which is the word everyone keeps using, is so essential to allowing that follow-up service. Absent the service, absent the quality, much lower price, much worse for everybody. So I know it's nice to trivialize it. It just turns out, logos do matter. And if you think they don't, just ask your fellow trademark lawyer.

I guess it's okay to imagine somebody saying, hey, I want to walk into a McDonald's and I want to get a totally different quality hamburger, a totally different quality shake. That's not why you go to McDonald's. If you want a different quality, you go to a different brand. So there really are customer values here that are respected by enforcing the IP and buy enforcing the relationship between the IP owner and the distributors.

JUDGE RADER: Thank you.

PROFESSOR KIEFF: Thank you.

JUDGE RADER: Let's go on to David.

PROFESSOR OLSON: I just would add a couple things. One that I don't think we've addressed enough is the potential transaction costs that get added onto every subsequent transaction in secondary markets across the board if you're not very clear about the rights of the purchaser.

Take eBay, for example, and all of the goods that are sold there; I don't know how many transactions a day. How are you supposed to know where a good was manufactured? How are you supposed to know under the terms? This is a big part of the economy. Secondary markets make a substantial amount of aspects of the economy. You need those to be efficient, as well, as creating incentives for the creation of the goods in the first instance. And that's the balance that gets struck. It's not one-sided.

It is the rights of purchaser and the normal property rights associated with that, that get built into the system. And if you allow things that are just added into some of these of these agreements and the like or you make a turn on things that nobody can know, like where it was produced half the time, you're really increasing the transaction costs for those secondary markets.

JUDGE RADER: Thank you.

David?

MR. SALMONS: So, a couple of thoughts. First, Sherman asked, if we could be sure, with exhaustion law and first sale, you know, could Judge Rader sell his watch? Could he even give it away? I'll take it, Judge, so if you've got it here, I'm not particularly worried about being sued afterwards. Let's say it's Omega or whichever watch brand. I'm not worried they're going to be suing, which goes to what Scott was saying.

Another thought I had was, Sherman said that without the first sale, once there's been a sale, the rights of the purchasers become paramount, and I don't really understand what that means. It also makes me think that, you know, I might be quite willing to pay a much lower price in exchange for lots of restrictions. I'm not a professional carpenter; you sell me a drill for much cheaper, I promise I won't use construction jobsites. That, to some people, might seem terribly unfair, but I might be really happy to get the drill for a quarter of the price if I agree to those restrictions. If I, as the consumer, am being made better off, if we come along with this philosophy that says, no, you're being hurt because once the purchase happened, your rights have to become paramount, I might start saying, no, no, I liked the rights I had when he was able to restrict me more.

So, if we're thinking about consumer welfare, I agree

with Scott, thinking in terms of rights of control and talking about the language without thinking about the actual effects and economics of it can be a little misleading. I'll stop there.

JUDGE RADER: Sherwin?

MR. SLY: Thanks.

What I wonder is, when are we going to rely upon principle and when are we going to be realistic? Having a system in which every single person who deals in secondhand goods or who gives things away being potentially liable is not tenable, whether or not you expect to be prosecuted for it. If you have the ability to sue somebody for this, it's going to be abused in some sense, in some way, when it's something that somebody can just throw on in another complaint. I mean the question of whether or not you can add value to something by having a brand and a quality that you stand behind, we'll, that's actually not a question of copyright; it's a question of trademark. And yet *Costco v Omega* wasn't filed as a trademark suit.

And if we are going to be asking about the practicalities of the situation and not just sort of the potential eventualities, then I think the question of what happens when you have an extremely long and detailed contract as a matter of ordinary business practice attached to every single piece of software sold, let's be realistic -- how many of those

are read? How many of those are read and understood? And what are the transaction costs for every single user in that market? There's a question of, well, we have these doctrines and we have a commerce still continuing. But when we're talking about copyrighted goods, not necessarily just patents, but I think, patents as well, the question is, how much of the market do you want to be able to participate freely in this exchange? Those transaction costs do exist, and they do prevent smaller actors from engaging in that market.

JUDGE RADER: Thank you.

Questions from any of you?