THE MURKY WATERS OF FIRST SALE: PRICE DISCRIMINATION AND DOWNSTREAM CONTROL IN THE WAKE OF *KIRTSAENG V. JOHN WILEY & SONS, INC.*

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Woven into the fabric of U.S. intellectual property law is the fundamental tension between providing incentives for creative innovation and facilitating access to the fruits of that innovation. As widely acknowledged as that tension may be, the policy considerations that shape the law run a significant risk of succumbing to the illusion that a sustainable balance between incentives and access has been struck. Indeed, to the naïve observer, the U.S. Constitution's Intellectual Property Clause[1] might appear to provide a clean mechanism for society to benefit from innovation. But a moment's consideration reveals that the Framers' chosen means of granting limited monopolies to innovators countervails their desired end of progress, at least inasmuch as "progress" includes broad access to the products of innovation.

Given its presence at the inception of American legal doctrine, this inherent tension has unsurprisingly permeated the debates that have followed in U.S. copyright law.[2] The result has been a perpetual tug-of-war between innovators' desire to capture the economic benefits of their labor and the public's desire for ready access to their creations. In economic terms, this struggle is simply an instance of the basic conflict between the welfare interests of the supply side and those of the demand side.

Copyright's first sale doctrine represents a tug of the rope toward the demand side by limiting a copyright holder's exclusive right to public distribution of his works.[3] In brief, the doctrine provides that once a

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1. U.S. CONST. art. I, § 8, cl. 8 (empowering Congress "To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries").

2. *See, e.g.*, Glynn S. Lunney, Jr., *Reexamining Copyright's Incentives-Access Paradigm*, 49 VAND. L. REV. 483 (1996).

3. *See* 17 U.S.C. § 109(a) (2012). Within the broader context of intellectual property law, including the patent and trademark regimes, the first sale doctrine may be viewed as part of the larger doctrine of "exhaustion" of intellectual property rights. *See, e.g.*, Michael V.

consumer purchases or otherwise lawfully obtains a copy of a copyrighted work, she may dispose of that particular copy as she pleases.[4] In addition to expressing the law's general disfavor of restraints on alienation, the first sale doctrine promotes the broad dissemination of copyrighted works.

On March 19, 2013, in its landmark 6-3 decision in *Kirtsaeng v. John Wiley & Sons, Inc.*, the U.S. Supreme Court clarified the geographic scope of the first sale doctrine.[5] The key question before the Court was whether U.S. copyright law's first sale doctrine constitutes a regime of "national exhaustion"—whereby the doctrine's limitation of the distribution right applies only to *domestically manufactured* goods—or one of "international exhaustion"—whereby the limitation applies to *all* copyright-protected goods, regardless of their origin of manufacture.[6] The Court ushered in a regime of "international first sale," holding that the scope of the first sale doctrine is not limited to goods manufactured within the United States.[7] Specifically, the Court held that, under the first sale doctrine, defendant Supap Kirtsaeng, a university student who had imported into the United States and resold textbooks that were lawfully manufactured and purchased abroad, did not violate the U.S. copyright owner John Wiley & Sons' exclusive right to distribution of the books.[8]

The importance of this geographic scope of the first sale doctrine springs from the desire of copyright-holding suppliers such as John Wiley & Sons to effect geographic price discrimination—the practice of charging different prices for identical products based on the geographic region in which the sale occurs—with a view toward increasing profits. Under the international first sale framework established in *Kirtsaeng*, however, copyright law allows enterprising parties such as Kirtsaeng to engage in international arbitrage: copyright-protected goods manufactured abroad can now be lawfully purchased at low prices abroad, imported into the United States, and resold at prices that undercut those of the U.S. copyright holder.[9] The resulting competition would ostensibly thwart suppliers' attempts to engage in geographic price discrimination. At first glance, such enhanced competition might be expected to result in lower prices for U.S. consumers, considering

Sardina, Introduction, *Exhaustion and First Sale in Intellectual Property*, 51 SANTA CLARA L. REV. 1055, 1055–57 (2011).

4. 17 U.S.C. § 109(a).
5. 133 S. Ct. 1351 (2013).
6. *See id.* at 1355.
7. *See id.* at 1355–56.
8. *See id.* at 1356–58.
9. *See id.* at 1370–71.

that the United States is often situated among the highest-priced regions in global geographic price discrimination schemes.[10]

But to regard the *Kirtsaeng* decision as a clear-cut victory for free trade and consumer welfare would be shortsighted, for it would fail to account for suppliers' and rights holders' likely *responses* to the Supreme Court's adoption of international first sale. Indeed, from an economic welfare perspective, balancing the costs and benefits of price discrimination is an exceedingly difficult and context-dependent task. As with any economic analysis, much of the complexity of policy determinations in this area stems precisely from the fact that one must consider how economic actors will respond to any proposed policy regime.

In the wake of the decision, U.S. rights holders will likely seek alternative means of price discrimination and downstream control of copyright-protected goods. As a collateral effect, implementation of these alternative means will likely usher in a more rapid transition from "traditional" media to digital media as the preferred vehicle for distribution of goods, where possible. Indeed, there are three potential facilitators of price discrimination that are especially amenable to the digital marketplace: digital rights management technologies, distribution of goods via license rather than sale, and distribution of goods via download rather than physical media. Copyright holders can use these approaches to regain the geographic price discrimination abilities lost under *Kirtsaeng*, but these approaches also facilitate significantly more downstream control than the mere ability to prevent arbitrage by importers.

Precisely due to this heightened degree of downstream control, these "digitally amenable" approaches to price discrimination imperil the fundamental policies of free alienability of chattel and broad access to copyrighted works that underlie the first sale doctrine itself.[11] Thus, these threats of digital distribution to the first sale doctrine reveal that some of the exuberance among consumer advocates after *Kirtsaeng* may be premature.[12]

10. *See infra* notes 87–89 and accompanying text.

11. This proposition is hardly novel, and in fact Professor Asay has already discussed these issues, albeit more briefly, in the specific context of the *Kirtsaeng* decision. *See generally* Clark D. Asay, Kirtsaeng *and the First-Sale Doctrine's Digital Problem*, 66 STAN. L. REV. ONLINE 17 (2013).

12. The following quote provides a colorful example of such a reaction to the decision, albeit in the context of a more balanced assessment of the implications of *Kirtsaeng*: "Perhaps territoriality was not long for this world anyway, given the rise of the Internet, of e-books, and of cheap book scanners. But the Supreme Court just kicked it into a well while screaming 'THIS IS FIRST SALE!'" James Grimmelmann, *Grimmelmann: Issues in Kirtsaeng 'Significant'*, PUBLISHERS WEEKLY (Mar. 20, 2013), http://www.publishersweekly.com/

Because the transition to digital distribution will likely bring to the fore much of copyright law's incongruity with the digital environment, *Kirtsaeng*'s real impact may be to intensify legal debates surrounding the first sale doctrine rather than to resolve them.

Part I of this Note provides statutory and case-law background on the first sale doctrine and the related importation right leading up to the *Kirtsaeng* decision, as well as basic concepts and terminology related to price discrimination. Part II summarizes the Supreme Court's *Kirtsaeng* decision. Part III continues by discussing policy considerations surrounding price discrimination, emphasizing the necessity of context-specific considerations when assessing the welfare effects of promoting or impeding price discrimination. Part IV analyzes the strategies that suppliers will likely employ in response to the *Kirtsaeng* decision in order to preserve some form of geographic price discrimination. These include both "traditional" approaches suitable for distribution of physical goods, as well as strategies particularly suited to distribution in digital formats. These latter strategies avoid significant costs imposed by the more traditional approaches and afford a high degree of control over redistribution of digital goods beyond the ability to effect geographic price discrimination. Accordingly, they will likely provide incentives for suppliers to shift to digital distribution models. Part V concludes by arguing that these "digitally amenable" strategies and the attendant shift to digital distribution raise many of the same policy concerns that influenced the Supreme Court's rejection of a geographical limitation on the first sale doctrine. As such, *Kirtsaeng* has not given the final word on price discrimination or the status of the first sale doctrine.

I. BACKGROUND: THE FIRST SALE DOCTRINE, THE IMPORTATION RIGHT, AND BASICS OF PRICE DISCRIMINATION

A. THE FIRST SALE DOCTRINE AND THE IMPORTATION RIGHT

U.S. copyright law grants rights holders five basic exclusive rights to original works of authorship, the most salient of which, for the purposes of this Note, is the exclusive right to public distribution of copies of a

pw/by-topic/digital/copyright/article/56444-grimmelmann-issues-in-kirtsaeng-too-signifcant-to-end-with-supreme-court.html; *see also* Gary Shapiro, *Supreme Court Gives American Consumers Victory Over Copyright Owners in Kirtsaeng v. John Wiley & Sons*, FORBES (Mar. 20, 2013), http://www.forbes.com/sites/garyshapiro/2013/03/20/supreme-court-gives-american-consumers-victory-over-copyright-owners-in-kirtsaeng-vs-john-wiley-sons.

copyrighted work by sale, other transfer of ownership, rental, lease, or lending.[13]

The first sale doctrine, encoded in § 109(a) of the Copyright Act of 1976 ("1976 Act"), limits a copyright owner's § 106(3) exclusive right to public distribution, providing that "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."[14] The doctrine has its origins in the Supreme Court's 1908 decision in *Bobbs–Merrill Co. v. Straus*, wherein the Court held that upon an initial sale of goods, a copyright holder had fully "exercised the right to vend," and accordingly the copyright statute of the day granted the owner no further right to restrict future sales of the goods.[15] From a policy perspective, the first sale doctrine expresses the law's general disfavor of restraints on alienation.[16] Further, the doctrine acts to promote broad access to and preservation of copyrighted works, to enhance transactional clarity, and to facilitate future innovation.[17]

The first sale doctrine as established in *Bobbs–Merrill* and statutorily encoded in § 109(a) clearly limits a copyright owner's exclusive right to public distribution, but the doctrine's impact on the owner's closely related § 602(a) exclusive right to control importation of goods[18] remained unclear until the Supreme Court's decision in *Kirtsaeng*. Section 602(a)(1) provides that any importation of copyright-protected goods—whether lawfully made or not—without the copyright owner's permission constitutes "an infringement of the

13. 17 U.S.C. § 106(3) (2012) (granting a copyright holder the exclusive right "to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending"). The other four exclusive rights are the rights "to reproduce the copyrighted work in copies or phonorecords," 17 U.S.C. § 106(1); "to prepare derivative works based upon the copyrighted work," 17 U.S.C. § 106(2); to perform the work publicly, 17 U.S.C. § 106(4); and to display the work publicly, 17 U.S.C. § 106(5). For sound recordings, rights holders also possess the exclusive right "to perform the copyrighted work publicly by means of a digital audio transmission." 17 U.S.C. § 106(6).

14. 17 U.S.C. § 109(a).

15. 210 U.S. 339, 351 (1908).

16. *See, e.g.*, Kirtsaeng v. John Wiley & Sons, Inc., 133 S. Ct. 1351, 1363 (2013) (discussing "the common law's refusal to permit restraints on the alienation of chattels" as part of the first sale doctrine's "impeccable historic pedigree"); Herbert Hovenkamp, *Post-Sale Restraints and Competitive Harm: The First Sale Doctrine in Perspective*, 66 N.Y.U. ANN. SURV. AM. L. 487, 493 (2011) ("The first sale doctrine grew out of the common law's strong policy against restraints on alienation . . . .").

17. *See, e.g.*, Aaron Perzanowski & Jason Schultz, *Digital Exhaustion*, 58 UCLA L. REV. 889, 894–901 (2011).

18. 17 U.S.C. § 602(a).

exclusive right to distribute copies or phonorecords" granted by § 106(3).[19] The open question leading up to *Kirtsaeng* was whether or to what extent § 109(a), which limits § 106(3), in turn provided a limitation on the § 602(a) prohibition of unauthorized importation.[20]

Prior to *Kirtsaeng*, the Supreme Court had addressed this question in *Quality King Distributors, Inc. v. L'anza Research International, Inc.*[21] The plaintiff in *Quality King* was a U.S. manufacturer of hair care products, the packaging for which included copyrighted labels.[22] The defendant, a distributor, lawfully acquired the plaintiff's products through another distributor in Malta.[23] The defendant distributor subsequently imported the hair care products into the United States and resold them at discount prices substantially below the retail price charged for the plaintiff's products in U.S. salons.[24] The plaintiff sued for copyright infringement of its distribution and importation rights based on the labels affixed to its products, and the defendant distributor claimed that its importation was protected by the first sale doctrine.[25] The Supreme Court held that § 109(a) did apply to extinguish a copyright owner's right to control importation, reasoning that violations of the § 602(a) importation right are simply particular instances of violation of the § 106(3) distribution right.[26] Therefore, the Court held, the first sale doctrine limits § 602(a).[27] Phrased as such, it may appear that *Quality King* completely settled the applicability of the first sale defense to the importation right.

However, an important factual peculiarity of the case left the door open for some uncertainty regarding the precise scope of that applicability: the goods at issue in *Quality King* had been manufactured in the United States, exported with authorization of the copyright owner, purchased abroad, and finally re-imported to the United States and resold.[28] In other words, the

19. 17 U.S.C. § 602(a)(1). Three types of unauthorized importation are exempt from infringement liability under § 602(a)(1): importation for government use, importation for private use by the individual importer, and importation for educational or religious purposes. 17 U.S.C. § 602(a)(3)(A)–(C). These exemptions notwithstanding, any importation of goods that are themselves infringing—including "piratical" goods created in violation of the copyright holder's exclusive right to reproduction under § 106(1)—constitutes an infringement of the § 106(3) distribution right. 17 U.S.C. § 602(a)(2).

20. *Kirtsaeng*, 133 S. Ct. at 1354–55.

21. 523 U.S. 135 (1998).

22. *Id.* at 135.

23. *Id.*

24. *Id.*

25. *Id.*

26. *Id.* at 149–50.

27. *Id.*

28. *See id.* at 154 (Ginsburg, J., concurring).

plaintiff's copyright-protected labels had made a "round trip," beginning with their manufacture in the United States and ending with their importation into the United States by the defendant. By contrast, in *Omega S.A. v. Costco Wholesale Corp.*,[29] the Ninth Circuit faced a similar case of unauthorized importation with a crucial distinguishing feature—the goods at issue, watches engraved with a U.S.-copyrighted design, were manufactured in Switzerland rather than in the United States.[30] The Ninth Circuit distinguished *Quality King* from existing Ninth Circuit precedent and held that the first sale doctrine did not protect the importation of goods that had been manufactured abroad.[31] Although the Supreme Court affirmed the Ninth Circuit's decision in *Omega*, the Court split 4–4 on the decision, leaving the holding without binding precedential effect outside the Ninth Circuit.[32]

B. THE BASICS OF PRICE DISCRIMINATION

The chief practical importance of the interaction between the first sale doctrine and the importation right is its effect on the ability of producers of copyrighted goods to effectively implement price discrimination. Price discrimination is an economic strategy wherein a supplier divides the market for identical (or substantially similar) goods into segments, charging a different price for the good to consumers within each market segment.[33] The supplier seeking an economically efficient strategy will, of course, only attempt to engage in such price discrimination if it will yield a higher profit than would a strategy of uniform pricing across the market.[34] Even if price discrimination is desirable to a supplier, the strategy will prove useless to him unless he can effectively prevent arbitrage—the practice of purchasing the good in a lower-priced market segment and then reselling it at a profit in a higher-priced market segment. Presumably, if arbitrage is permitted, competition from arbitrageurs will drive the price for the entire market down to that of the lowest-priced segment.[35] In other words, it is essential that the

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29. 541 F.3d 982 (9th Cir. 2008), *aff'd by an equally divided court*, 131 S. Ct. 565 (2010).

30. *See id.* at 983–84.

31. *Id.* at 987–90. More precisely, the Ninth Circuit held that § 109(a) "provide[s] no defense to an infringement action under §§ 106(3) and 602(a) that involves (1) foreign-made, nonpiratical copies of a U.S.-copyrighted work, (2) *unless* those same copies have already been sold in the United States with the copyright owner's authority." *Id.* at 983; *see also infra* notes 50–52 and accompanying text.

32. *See* Costco Wholesale Corp. v. Omega S.A., 131 S. Ct. 565 (2010).

33. *See, e.g.*, William W. Fisher III, *When Should We Permit Differential Pricing of Information?*, 55 UCLA L. REV. 1, 3 (2007). This Note will also use the terms "market segmentation" and "market division" to refer to price discrimination.

34. *See id.*

35. *See id.* at 3–4.

would-be price discriminator be able to keep his market segments firmly divided.

Price discrimination can be implemented in diverse ways, both with respect to the criteria under which market segments are divided and with respect to the means of maintaining their division.[36] The particular form at issue in the *Kirtsaeng* decision is *geographic* price discrimination. Plaintiff John Wiley & Sons divided the market for its textbooks by selling them at different prices in different geographic regions of the world, and it sought to maintain this division by prohibiting importation and exportation of its books between these regions.[37] The importation of foreign-manufactured goods protected by U.S. intellectual property rights without the authorization of the rights holder is known as "parallel importation," and the resale market in the United States for such goods is commonly referred to as the "gray market."[38] Of course, the goal of gray-market resellers is to engage in arbitrage; effectively, the Supreme Court's decision in *Kirtsaeng* permits arbitrage via the U.S. gray market, at least with respect to copyright law.

36. *See id.* at 4. Economists generally characterize price discrimination schemes as either "first-degree," "second-degree," or "third-degree" price discrimination based on the criteria by which the supplier segments the market. In first-degree price discrimination, which is rarely practically implementable, the supplier segments the market into individual consumers, charging each consumer the maximum price she is willing to pay for the supplied good. In second-degree price discrimination, the supplier segments the market according to "hidden" consumer pricing preferences, inducing consumers to reveal their preferences through purchasing decisions. A quintessential example of second-degree price discrimination is "versioning"—the practice of offering similar but distinct versions of a good, such as business-class and economy-class airplane tickets, at different prices. Finally, in third-degree price discrimination, the supplier segments the market according to "overt" consumer characteristics that ostensibly correspond to consumers' pricing preferences. For example, the supplier might charge different prices based on the age group or geographic location of the consumer. *See id.*

37. *See* Kirtsaeng v. John Wiley & Sons, Inc., 133 S. Ct. 1351, 1356 (2013). Geographic price discrimination is, as noted above, a form of "third-degree" price discrimination. *See supra* note 36.

38. To be more precise, gray market goods are goods *lawfully* manufactured and obtained abroad and subsequently imported without the rights holder's authorization; thus, gray-market goods are distinguished from goods whose foreign manufacture or procurement constituted infringement prior to importation. *See, e.g.*, Michael Stockalper, Note, *Is There a Foreign "Right" of Price Discrimination Under United States Copyright Law?: An Examination of the First-Sale Doctrine as Applied to Gray-Market Goods*, 20 DEPAUL J. ART TECH. & INTELL PROP. L. 513, 520 (2010) (citing Quality King Distribs., Inc. v. L'Anza Research Int'l, Inc., 523 U.S. 135, 153 (1998)).

II. INTERNATIONAL FIRST SALE: *KIRTSAENG V. JOHN WILEY & SONS*

The Supreme Court in *Kirtsaeng* framed the issue before it as whether or not the phrase "lawfully made under this title" in § 109(a) worked a geographic limitation into the first sale doctrine.[39] In a 6-3 decision, the Court held that it did not, at last establishing that the first sale doctrine applies to the importation of all lawfully made and lawfully obtained copyrighted goods, including those manufactured abroad.[40]

A. FACTS AND PROCEDURAL HISTORY

Plaintiff John Wiley & Sons, Inc. ("Wiley") is a publisher of academic textbooks.[41] Wiley assigns to its subsidiary John Wiley & Sons (Asia) Pte Ltd. ("Wiley Asia") the rights to publish, print, and sell foreign editions of its textbooks outside the United States.[42] The copies of textbooks published by Wiley Asia are marked with notices forbidding their exportation outside of Europe, Asia, Africa, and the Middle East.[43]

Defendant Supap Kirtsaeng ("Kirtsaeng"), a native of Thailand who moved to the United States for his undergraduate and graduate studies, devised a gray-market arbitrage scheme for textbooks.[44] Kirtsaeng arranged for friends and family in Thailand to purchase foreign editions of American textbooks, including books published by Wiley Asia, and to ship those copies to him in the United States.[45] He then resold the copies in the United States at prices undercutting those of American-manufactured books and retained the residual profits after reimbursing his friends and family.[46]

Wiley filed suit against Kirtsaeng in the Southern District of New York, alleging that Kirtsaeng's importation and resale of Wiley Asia's books constituted infringement of Wiley's § 106(3) exclusive right to public distribution, as well as infringement of Wiley's § 602(a) right to control importation of copyrighted works.[47] The district court found for Wiley, holding that Kirtsaeng's invocation of the first sale defense was unavailing because the doctrine did not apply to copies of copyrighted works

39. *Kirtsaeng*, 133 S. Ct. at 1357.
40. *Id.* at 1355–56.
41. *Id.* at 1356.
42. *Id.*
43. *Id.*
44. *See id.*
45. *Id.*
46. *Id.*
47. *Id.* at 1357.

manufactured abroad.[48] On appeal, the Second Circuit affirmed the district court's holding, interpreting § 109(a)'s reference to copies "lawfully made under this title" as applying only to copies manufactured within the United States.[49]

The Second Circuit's holding created a split between the circuits. In *Omega S.A. v. Costco Wholesale Corp.*, the Ninth Circuit had previously held that the first sale doctrine did in fact apply to copies manufactured abroad, but only when an authorized first sale occurred *within* the United States.[50] Thus, in contrast with the Second Circuit's imposition of a geographic restriction on the first sale doctrine, the Ninth Circuit adopted a hybrid "half-geographical/half-nongeographical" approach,[51] under which the scope of the first sale doctrine is restricted to copies either (1) lawfully manufactured within the United States, or (2) lawfully manufactured outside the United States but whose first sale within the United States occurred with the copyright holder's authorization.[52] Furthering the tension of this split, in *Sebastian International, Inc. v. Consumer Contacts (PTY) Ltd.*, the Third Circuit reasoned that a restriction of the first sale doctrine to copies made within the United States "does not fit comfortably within the scheme of the Copyright Act."[53] To resolve the question of the first sale doctrine's applicability to copies made abroad, the Supreme Court granted Kirtsaeng's petition for certiorari.[54]

B. SUPREME COURT ANALYSIS

In his opinion for the Court, Justice Breyer focused on the question of whether the phrase "lawfully made under this title" in § 109(a) imposes a geographic or a non-geographic limitation on the scope of copies to which the first sale doctrine applies.[55] The Court held the limitation to be non-geographical, so the location of manufacture of copies is irrelevant to determining applicability of the first sale doctrine.[56] As discussed below, in support of this reading, Justice Breyer first relied on the interpretive canons

48. *Id.*

49. *Id.*

50. 541 F.3d 982, 986 (9th Cir. 2008), *aff'd by an equally divided court*, 131 S. Ct. 565 (2010).

51. *See Kirtsaeng*, 133 S. Ct. at 1360.

52. *Id.* (citing Denbicare U.S.A. v. Toys "R" Us, Inc., 84 F.3d 1143, 1149–50 (9th Cir. 1996)).

53. 847 F.2d 1093, 1098 n.1 (3d Cir. 1988).

54. *See* Kirtsaeng v. John Wiley & Sons, Inc., 132 S. Ct. 1905 (2012) (granting petition for certiorari).

55. *See* Kirtsaeng v. John Wiley & Sons, Inc., 133 S. Ct. 1351, 1357 (2013).

56. *Id.* at 1355–56.

of direct textual analysis, legislative intent, and common-law precedent in analyzing the language of § 109(a). He concluded by addressing several significant policy concerns that, according to the Court, weighed in favor of adopting Kirtsaeng's non-geographic interpretation.

1. Statutory Analysis Under a Literal Textual Interpretation

Based on the language of § 109(a), the Court rejected Wiley's interpretation of "under this title" as meaning "in conformance with the . . . Copyright Act *where the Copyright Act is applicable*."[57] As a preliminary matter, Justice Breyer noted that the dictionary meaning of "under," as used in § 109(a), does not denote "where."[58] More importantly, he noted that—if one were to adopt Wiley's reading of the language—injecting a geographic limitation into the phrase "where the Copyright Act is applicable" would be problematic because it would imply that the Copyright Act does not apply to copies made outside the United States.[59] Finally, the Court concluded that the Ninth Circuit's hybrid geographical–non-geographical restriction of § 109(a), to copies either (1) made in the United States or (2) made abroad but first sold in the United States with authorization, cannot be reconciled with any consistent definition of copies "lawfully made under this title."[60] Indeed, Justice Breyer noted that "[a]s a matter of English, it would seem that those five words either do cover copies lawfully made abroad or they do not."[61]

2. Legislative Intent and Common-Law Precedent

In its analysis of the legislative intent behind the first sale doctrine as encoded in § 109(a) of the 1976 Act, the Court first compared the language of § 109(a) with that of its predecessor in the Copyright Act of 1909 ("1909 Act").[62] The first sale doctrine provision of the 1909 Act, appearing in Section 41, limits its application to copies "the possession of which has been lawfully obtained."[63] The Court declined to read the change from that language to the phrase "lawfully made under this title" as an adoption of a

57. *Id.* at 1358 (internal quotation marks omitted).

58. *Id.* at 1359.

59. *Id.*

60. *Id.* at 1360.

61. *Id.* However, the Court did state that it "[could] understand why the Ninth Circuit may have thought it necessary to add the second part of its definition" of the first sale doctrine's scope. *Id.* The Court noted that without a qualification allowing for goods first sold in the United States with the rights holder's authorization, "[a] publisher such as Wiley would be free to print its books abroad, allow their importation and sale within the United States, but prohibit students from later selling their used texts at a campus bookstore." *Id.*

62. *See id.* at 1360–61.

63. Copyright Act of 1909, ch. 320, § 41, 35 Stat. 1075 (amended 1976).

geographic limitation on the doctrine. Rather, the Court interpreted this change as narrowing the class of parties who may invoke the first sale doctrine. That is, whereas under the 1909 Act any lawful possessor of a copy could invoke the doctrine, under the 1976 Act only a lawful *owner* of a copy may do so.[64] In particular, the Court noted that, as a result of the changed language, a lessee who may have been protected by the first sale doctrine under the 1909 Act is no longer so protected by § 109(a) of the 1976 Act.[65]

Next, the Court cited the 1976 Act's phasing out of the "manufacturing clause," which had limited the importation of copies manufactured abroad, as evidence of a congressional intent to establish parity between the treatment of copies made in the United States and the treatment of those made abroad.[66] This policy intent, the Court reasoned, is incompatible with an interpretation of the "lawfully made under this title" language as a geographic limitation on the first sale doctrine.[67]

Finally, the Court relied on the presumption that language should be interpreted consistently when it appears in related sections of a statute.[68] In particular, the phrase "lawfully made under this title," which appears in other subsections of § 109, as well as in § 110(1), creates an exception to the exclusive rights of performance and display, allowing for unauthorized performance or display by a teacher in face-to-face teaching activities.[69] The Court noted that reading a geographic limitation into these sections would have undesirable consequences similar to the policy concerns discussed

64. *See Kirtsaeng*, 133 S. Ct. at 1361.

65. *Id.* Notably, the Court did not directly address whether or not the first sale doctrine applies to copies distributed under *licenses* as a general matter. *See* discussion *infra* Section IV.B.2. However, the Court did suggest that the first sale doctrine should apply to copies distributed under a statutory *compulsory* license, because such licenses are provided for in § 115 of "this title." *Kirtsaeng*, 133 S. Ct. at 1361.

66. *Id.* (citing H.R. REP. NO. 94-1476, at 165–66 (1976)).

67. The court noted:

> The "equal treatment" principle . . . is difficult to square with a geographical interpretation of the "first sale" clause that would grant the holder of an American copyright . . . permanent control over the American distribution chain . . . in respect to copies printed abroad but not in respect to copies printed in America. And it is particularly difficult to believe that Congress would have sought this unequal treatment while saying nothing about it and while, in a related clause (the manufacturing phase-out), seeking the opposite kind of policy goal.

Id. at 1362 (citations omitted).

68. *Id.*

69. *Id.*

below in Section II.B.3 by prohibiting numerous beneficial uses of copyrighted works in the absence of authorization from the rights holder.[70]

Furthermore, the Court relied on an interpretive canon under which courts "must presume that 'Congress intended to retain the substance of the common law'" when enacting legislation codifying existing common-law precedent.[71] The Court noted the first sale doctrine's pedigree as part of the common law's disfavor of restraints on alienation, as well as its promotion of competition, finding that neither *Bobbs–Merrill*, which introduced the first sale doctrine, nor the general common-law doctrine contained any "geographical distinctions."[72]

3. Policy Considerations

In declining to adopt Wiley's geographically restricted interpretation of § 109(a), the Court considered a "parade of horribles"[73] that would potentially contravene the constitutional mandate to "promote the Progress of Science and useful Arts"[74] if the Court were to accept Wiley's reading. Specifically, Wiley's interpretation could potentially impose a significant burden of obtaining permissions—or at least great uncertainty regarding that burden—on institutions that have traditionally relied on the first sale doctrine in their distribution of copies produced abroad, including libraries, used-book dealers, and art museums.[75] Furthermore, technology companies and retailers who routinely sell and distribute products with many component parts manufactured abroad and subject to copyright protection could face a similar burden in obtaining permission to distribute from copyright owners.[76] According to the Court, these threats "help explain *why* American copyright law has long applied [the first sale] doctrine."[77]

By contrast, the dissent—written by Justice Ginsburg, joined by Justice Kennedy, and joined in part by Justice Scalia—downplayed these policy

70. *Id.* For example, the Court noted that if a geographic limitation were read into other subsections of § 109, an automobile owner in America could not display a bumper sticker purchased in Canada without authorization from the copyright owner, and an arcade owner could not perform or display an arcade game manufactured in Japan without similar authorization. *Id.* Moreover, American teachers could not lawfully present foreign-made copies of films in class without rights-holder authorization if a geographic limitation were read into § 110(1). *Id.*

71. *Id.* at 1363 (quoting Samantar v. Yousuf, 560 U.S. 305, 320 n.13 (2010)).

72. *Id.* at 1363–64.

73. *See id.* at 1373 (Ginsburg, J., dissenting).

74. U.S. CONST. art. I, § 8, cl. 8.

75. *See Kirtsaeng*, 133 S. Ct. at 1364–65.

76. *See id.* at 1365.

77. *Id.* at 1365–66.

concerns.[78] Instead, the dissent focused largely on the policy issue of affording copyright owners the right to divide domestic and foreign markets, thereby enabling them to engage in price discrimination shielded from the competitive effects of arbitrage.[79] In this vein, the dissent cited the Court's treatment of the § 602(a)(1) right to control importation in *Quality King*.[80] In particular, Justice Ginsburg cited language from *Quality King* specifically suggesting a geographic restriction of the kind that Wiley argued for, namely "that § 602(a)(1) authorizes a copyright owner to bar the importation of a copy manufactured abroad for sale abroad."[81] Justice Ginsburg further focused on the legislative history of the § 602(a)(1) importation ban, rather than that of § 109(a), in support of the dissent's conclusion that Congress did not intend the first sale doctrine to apply to copies manufactured outside of the United States.[82] Indeed, the dissent argued that the Court's holding in *Kirtsaeng* "reduces § 602(a)(1) to insignificance."[83]

78. *See id.* at 1373–74 (Ginsburg, J., dissenting) (stating that "[t]he Court's parade of horribles . . . is largely imaginary").

79. *Id.*

80. *Id.* at 1374–76 (citing Quality King Distribs., Inc. v. L'anza Research Int'l, Inc., 523 U.S. 135 (1998)).

81. *Id.* at 1376. Specifically, Justice Ginsburg quoted the following passage from the Court's *Quality King* decision:

> If the author of [a] work gave the exclusive United States distribution rights—enforceable under the Act—to the publisher of the United States edition and the exclusive British distribution rights to the publisher of the British edition, . . . presumably only those [copies] made by the publisher of the United States edition would be "lawfully made under this title" within the meaning of § 109(a). The first sale doctrine would not provide the publisher of the British edition who decided to sell in the American market with a defense to an action under § 602(a) (or, for that matter, to an action under § 106(3), if there was a distribution of the copies).

Id. at 1375 (quoting *Quality King*, 523 U.S. at 148).

82. In particular, Justice Ginsburg cited to the House and Senate Committee Reports on the 1976 Act:

> Section 602 [deals] with two separate situations: importation of "piratical" articles (that is, copies or phonorecords made without any authorization of the copyright owner), and unauthorized importation of copies or phonorecords that were lawfully made. *The general approach of section 602 is to make unauthorized importation an act of infringement in both cases*, but to permit the Bureau of Customs to prohibit importation only of "piratical" articles.

Id. at 1382 (quoting and citing S. REP. NO. 94-473, at 151 (1975) (emphasis added); H.R. REP. NO. 94-1476, at 169 (1976)).

83. *Id.* at 1378.

In response to the dissent, the Court noted that the cited statement from *Quality King* is "pure dictum."[84] And, although conceding that its decision potentially diminished the significance of § 602(a)(1), the Court gave examples of situations where the importation ban would still apply, all involving importation by parties who are not "owners" of the goods at issue.[85] In response to the dissent's assessment of congressional intent, the Court noted that "the historical events to which [the 1976 Act's legislative history] points took place more than a decade before the enactment of the Act and, at best, are inconclusive."[86] With regard to the more general policy issue of affording the power to effect market division, the Court found no mandate within the intellectual property clause of the Constitution to afford such a power.[87] The question of whether or not that power should be promoted, according to the Court, should be left to Congress.[88]

III. POLICY CONSIDERATIONS SURROUNDING GEOGRAPHIC PRICE DISCRIMINATION

Before exploring the future implications of the *Kirtsaeng* holding, it is instructive to examine some of the policy considerations surrounding price discrimination. Justice Breyer's analysis of price discrimination in *Kirtsaeng* was apt in its specificity. That is, instead of adopting a broadly positive or negative view of price discrimination in the abstract, Justice Breyer addressed particular policy concerns that would arise from facilitating the practice through a geographic limitation of the first sale doctrine.[89] But those underlying concerns remain as relevant after the Supreme Court's decision as

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84. *Id.* at 1368 ("[The cited statement] is dictum contained in a rebuttal to a counterargument. And it is *unnecessary* dictum even in that respect. Is the Court having once written dicta calling a tomato a vegetable bound to deny that it is a fruit forever after?").

85. *Id.* at 1368. In her concurrence, joined by Justice Alito, Justice Kagan appeared to be more concerned about the diminished significance of the importation ban, but she noted that the Court's holding was inevitable in light of *Quality King*'s "holding that § 109(a) limits § 602(a)(1)." *Id.* at 1372–73 (Kagan, J., concurring).

86. *Id.* at 1369. This response is somewhat puzzling and not entirely satisfying, given that the dissent cited House and Senate Reports dated from 1975 to 1976 in its analysis of congressional intent. *See supra* note 82.

87. *Kirtsaeng*, 133 S. Ct. at 1370–71 ("[T]he 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. Neither, to our knowledge, did any Founder make any such suggestion.").

88. *Id.* at 1371 ("Whether copyright owners should, or should not, have more than ordinary commercial power to divide international markets is a matter for Congress to decide. We do no more here than try to determine what decision Congress has taken.").

89. *See id.* at 1364–67.

they were before, and accordingly they are crucial to understanding the decision's ramifications in the changed landscape of international first sale.

Much of the twentieth-century legal scholarship addressing price discrimination in the context of copyright law took a decidedly "rosy view" of the practice, and facilitation of price discrimination has sometimes been cast as an unqualified benefit in policy considerations.[90] However, economists generally agree that in fact the social welfare effects of price discrimination are too complex to analyze in full generality.[91] Thus, price discrimination cannot serve as a self-sufficient justification for a given copyright policy, and any policy analysis must take into account the specific context and collateral effects of the particular price discrimination scheme at issue.

Due to this need for specificity, this Part will restrict attention to the context of price discrimination at issue in *Kirtsaeng*—namely, that of geographic price discrimination and parallel importation. Furthermore, it will be appropriate to particularize further and consider the welfare effects of using a geographic restriction on the first sale doctrine as the means of maintaining market division.

A. GENERAL ECONOMIC SURPLUS CONSIDERATIONS

Although price discrimination unequivocally increases supplier surplus,[92] the effects of geographic price discrimination on consumer surplus and net surplus are decidedly unclear. A primary argument against geographic price discrimination, and therefore in favor of permitting gray-market activity, comes from a free-trade, consumer-advocacy viewpoint. Simply put, U.S. consumers often find themselves among the highest-priced market segments

90. *See, e.g.*, Michael J. Meurer, *Copyright Law and Price Discrimination*, 23 CARDOZO L. REV. 55, 64 (2001); *see also id.* at 64 n.30 (discussing shortcomings of prior copyright scholarship on price discrimination and noting that, with few exceptions, much of such scholarship failed to "link specific copyright doctrines to price discrimination"); Wendy J. Gordon, *Intellectual Property as Price Discrimination: Implications for Contract*, 73 CHI.-KENT L. REV. 1367, 1369 (1998) (noting that "the tool of price discrimination [had, at the time of writing,] recently been employed as if it were self-justifying").

91. *See* Fisher, *supra* note 33, at 22 ("[I]t is impossible to say, in the abstract, whether price discrimination increases or decreases aggregate social welfare. Rather, whether it is beneficial from the standpoint of allocative efficiency depends upon the character of the markets that the discriminating firm seeks to keep separate . . . ."); Ariel Katz, What Antitrust Law Can (and Cannot) Teach About the First Sale Doctrine 20 (Jan. 23, 2012) (unpublished manuscript) (on file with author), *available at* http://ssrn.com/abstract=1845842 ("Differences in local demand may be the outcome of a myriad of reasons, with the result that it is impossible to generalize and determine a priori whether price discrimination should be encouraged or not.").

92. *See supra* note 34 and accompanying text.

in geographic price discrimination schemes,[93] and therefore they might enjoy lower prices as a result of heightened competition in the absence of such schemes.[94] That is, competition from secondary markets created by gray-market arbitrageurs who are able to undercut suppliers' prices should theoretically pressure suppliers to lower their prices in the U.S. market.[95]

The most obvious rebuttal to this argument is that suppliers will not allow it to bear fruit. According to this opposing argument, large-scale gray markets simply cannot sustain themselves for long because suppliers will raise worldwide prices in order to undermine competition from arbitrageurs.[96] The resulting price increase in lower-income foreign markets—or the abandonment of those markets altogether—will therefore harm consumers in lower-income segments of the supplier's geographic division and result in a deadweight loss.[97]

However, as compelling as this counterargument to the free-trade argument may be, it is not conclusive. Even from the point of view of maximizing global economic welfare—as opposed to focusing on consumer welfare in higher-priced market segments—this argument does not take full

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93. *See, e.g.*, David A. Malueg & Marius Schwartz, *Parallel Imports, Demand Dispersion, and International Price Discrimination*, 37 J. INT'L ECON. 167, 191 (1994) (characterizing the United States as a "rich countr[y]," which is likely to "pay relatively high discriminatory prices").

94. *See, e.g.*, FREDERICK M. ABBOTT, INT'L INST. FOR SUSTAINABLE DEV., PARALLEL IMPORTATION: ECONOMIC AND SOCIAL WELFARE DIMENSIONS 6 (2007), *available at* http://www.iisd.org/pdf/2007/parallel_importation.pdf; Katz, *supra* note 91 at 17.

95. *See, e.g.*, ABBOTT, *supra* note 94, at 6. From a less United States-focused perspective, free-trade advocates have suggested that competition resulting from the gray market may lead to lower worldwide prices. *See, e.g.*, Matthias Ganslandt & Keith E. Maskus, *Vertical Distribution, Parallel Trade, and Price Divergence in Integrated Markets*, 51 EUROPEAN ECON. REV. 943, 944 (2007) (asserting that support for parallel importation essentially rests on "a belief that parallel imports . . . generate competition at the retail level, inducing a tendency toward retail price convergence and pro-competitive gains from price integration").

96. *See* Guy A. Rub, *The Economics of* Kirtsaeng v. John Wiley & Sons, Inc.*: The Efficiency of a Balanced Approach to the First Sale Doctrine*, 81 FORDHAM L. REV. RES GESTAE 41, 47 (2013) (predicting that "if massive international arbitrage is allowed, the price will probably be high worldwide"); Malueg & Schwartz, *supra* note 93, at 190.

97. *See* Rub, *supra* note 96, at 46; Fisher, *supra* note 33, at 25 ("[P]rice discrimination often, though not invariably, results in a progressive redistribution of wealth . . . because occupants of the lower-margin submarket are often poorer than the occupants of the higher-margin market."). Economics professors David A. Malueg and Marius Schwartz explain:

> If parallel imports are prevented, at least between certain groups of countries, firms could offer lower prices to lower-demand (more elastic) countries without fear of the products resurfacing in high-price markets. Absent such (partial) segmentation, firms may well choose relatively high uniform prices, at which many low-demand countries are likely to go unserved.

Malueg & Schwartz, *supra* note 93, at 190.

account of the effects of income disparities within market segments.[98] Similarly, although much of the focus of this counterargument is on lower-income markets' becoming underserved, the ethical considerations underlying the counterargument might be complicated by the fact that demand curves can differ between market segments for reasons other than income.[99]

B. GENERAL INTELLECTUAL PROPERTY POLICY CONSIDERATIONS

Within the context of copyright, or of intellectual property rights more generally, proponents of fostering price discrimination by curbing parallel importation also marshal a "copyright maximalist" argument—namely, that any systematic economic benefit that inures to rights holders serves to encourage creativity and innovation.[100] With nothing more, such an argument

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98. More precisely, even in the absence of parallel importation, suppliers may deem it economically efficient to sell low volumes of goods at relatively high prices in lower-income market segments, targeting only the wealthiest consumers in those segments. *See* Sarah Wasserman Rajec, *Free Trade in Patented Goods: International Exhaustion for Patents*, 29 BERKELEY TECH. L.J. 315, 363 (2014) (discussing this possibility within the context of patent exhaustion in the pharmaceutical industry); *cf.* Fisher, *supra* note 33, at 25 (noting that price discrimination may result in a "downward" redistribution of wealth that increases social welfare, contingent upon the assumption "that utility curves are randomly distributed within the population of pertinent customers"). In effect, then, it is not immediately clear that shutting down the gray market would increase access to goods for individual lower-income consumers at a global scale. Furthermore, the basic effect of price discrimination on global welfare measured in terms of net surplus is inconclusive; price discrimination may either increase or reduce output and net surplus from a global perspective. *Compare* Meurer, *supra* note 90, at 100 (noting that price discrimination may decrease output and that, even if output increases, overall allocative efficiency may decrease), *with* Malueg & Schwartz, *supra* note 93, at 190 (concluding that, under the constraints of a certain theoretical model, price discrimination may provide a Pareto improvement over uniform pricing, in terms of net surplus).

99. For example, textbook prices in the United Kingdom are significantly lower than in the United States; the price difference has been conjecturally attributed to differences between educational practices in the two countries rather than to any income disparity. *See* Christos Cabolis et al., *A Textbook Example of International Price Discrimination*, 95 ECON. LETTERS 91, 94–95 (2007). Professor Ariel Katz explains:

> [P]rice differences may be a function of differences in the cross-elasticity of demand between the product and other products within each country. That is, consumers in countries A and B with the same disposable income might be willing to pay different prices for the same product because they have different preferences for the product given available alternatives.

Katz, *supra* note 91 at 20. Thus, price discrimination may not always function to benefit lower-income markets at the expense of higher-income markets.

100. *See, e.g.*, Meurer, *supra* note 90, at 95 (noting that supporters of expanded copyright protection tend to support price discrimination, because "price discrimination raises profit to copyright owners and attracts more investment to copyright dependent industries"); Rub,

is overly simplistic: it focuses solely on incentives for innovation without considering their effects on society's ability to enjoy the fruits of that innovation. In other words, it addresses only one side of the balance of access and incentives that copyright law seeks to achieve.[101] The traditional copyright maximalist argument is simply that price discrimination promotes an ideal balance. To wit, even in situations where price discrimination reduces output and diminishes allocative efficiency, the resulting increase in "dynamic efficiency"—that is, efficient encouragement of innovation—provides a worthy trade.[102] This argument may be countered by the assertion that price discrimination's economic rewards to rights holders can exceed the incentives necessary to promote the production of creative works, and as such price discrimination is simply a form of rent-seeking by copyright holders.[103] The debate surrounding the access-incentives balance is of course the fundamental economic tension at the heart of copyright law,[104] and it is no more easily settled in the specific context of price discrimination than in general.

Proponents of price discrimination could also argue that a lack of price discrimination will lead to higher prices in lower-income countries, which in turn will lead to increased piracy in those countries to compensate for diminished access to works. Some commentators argue that piracy itself is not unequivocally harmful from the perspective of social welfare because there may be circumstances in which piracy might be an acceptable price to pay for increased access in lower-income countries.[105] However, as a matter

supra note 96, at 46; Gordon, *supra* note 90, at 1368–69 ("Price discrimination increases a producer's revenues, and thus potentially increases incentives.").

101. *See* Gordon, *supra* note 90, at 1369 (noting that price discrimination "can also raise price[s] and reduce quantities, without yielding any incentive payoff large enough to compensate"); Lunney, *supra* note 2, at 492–98 (discussing the basics of the "incentives-access paradigm" in copyright law).

102. *See, e.g.*, Meurer, *supra* note 90, at 98; Fisher, *supra* note 33, at 25; RICHARD A. POSNER, ANTITRUST LAW 203 (2d ed. 2001).

103. *See, e.g.*, Gordon, *supra* note 90, at 1369 n.4 ("The increase in incentives is 'potential' rather than inevitable, because at some point incentives will be adequate to call forth the desired work, and any further increase in revenues will be pure rent."); Meurer, *supra* note 90, at 95–97 (arguing that the socially optimal incentive for creation "usually arises at some profit level that is less than expected total surplus" and that "the private incentive created by expected profit can easily exceed the expected social value of a work"); *see also id.* at 100–02 (discussing additional preservation and implementation costs stemming from rent-seeking by copyright holders).

104. *See, e.g.*, Meurer, *supra* note 90, at 98 ("Economists have long understood that an optimal copyright policy balances the dynamic efficiency concerns relating to the incentive to supply works with the allocative efficiency concerns relating to access.").

105. *Cf.* Fisher, *supra* note 33, at 36 (asserting that "[p]rice discrimination is bad if it corrodes the spirit of altruistic sharing of ideas and innovations" and noting that "[i]t is

of directing legal policy, it would seem doctrinally distasteful—if not unacceptably self-contradictory—to adopt copyright policy that knowingly encourages infringement. But where such infringement arises as a side effect of economic practices, such as price discrimination or the lack thereof, these deleterious effects must be weighed against competing concerns in the context of the specific copyright policy at issue.

C. POLICY CONCERNS RELATED TO INTERNATIONAL FIRST SALE

The preceding discussion should illustrate that the debate surrounding price discrimination, both in terms of general welfare effects and in terms of copyright law policy, is complex and difficult to resolve. However, focusing further on the question presented in *Kirtsaeng*—namely, whether a geographic limitation on the first sale doctrine is an appropriate mechanism to effect geographic price discrimination—facilitates more concrete arguments.

First, limiting the first sale doctrine to goods manufactured in the United States would introduce a "free-rider" problem: it would turn U.S. copyright law into a source of economic advantage for foreign manufacturers who do not contribute directly to the U.S. economy.[106] That is, foreign suppliers would be able to market their goods in the United States at high prices insulated from the threat of gray-market arbitrage, whereas domestic suppliers would not. As a corollary, and perhaps more importantly, this free-rider effect would create a perverse incentive for U.S. suppliers of copyrighted works to relocate their manufacturing operations abroad.[107]

The decisive factor in the Supreme Court's decision in *Kirtsaeng* could be seen as the desire to avoid the parade of horribles that could result from imposing a geographic limitation on the first sale doctrine—namely, the adverse effects that would arise if libraries, used-book sellers, retailers, and other downstream redistributors were required continually to obtain distribution permissions from copyright holders.[108] Accordingly, *Kirtsaeng* may

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reasonably common for intellectual property owners to charge uniform prices for access to their works but then either to provide access for free to (or tacitly to tolerate unauthorized usage by) persons who cannot afford the flat price").

106. *Cf.* NEC Elecs. v. CAL Circuit Abco, 810 F.2d 1506, 1511 (9th Cir. 1987) ("This country's trademark law does not offer [the plaintiff] a vehicle for establishing a worldwide discriminatory pricing scheme simply through the expedient of setting up an American subsidiary with nominal title to its mark."); Rajec, *supra* note 98, at 339 ("There is nothing constitutive of patent law that requires protecting the national market for the patent holder's benefit when the patent holder does nothing *for* the domestic market in exchange.").

107. *See* Melissa Goldberg, Note, *A Textbook Dilemma: Should the First Sale Doctrine Provide a Valid Defense for Foreign-Made Goods?*, 80 FORDHAM L. REV. 3057, 3089 (2012).

108. *See* Kirtsaeng v. John Wiley & Sons, 133 S. Ct. 1351, 1364–67 (2013) ("[W]e believe that the practical problems that petitioner and his *amici* have described are too serious, too

have articulated the sound policy decision that, given the uncertain welfare effects of geographic price discrimination, worldwide market segmentation should not be preserved through the means of curtailing the basic "first sale values" of access, preservation, and transactional clarity.[109] However, the decision's ultimate success in protecting those policy interests at the core of the first sale doctrine is uncertain, given the likely industry response that will follow.

IV. LIKELY INDUSTRY RESPONSES TO *KIRTSAENG*

In the case of the specific parties in *Kirtsaeng*, the basic rebuttal to the consumer-advocacy argument against geographic price discrimination—that gray-market competition will not drive prices down but will simply result in high worldwide prices[110]—has already played out. In response to the Supreme Court's decision, Wiley reset its worldwide textbook prices uniformly to match the U.S. price.[111] But to conclude that such effects will necessarily persist and become prevalent in the wake of *Kirtsaeng*—either within the textbook industry or more generally—is myopic for at least two closely related reasons. First, geographic price discrimination can be implemented by other means than a geographic limitation of the first sale doctrine. Second, methods of price discrimination other than the geographic variety can be exploited by suppliers of copyright-protected goods.

Industry copyright holders will likely respond to the *Kirtsaeng* decision by employing various strategies to preserve price discrimination and prevent parallel importation within the international first sale framework. Some of these strategies are "traditional" in nature, relying on modifications of existing distribution practices for physical goods in order to decrease

extensive, and too likely to come about for us to dismiss them as insignificant . . . ."). The Court's relatively cursory (and perhaps questionable) responses to the dissent's concerns regarding legislative history and the near irrelevance of the importation ban as a result of the decision suggest that these policy concerns were among the most significant factors in its decision. *See supra* notes 84–86 and accompanying text.

109. *See Kirtsaeng*, 133 S. Ct. at 1371; *see also* Kirtsaeng v. John Wiley & Sons*: Regulatory Arbitrage vs. Market Arbitrage*, ARIEL KATZ ON INTELLECTUAL PROP., COMPETITION, INNOVATION, & OTHER ISSUES (Oct. 29, 2012), http://arielkatz.org/archives/2130 (arguing that U.S. intellectual property law, and the § 602 importation right in particular, is meant to prevent "regulatory arbitrage" resulting from the lack of harmonization of international intellectual property regimes, rather than "market arbitrage").

110. *See supra* note 96 and accompanying text.

111. *Preisgestaltung von US-Lehrbüchern* [*Pricing of U.S. Textbooks*], WILEY-VCH, (Jul. 10, 2013), http://www.wiley-vch.de/publish/dt/company/news/archive/19545/ [hereinafter WILEY-VCH].

incentives for parallel importation, or on preventing parallel importation through direct monitoring and enforcement within distribution chains.[112] More significantly, however, suppliers are likely to employ other methods particularly applicable to digitally distributed goods, including digital rights management technologies, distribution of goods via license rather than sale, and reliance on a perceived judicial abrogation of the first sale doctrine for digital goods.[113] These "digitally amenable" tactics avoid significant costs imposed by the more traditional strategies for preserving price discrimination, and they are particularly noteworthy because they facilitate price discrimination by securing suppliers a high degree of downstream control, circumventing the first sale doctrine—international or otherwise—altogether.

A. TRADITIONAL DISTRIBUTION STRATEGIES AND DIRECT VERTICAL CONTROLS

As a preliminary matter, even without the assistance of the copyright law, suppliers of copyrighted works can continue to practice geographic price discrimination by manipulating their current distribution practices to render parallel importation unprofitable. Most simply, suppliers might continue to charge different prices in distinct geographic regions but narrow the price gap between geographic market segments to an extent that shipping costs and other expenses would exceed the potential profits to would-be gray-market arbitrageurs.[114] However, such a strategy is a compromise for suppliers in the absence of a legally enforceable ban on parallel importation; suppliers' choices of price differentials between market segments would be dictated by market forces rather than by the suppliers' own profit-maximization strategies.[115]

112. *See* discussion *infra* Section IV.A.

113. *See* discussion *infra* Section IV.B.

114. *Cf.* Shubha Ghosh, *An Economic Analysis of the Common Control Exception to Gray Market Exclusion*, 15 U. PA. J. INT'L BUS. L. 373, 377 (1994) ("Advocates of gray marketing . . . ignore the transportation costs associated with cross-hauling goods to another geographic market.").

115. Nonetheless, even this more limited ability to price discriminate would likely afford suppliers greater profits than uniform worldwide pricing. Thus, especially given that Wiley chose to set worldwide textbook prices at the U.S. market price rather than a recalibrated, profit-maximizing worldwide price, Wiley's uniform pricing response to *Kirtsaeng* appears at least in part to be more a statement of principled objection to the decision than a long-term strategy. *See* WILEY-VCH, *supra* note 111. Indeed, the cited German press statement from Wiley characterizes the Supreme Court's decision as holding that differential geographic pricing of textbooks with essentially identical content is "not lawful." *Id.* This mischaracterization of the holding as a direct bar on price discrimination rather than a limitation of copyright, in combination with the imposition of a high uniform worldwide

More subtly, suppliers can continue to implement their current geographic differential pricing schemes by using versioning to implement geographic price discrimination.[116] That is, suppliers can release distinct versions that are substantially similar but not direct substitutes in different geographic market segments, thereby curbing demand for gray-market versions of their goods.[117] This strategy could be effective in industries such as the textbook industry, where successive editions of a given book are already routinely released in sufficiently altered form to eliminate competition from the resale of used books.[118] However, for many other goods, such as novels or musical recordings, it is unlikely that suppliers could release distinct versions of a product sufficiently different to eliminate the gray market or other secondary markets.[119] Furthermore, even when such distinct versions can be created, effecting geographic price discrimination through versioning would likely impose nontrivial costs on suppliers by forcing them to develop and manufacture the different versions for sale in each market segment.[120]

Suppliers can also prevent parallel importation within their current geographic price discrimination schemes by tightening regulation of their distribution networks through a variety of "vertical control" mechanisms. For example, rights holders might choose to conduct more thorough reviews of their distributors' and retailers' sales practices in order to curtail parallel importation through a combination of contractual agreements and more informal business incentives.[121] Such mechanisms are most feasible for

price, might have been intended to encourage opposition to the *Kirtsaeng* decision among foreign consumers.

116. This is an example of using "second-degree" price discrimination to effect "third-degree" price discrimination. *See supra* note 36.

117. *See* Rub, *supra* note 96, at 45 (predicting, before the *Kirtsaeng* decision, that Wiley itself may choose to implement such a strategy in the event of a victory for Kirtsaeng).

118. *See* James E. Foster & Andrew W. Horowitz, *Complimentary Yours: Free Examination Copies and Textbook Prices*, 14 INT'L J. INDUS. ORG. 85, 86–87 (1996). A notable feature of the textbook market that makes it particularly amenable to versioning strategies is that, at least in the U.S. market, students are often constrained to using the particular edition of a textbook selected by their instructor. *Id.* at 88. *But see* Cabolis et al., *supra* note 99, at 95 (noting that in the United Kingdom textbooks are generally treated as supplementary study aids rather than mandatory course materials, so that "students feel much less of an obligation to buy particular books").

119. *See* Rub, *supra* note 96, at 45.

120. *See id.*

121. A supplier could presumably examine sales records to ensure that its channel partners are not themselves engaging in parallel importation of the supplier's goods, and the supplier could also attempt to detect distribution to third parties who are likely to engage in parallel importation. *Cf.* Ganslandt & Maskus, *supra* note 95, at 944 n.4 (noting that "the bulk of parallel trade happens at the wholesale or distributor level," and accordingly, "empirical evidence points to the vertical-control problem as being central to [parallel importation]"). A

relatively low-volume suppliers, who can directly monitor their distribution networks for gray-market activity without prohibitive cost.[122] These suppliers could then impose penalties on distributors who engage in or facilitate parallel importation.[123] The costs of vigilant direct monitoring of distribution networks are less likely to be manageable for higher-volume suppliers, so this "hands-on" restriction of the gray market may be less tractable for such suppliers.[124] Some commentators have suggested that high-volume suppliers may still be able to use less finely tailored methods to prevent parallel importation, such as contractually prohibiting distributors from selling to wholesalers outright.[125] However, in practice these contractual prohibitions would likely be difficult to implement because wholesalers—especially freelance resellers such as Kirtsaeng himself—may be difficult for distributors to detect. Imposing per-customer volume limits on distributors may be somewhat effective in curbing large-scale parallel importation, but, as with other methods of direct vertical control of distribution chains, such a strategy would likely entail significant monitoring and enforcement costs.

All of these strategies to preserve geographic price discrimination within traditional distributional frameworks for physical goods impose nontrivial costs on suppliers, either by constraining suppliers' choice of prices in a differential pricing scheme or by entailing new production, monitoring, or enforcement costs. Accordingly, industries supplying copyright-protected goods will likely be receptive to alternative means of pursuing their price discrimination goals in the face of international first sale.

B. PRICE DISCRIMINATION STRATEGIES AMENABLE TO DIGITAL DISTRIBUTION

More significantly, suppliers will likely employ price discrimination strategies particularly amenable to digital media. These include digital rights management technologies, distribution of goods under restrictive licensing agreements rather than sales, and a shift toward distribution of copyrighted works over the Internet, in the hope that courts will decline to recognize, or

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more extreme approach to controlling the distribution chain would be actual vertical integration. That is, rights holders could actually *acquire* their distributors and thus position themselves to police gray-market activity. *See id.* at 948. Presumably vertical integration, if undertaken as a response to the international first sale regime ushered in by *Kirtsaeng*, would impose significant costs on suppliers who had not previously deemed it efficient.

122. *See* Meurer, *supra* note 90, at 146 (discussing this strategy in the context of software).

123. *See id.*

124. *See id.* at 146 n.399.

125. *See, e.g.*, *id.* at 147 ("A third option is to stipulate by contract with distributors that they shall not facilitate gray market goods.").

at least severely limit, a "digital first sale right" for downloaded works. Indeed, distribution of music and books via download has been eclipsing physical distribution since before the *Kirtsaeng* decision.[126] Accordingly, employing strategies that rely on digital distribution will not likely be unduly burdensome for suppliers. Furthermore, as will be discussed below, these strategies avoid some of the significant costs imposed by the more traditional approaches discussed in Section IV.A, *supra*.

Whereas the traditional strategies discussed above proceeded by mitigating the legality of parallel importation, these "digitally amenable" tactics proceed by circumventing the first sale doctrine altogether. As such, they are notable for securing a higher degree of downstream control over copyrighted works beyond the mere ability to prevent parallel importation and arbitrage. Indeed, these digital distribution strategies operate essentially by preventing possessors of lawfully obtained copies from disposing of the copies as they please. Thus, these tactics may serve as incentives for suppliers to hasten the already seemingly inevitable transition to digital distribution of copyright-protected works.

1. *Digital Rights Management Strategies*

If copyright holders cannot rely on a limitation of the first sale doctrine to prevent international arbitrage, it would seem that one of the most direct alternative means would be to render downstream redistribution after a first sale physically impossible or highly impracticable. Although implementing such a strategy is difficult to imagine for most physical goods, it can be achieved to some extent in the digital context through the use of digital rights management ("DRM") technologies.

a) Tethering and Similar Strategies as Sources of Downstream Control

DRM, also known as technological protection measures ("TPMs") or trusted systems,[127] is a category of technologies that allow rights holders to

126. *See, e.g.*, Sam Gustin, *Digital Music Sales Finally Surpassed Physical Sales in 2011*, TIME (Jan. 6, 2012), http://business.time.com/2012/01/06/digital-music-sales-finally-surpassed-physical-sales-in-2011/; Clair Cain Miller & Julie Bosman, *E-Books Outsell Print Books at Amazon*, N.Y. TIMES, May 19, 2011, at B2, *available at* http://www.nytimes.com/2011/05/20/technology/20amazon.html; Andrew Albanese, *Judge Deals 'Used' E-book Market a Setback*, PUBLISHERS WEEKLY (Apr. 5, 2013), http://www.publishersweekly.com:8080/pw/by-topic/digital/copyright/article/56701-judge-deals-used-e-book-market-a-setback.html ("Digital textbooks are gaining rapidly in popularity as tablets like the iPad become standard in education settings.").

127. *See, e.g.*, Stephen McIntyre, *Game Over for First Sale*, 29 BERKELEY TECH. L.J. 1, 20–21 (2014) (using the term "technological protection measures"); JONATHAN ZITTRAIN, THE

control and restrict the use, modification, and copying of digital goods.[128] By embedding these restrictions into the goods themselves, DRM affords suppliers of digital goods a high degree of predictable downstream control and thereby facilitates price discrimination, geographic or otherwise.[129]

A prime example of DRM's utility in securing downstream control is the practice of "tethering," wherein a given distributed copy of a digital work is encrypted so that it can be accessed only on particular playback or access devices.[130] Assuming the encryption technology works as intended, a customer could only transfer such a copy if she also transferred possession of an access device, such as a computer, an mp3 player, or an e-book reader, to which it was tethered. Since she would typically use the device to access a large number of digital works, this would be an impractical method for the customer to transfer a copy of a single work. Thus, effective tethering cuts off the downstream distribution chain after an initial purchase.[131]

A slight twist on this tethering practice, for digital works distributed in physical media, is configuring hardware access or playback devices and their accompanying media differently in distinct geographic market segments so that media marketed in one segment are incompatible with hardware sold in other market segments.[132] A quintessential example of this approach to DRM

FUTURE OF THE INTERNET—AND HOW TO STOP IT 105 (2008) (using the term "trusted systems").

128. Priti Trivedi, Note, *Writing the Wrong: What the E-Book Industry Can Learn from Digital Music's Mistakes with DRM*, 18 J.L. & POL'Y 925, 931 (2010); *see* Stefan Bechtold, *Digital Rights Management in the United States and Europe*, 52 AM. J. COMP. L. 323, 326–31 (2004) (describing several varieties of DRM systems). This definition of DRM is admittedly vague, and the discussion of DRM in this Note is far from comprehensive. Bechtold provides a more detailed description of specific varieties of DRM systems, and indeed he notes that "DRM" is not a well-defined term. Bechtold, *supra*, at 324 ("[N]o generally accepted definition for the term 'Digital Rights Management' exists.").

129. *See, e.g.*, *id.* at 324 ("Compared to traditional copyright law, DRM promises an unprecedented degree of control over the entire distribution chain and the usage of digital content."); Dan L. Burk, *Legal and Technical Standards in Digital Rights Management Technology*, 74 FORDHAM L. REV. 537, 551 (2005) ("[I]t is the deterministic, bright-line predictability of DRM that makes it an attractive cost-saving mechanism to the copyright holder.").

130. *See* R. Anthony Reese, *The First Sale Doctrine in the Era of Digital Networks*, 44 B.C. L. REV. 577, 613 (2003).

131. In addition to the heightened degree of downstream control it affords, market division through tethering does not require suppliers to create any content differences between goods sold in distinct market segments, thereby eliminating some of the potential costs of traditional versioning. *See supra* notes 116–119 and accompanying text. Thus, because thwarting the gray market through such a use of DRM does not entail the cost of producing distinct versions of a given good, suppliers will likely find it an attractive additional incentive to shift to digital distribution of copyrighted works.

132. *See* Fisher, *supra* note 33, at 6.

is the region-coding system used in the DVD standard, which divides the world into six geographic regions; a DVD purchased in the United States, for example, cannot be played on a DVD player distributed in the United Kingdom.[133] This compatibility restriction creates distinct geographic market segments, allowing film and television distributors to charge different prices for DVDs in each region.[134] The region-coding strategy implements geographic price discrimination more directly and provides suppliers with less extreme downstream control than does all-out tethering. That is, rather than aiming to halt all downstream distribution after an initial sale, the region-coding approach allows secondary markets for DRM-protected goods to persist within geographic market segments. For example, although region-coding may curtail the market for U.S.-manufactured DVDs in the United Kingdom, it does little to impede the market for used U.S.-manufactured DVDs within the United States itself.

Finally, "rights locker architectures," such as the UltraViolet cloud-based authentication and licensing system, provide yet another variant of the tethering strategy.[135] Instead of tethering use of a copyrighted work to a particular device or devices, rights locker architectures focus on restricting access and usage to particular *users*.[136] More specifically, a rights locker system is centered around a database that stores consumers' use and access rights for a particular collection of works. For example, a customer who purchases a movie on an UltraViolet-compatible DVD or Blu-ray disc obtains an UltraViolet authentication code. After registering the code with his account on UltraViolet's cloud-based database, he can then download a copy of the movie for viewing on an UltraViolet-compatible device or stream the movie through an UltraViolet-compatible website or application. Whatever the means of access, the access device must first "check with" the rights locker database to ensure that the customer has the appropriate rights before he can view the movie.[137] Although such a rights locker system does little in itself to hamper secondary markets—gray or otherwise—for the original DVD or Blu-ray discs themselves, the additional viewing privileges of downloading or streaming the movie to other devices are tied to the original consumer's account.

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133. *See id.*

134. *Id.*

135. *See* Mark Chacksfield, *UltraViolet: What You Need to Know*, TECHRADAR (Apr. 25, 2012), http://www.techradar.com/us/news/home-cinema/ultraviolet-what-you-need-to-know-1077658; *Frequently Asked Questions*, ULTRAVIOLET, http://www.uvvu.com/faq (last visited Feb. 18, 2014).

136. Bechtold, *supra* note 128, at 327 n.12.

137. *See* Chacksfield, *supra* note 135.

Thus, provided a consumer's access rights cannot be transferred out of his particular locker, a downstream purchaser of a second-hand physical disc will not enjoy the same ability to download or stream the movie to multiple devices as she would if she purchased a new disc. Accordingly, if the rights locker system can gain sufficient traction to render these ancillary privileges an essential component of the expected consumer experience,[138] then second-hand discs might become unacceptable as market substitutes for new discs with full access rights.[139] Thus, the secondary market for discs compatible with the rights locker architecture would be effectively nullified. As in the case of tethering, then, suppliers would be free to engage in price discrimination as they please.

b) Downsides to DRM: Technological Circumvention and Consumer Backlash

DRM theoretically affords suppliers of copyright-protected goods a wealth of opportunities to exert varying degrees of downstream control in order to preserve their existing geographic price discrimination schemes. However, in practice, DRM is far from a fail-safe protection for price discrimination for two primary reasons. First, DRM systems are often not sufficiently robust to resist circumvention of their intended restrictions by technologically adept users. Second, in some cases market forces driven by consumer backlash have led suppliers to abandon or relax DRM protection of their goods.[140]

Suppliers facing the prospect of users' technologically bypassing their DRM systems can find some measure of legal comfort in the anti-circumvention provisions of § 1201 of the Digital Millennium Copyright Act ("DMCA").[141] Section 1201(a) prohibits the circumvention of any DRM technology that "effectively controls access to" a copyrighted work, as well as

138. *Cf.* Terence Keegan, *Can Consumers Legally Sell Unused UltraViolet Movie Codes?*, MEDIA & ENTM'T SERVS. ALLIANCE (Apr. 20, 2012), http://mesalliance.org/blog/me-daily/2012/04/20/can-consumers-legally-sell-unused-ultraviolet-movie-codes/ ("[I]t seems likely that for now, simply introducing consumers to UltraViolet, and selling them on the benefits of the system, will remain studios' biggest challenges.").

139. The non-transferability of authentication codes (and of access rights themselves) can likely be enforced by license agreements. *See id.*; *see also* discussion *infra* Section IV.B.2.

140. *See, e.g.*, ZITTRAIN, *supra* note 127, at 105 ("Most trusted systems have failed, often because either savvy users have cracked them early on or the market has simply rejected them."); Fisher, *supra* note 33, at 7 (noting that the proliferation of multiregion DVD players and software capable of wiping region-coding restrictions from DVDs have diminished the efficacy of the region-coding system, thereby increasing opportunities for gray-market arbitrage).

141. *See* 17 U.S.C. §§ 1201(a)–(b) (2012).

trafficking in technologies designed to facilitate such circumvention.[142] Similarly, § 1201(b) prohibits trafficking in technologies designed to circumvent any DRM technology that "effectively protects a right of a copyright holder."[143]

However, as plainly as these provisions of the DMCA may appear to protect DRM technologies against hacking, judicial interpretation of § 1201 has not been uniform.[144] The Federal Circuit has established a framework under which it seems likely that circumvention of tethering DRM for the sole purpose of reselling a tethered copyright-protected good would *not* be prohibited by § 1201.[145] The Ninth Circuit, however, appears to interpret § 1201 as providing absolute protection against circumvention of tethering technologies.[146] This circuit split between the Federal and Ninth Circuits

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142. 17 U.S.C. §§ 1201(a)(1)(A), 1201(a)(2).

143. 17 U.S.C. § 1201(b)(1). Notably, § 1201(b) prohibits only trafficking in circumvention devices; it does not prohibit the actual act of circumvention itself. Thus, for instance, a consumer who bypassed a copy-protection DRM encryption on a lawfully purchased Blu-ray disc would not be liable for violation of § 1201(b), although she would be liable if she were to manufacture and sell software for the purpose of bypassing that copy-protection encryption. For the purposes of this Note, however, the most relevant DRM protection measures—tethering, region-coding, and rights locker architectures—all control access to copyrighted works and are thus governed by § 1201(a).

144. A circuit split has resulted from the Federal Circuit's 2004 decision in *Chamberlain Group, Inc. v. Skylink Technologies, Inc.*, 381 F.3d 1178 (Fed. Cir. 2004), and the Ninth Circuit's 2010 decision in *MDY Industries, LLC v. Blizzard Entertainment, Inc.*, 629 F.3d 928 (9th Cir. 2010), both discussed in further detail below.

145. In *Chamberlain*, the Federal Circuit introduced a nexus requirement into the analysis of liability for circumvention of access-control DRM technologies. Reasoning that the DMCA's anti-circumvention provisions "do not establish a new property right," the court held that § 1201 prohibits only those forms of unauthorized access that "bear a reasonable relationship to the protections that the Copyright Act otherwise affords copyright owners." *Chamberlain*, 381 F.3d at 1192, 1202.

Under the Federal Circuit's *Chamberlain* rule, it seems likely that circumvention of tethering DRM for the sole purpose of reselling a tethered copyright-protected good would not be prohibited by § 1201(a), because although resale of the good arguably bears a reasonable relationship to the distribution right under § 106, that right is limited by the first sale doctrine. *See* McIntyre, *supra* note 127, at 38–39 (discussing the likely permissibility of circumventing tethering for the purpose of reclaiming first sale protections under *Chamberlain*). It is crucial to note that any circumvention of a DRM access control that infringed another § 106 exclusive right—most saliently, the reproduction right—would not benefit from *Chamberlain*'s nexus requirement. *Cf.* discussion *infra* Section IV.B.3.

146. In *MDY Industries, LLC v. Blizzard Entertainment, Inc.*, the Ninth Circuit explicitly rejected the Federal Circuit's approach, reasoning that adding an "infringement nexus requirement" for liability under the anti-circumvention provisions would be inconsistent with the plain language of § 1201. *MDY*, 629 F.3d at 950. Instead, the Ninth Circuit interpreted § 1201 as creating an entirely new right against circumvention of access controls for copyright-protected works, independent of whether or not such circumvention infringes any existing right granted by the Copyright Act. *Id.* at 944–45. Under the *MDY* approach,

leaves suppliers with significant uncertainty regarding how effectively they might combat hacking of their DRM protection measures in court, rendering § 1201 a less-than-ideal safeguard against DRM's lack of technological robustness.[147]

An equally important concern for suppliers who wish to preserve price discrimination through tethering and similar technological mechanisms is market rejection of restrictive DRM technologies. Consumer resentment of DRM has been widespread in the online music and e-book markets, with tethering-induced "lock-in"—the inability to switch freely between access devices for digital works—serving as a primary source of discontent.[148] This resentment is compounded further by the perception that DRM imposes significant restrictions on lawful purchasers of protected content, while downloaders of pirated copies may enjoy the same content free of those restrictions. Indeed, consumer indignation over the restrictive effects of DRM may actually encourage piracy of copyrighted works.[149] More generally, commentators have suggested that the prevalence of file sharing has created a "culture of free content," in which users are accustomed to downloading digital media free of cost and restrictions.[150] Presumably, consumers reared on free file sharing would be less inclined to pay for content encumbered by DRM than they would be to convert themselves into lawful purchasers of DRM-free digital media.

Faced with a general disfavor of DRM in the marketplace, some content suppliers have elected to scale back these technological protection measures. Apple's nearly complete abandonment of the "FairPlay" tethering system for music files downloaded from its iTunes store is one of the most prominent

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then, tethering technologies are protected by an independent right not limited by the first sale doctrine, and suppliers could invoke § 1201 to safeguard price-discrimination schemes implemented by DRM. In short, the *MDY* rule allows DRM to secure downstream control as an "end-run" around the first sale doctrine, whereas the *Chamberlain* rule does not.

147. *See* McIntyre, *supra* note 127, at 41–42 (cataloging court decisions following either *Chamberlain* or *MDY* and noting that "[s]ince circumventing tethering technology would likely be lawful under *Chamberlain* but unlawful under *MDY* . . . , it is difficult to make any prediction as to how the controversy might fare in court").

148. *See, e.g.*, Trivedi, *supra* note 128, at 934; Perzanowski & Schultz, *supra* note 17, at 907 (noting the increasing severity of lock-in and the attendant increase in platform-switching costs).

149. *See* Trivedi, *supra* note 128, at 934 (citing Nate Anderson, *Landmark Study: DRM Truly Does Make Pirates Out of Us All*, ARS TECHNICA (May 27, 2009), http://arstechnica.com/tech-policy/2009/05/landmark-study-drm-truly-does-make-pirates-out-of-us-all/ ("DRM is so rage-inducing, even to ordinary, legal users of content, that it can even drive the blind to download illegal electronic Bibles.")).

150. *See id.* at 955–56.

examples of this flight from DRM.[151] It appears that at least some rights holders and online merchants have decided that highly rigid use and access controls over digital media are not necessarily helpful in combating piracy, or at least that such controls are unprofitable when balanced against consumer resistance.[152] But post-*Kirtsaeng*, the need to preserve some form of price discrimination in the face of international first sale—beyond concerns over piracy per se—may give rights holders some pause in jettisoning DRM from their digital distribution strategies.[153]

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151. *See* Peter Cohen, *iTunes Store Goes DRM-Free*, MACWORLD (Jan 6, 2009, 10:40 AM), http://www.macworld.com/article/1137946/itunestore.html; *iTunes Store: iTunes Plus Frequently Asked Questions (FAQ)*, APPLE, http://support.apple.com/kb/ht1711 (last updated Dec. 5, 2012). However, Apple's iTunes store has not completely abandoned DRM protection for music, as "certain music and music videos . . . have not been provided in [the DRM-free] iTunes Plus format from the music label." *Id.*

152. *See* Trivedi, *supra* note 128, at 945–46. As a specific example, U.K. book publisher Tor Books UK has decided in 2012 to release all of its e-books free of DRM protection largely due to the perception of DRM as "an irritant taking away the flexibility and [readers'] choice of reading device and format." Julie Crisp, *One Year Later, the Results of Tor Books UK Going DRM-Free*, TOR.COM (Apr. 29, 2013, 1:00 PM), http://www.tor.com/blogs/2013/04/tor-books-uk-drm-free-one-year-later (internal quotation marks omitted) (noting that "DRM doesn't impede pirates, but it subjects honest customers to a monopoly tightly controlled by the owners of the DRM software," and that many Tor readers and authors have responded enthusiastically to the decision to abandon DRM protection).

But it is important to note that DRM-free e-books are not currently the norm. Indeed, in marked contrast with its large-scale abandonment of DRM protection for music, Apple's iTunes store sells many e-books restricted by DRM. *See* Kirk McElhearn, *Apple Should Lead the Move to DRM-Free Ebooks*, MACWORLD (Jul. 17, 2013, 3:20 AM), http://www.macworld.com/article/2044161/apple-should-lead-the-move-to-drm-free-ebooks.html.

153. Indeed, in the textbook industry in particular, the consumer backlash concerns generally surrounding the use of DRM may be less severe than in the context of digital music or the general market for e-books. To wit, the U.S. market for textbooks consists by and large of a captive audience. Students purchasing textbooks are used to having little to no choice in the precise edition of a book they must purchase for a given class, and in lieu of the "culture of free content" that has arisen around file sharing of music and popular e-books, the norm for consumers of textbooks is arguably one of begrudging tolerance of perceived price gouging. *See* Foster & Horowitz, *supra* note 118, at 88 (discussing U.S. students' limited choices in purchasing textbooks); Trivedi, *supra* note 128, at 955–56 (discussing the "culture of free content"); John J. Siegfried & Christopher Latta, *Competition in the Retail College Textbook Market*, 17 ECON. EDUC. REV. 105, 105 (1998) ("There is hardly a college or university bookstore manager who has not been vilified at some time by the campus newspaper for price gouging. The usual charge is exploitation of monopoly power by setting high prices for required classroom textbooks."). Accordingly, in the textbook industry, the effects of lock-in through tethering may not faze consumers as much as they have with digital music and other e-books.

If the industry chooses to respond to *Kirtsaeng* by switching to digital distribution models with heavy DRM protection in order to maintain market segmentation, the decision may help to keep DRM a viable force for longer than expected. However, the U.S. textbook

All in all, although tethering and similar DRM-based practices present attractive possibilities for solidifying market segmentation through digital distribution of copyrighted works, concerns over circumvention and market disfavor of these mechanisms suggest that suppliers would be unwise to rely solely on DRM to combat parallel importation in the age of international first sale. Accordingly, whether or not they incorporate DRM into their market segmentation efforts, suppliers will likely seek to shore up their price discrimination strategies with additional legal protections.

2. *Licensing Strategies*

In order to control downstream redistribution and avoid the first sale doctrine's crippling effects on price discrimination, suppliers can employ a contractual strategy distinct from the direct vertical distribution chain controls discussed above in Section IV.A: they can distribute goods under license agreements rather than sales. In short, whereas DRM attempts to thwart the first sale doctrine by making a "second sale" impossible or appropriately restricted as a technical matter, this licensing strategy does so essentially by declaring that no "first sale" actually occurs. More precisely, as encoded in § 109(a), the first sale doctrine provides only that "the *owner* of a particular copy" of a copyrighted work may dispose of her copy as she pleases.[154] Thus, in theory, by designating a customer as a licensee rather than an owner, a supplier may effectively nullify the first sale doctrine by fiat.[155]

market is admittedly pathological in the relevant respects, and it is difficult to think of other forms of digital content that would be similarly insulated from consumer backlash against restrictive DRM technologies to the same degree. *Cf.* Cabolis et al., *supra* note 99, at 94–95 (conjecturing potential sources of relatively high textbook prices in the United States, including peculiarities related to the cost and culture of U.S. university education). Furthermore, in order to exploit consumers' current acceptance of constrained access choices for textbooks, the industry would be well advised to implement rigid device tethering before other, more flexible user-access options become the norm. *Cf.* Albanese, *supra* note 126 ("Digital textbooks are gaining rapidly in popularity as tablets like the iPad become standard in education settings."); Motoko Rich, *Print Books Are Target of Pirates on the Web*, N.Y. TIMES, May 11, 2009, at B1, *available at* http://www.nytimes.com/2009/05/12/technology/internet/12digital.html (quoting the chairman of Random House's parent company) ("If iTunes started three years earlier, I'm not sure how big Napster and the subsequent piratical environments would have been, because people would have been in the habit of legitimately purchasing at pricing that wasn't considered pernicious.").

If source markets for parallel importation would not tolerate highly restrictive DRM technologies, the efficacy of tethering as a strategy for preserving geographic price discrimination might decrease significantly. Accordingly, the prediction that *Kirtsaeng* may indirectly enhance the viability of DRM is quite tenuous and concededly speculative.

154. 17 U.S.C. § 109(a) (2012) (emphasis added).

155. *See* Asay, *supra* note 11, at 19 ("In other words, a copyright owner can eliminate first-sale rights by specifying, essentially, that they do not apply.").

The supplier could then insert contractual restrictions on downstream redistribution of the copy into the license agreement as he pleases.[156] In essence, this strategy relies upon judicial recognition of a "license-versus-sale" or "licensee-versus-owner" distinction for the purposes of the first sale doctrine.

As an example, although Wiley's notices prohibiting export of its Asian textbooks did not withstand the first sale doctrine in *Kirtsaeng*, the theory underlying this licensing strategy posits that Wiley's notices would have been legally enforceable if they had been terms of a contract under which use of textbooks had been *licensed*, rather than notices on textbooks that had been *sold*. Indeed, there are indications that the Supreme Court's decision in *Kirtsaeng* has triggered a shift toward a licensing model of distribution among suppliers of copyrighted works.[157]

As this example in the context of textbooks illustrates, from a purely theoretical standpoint the licensing strategy may appear to be equally applicable to all varieties of copyrighted works.[158] However, the doctrinal landscape and various practical considerations make digital formats a particularly apt vehicle for avoiding the first sale doctrine through licensing. Having consumers sign license agreements on paper—to say nothing of actually negotiating over such agreements—would be a practical impossibility in the context of mass-marketed goods. But in much of the digital marketplace, distribution of goods under non-negotiable end-user license agreements ("EULAs") has long been an accepted practice.[159] These EULAs

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156. *See* Reese, *supra* note 130, at 615. By contrast with the contractual controls discussed in Section IV.A, which attempt to exert downstream control at the distribution level, the licensing approach attempts to block further redistribution at the end-user level.

157. *See, e.g.*, *Digital Goods Moving to Licensing Model, Especially after 'Kirtsaeng,' SIIA Official Says*, 14 WASH. INTERNET DAILY, no. 123, June 26, 2013 (quoting the Software and Information Industry Association's Senior Vice President of Intellectual Property, who claimed that *Kirtsaeng* is "pushing more companies to look at the licensing model for better or worse, because they don't have any other options" and that companies are "looking at ways that they change from the selling of textbooks to the licensing" of copyrighted works).

158. Indeed, critics of the license-versus-sale distinction in the context of the first sale doctrine have pointed out that, although restrictive licensing has gained widespread acceptance in the digital marketplace, application of the strategy in markets for more traditional physical goods could lead to upsetting results. *See infra* notes 183–184 and accompanying text.

159. *See* McIntyre, *supra* note 127, at 16–17 (describing the rise of EULAs in the mass-marketed computer software industry in the 1980s and the continuing prevalence of distribution under EULAs). The widespread acceptance of EULAs in the digital marketplace is the primary reason for which distribution under license is particularly amenable to digital goods. However, licensing strategies, particularly when implemented through "shrinkwrap"

dispense with the inconvenience of traditional signed contracts by declaring that a customer manifests assent to the terms of the license by performing acts as simple as removing the shrinkwrap packaging from a software box, clicking a button marked "I agree" or "continue" on a computer screen, or even simply browsing through a website.[160] As a matter of contract law, courts have generally held such adhesion contracts to be enforceable, and accordingly purveyors of digital goods are able to distribute products under license agreements free from the practical burden of pen-and-paper transactions.[161]

Case law regarding the efficacy of a licensing end-run around the first sale doctrine is not completely well developed, but it suggests that the strategy may be viable especially for digital media. In the specific context of software, the current trend appears to be for courts to recognize the license-versus-sale distinction, thereby enabling software suppliers to circumvent the first sale doctrine.[162] In particular, the Ninth Circuit's approach to this distinction should be especially encouraging for suppliers hoping to rely on licensing strategies in the digital context. In *Vernor v. Autodesk*, the Ninth Circuit held 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)

EULAs, are by no means categorically limited to digital goods. *See infra* notes 183–184 and accompanying text.

160. These EULAs are commonly referred to, depending on context, under the apt nomenclatures of "shrinkwrap" and "clickthrough" agreements, as well as the more whimsical but still commonplace "clickwrap" and "browsewrap" agreements. *See, e.g.*, Cheryl B. Preston & Eli W. McCann, *Unwrapping Shrinkwraps, Clickwraps, and Browsewraps: How the Law Went Wrong from Horse Traders to the Law of the Horse*, 26 BYU J. PUB. L. 1, 9 (2012) (defining shrinkwrap contracts); *id.* at 17–18 (defining and discussing clickwrap and browsewrap agreements); McIntyre, *supra* note 127, at 16 (using the term "click-through"); Burk, *supra* note 129, at 544 ("The ['shrinkwrap' or 'clickwrap'] license takes its name from the legal fiction that the purchaser demonstrates agreement to the license terms by breaking the 'shrink-wrap' cellophane on the product package or, more recently, by using the computer mouse cursor to click on a graphic labeled 'I agree.'").

161. The seminal decision establishing the enforceability of shrinkwrap agreements is Judge Easterbrook's opinion for the Seventh Circuit in *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996) (Easterbrook, J.). Although some measure of notice to the consumer is required for enforceability of shrinkwrap and online EULAs, the standard of clarity for such notice, especially with regard to the specific terms of the license agreement, is not exceedingly high. *See* Specht v. Netscape Commc'ns Corp., 306 F.3d 17, 35 (2d Cir. 2002) (emphasis added) ("Reasonably conspicuous notice of *the existence of contract terms* and unambiguous manifestation of assent to those terms by consumers are essential if electronic bargaining is to have integrity and credibility."); Preston & McCann, *supra* note 160, at 18–19 (discussing the potential for browsewrap agreements with inconspicuous terms to be enforceable).

162. *See* Jenny Lynn Sheridan, *Does the Rise of Property Rights Theory Defeat Copyright's First Sale Doctrine?*, 52 SANTA CLARA L. REV. 297, 299–300 (2012).

significantly restricts the user's ability to transfer the software; and (3) imposes notable use restrictions."[163] Although the *Vernor* holding applied to software in particular, it appears likely that the Ninth Circuit would recognize the license-versus-sale distinction in a broader context of goods distributed in digital media, particularly those equipped with DRM protections.[164] Essentially, then, *Vernor* invites suppliers ambitiously to exert downstream control: the more strongly a supplier restricts a transfer of goods, the more likely he is to avoid the first sale doctrine.

Thus, under the current Ninth Circuit framework, suppliers seeking to engage in geographic price discrimination may be able to avoid the effects of *Kirtsaeng*'s international first sale doctrine by declaring transfers of goods to be licenses and writing geographic transfer restrictions into the license agreements. Indeed, the more restrictive or "notable" those transfer

163. Vernor v. Autodesk, Inc., 621 F.3d 1102, 1111 (9th Cir. 2010). The Ninth Circuit again applied the license-versus-sale framework of *Vernor* in *Apple Inc. v. Psystar Corp.*, where it noted that "[i]t is this distinction between sales and licenses that has caused the use of software licensing agreements to flourish and become the preferred form of software transactions." 658 F.3d 1150, 1156 (9th Cir. 2011). The *Psystar* court rejected a defendant's copyright misuse defense as an invalid "attempt to apply the [f]irst [s]ale [d]octrine to a valid license agreement." *Id.* at 1159.

164. A comparison of *Vernor* with the Ninth Circuit's subsequent opinion in *UMG Recordings v. Augusto*, 628 F.3d 1175 (9th Cir. 2011), highlights why the licensing strategy for circumventing the first sale doctrine is particularly amenable to digital distribution. In *UMG*, the Ninth Circuit held that a record company's distribution of promotional CDs constituted a transfer of ownership rather than a license, in spite of the record company UMG's having placed a label on the CDs declaring that they were distributed under a license. *Id.* at 1177–78. In distinguishing *Vernor*, the court noted that "software users who order and pay to acquire copies are in a very different position from that held by the recipients of UMG's promotional CDs." *Id.* at 1183. Specifying further, the court noted that "UMG has virtually no control over the unordered CDs it issues because of its means of distribution . . . ." *Id.* In part, the promotional CDs in *UMG* were distinguishable from the software at issue in *Vernor* because they were sent to recipients without solicitation, *see id.* at 1180–81, but the distinction highlights the importance of the second and third *Vernor* factors of exercising control over use and transfer of the distributed goods. *See supra* note 163 and accompanying text. In this respect, digitally distributed media encrypted with DRM to control use and transfer are more akin to software than promotional CDs. *See* Jennifer Lahm, Note, *Buying a Digital Download? You May Not Own the Copy You Purchase*, 28 TOURO L. REV. 211, 213–14 (2012); Meurer, *supra* note 90, at 87 (noting that copyright owners can monitor usage of digital works through technological measures and that "[s]uch metering is not possible for traditional works"). Indeed, under the Ninth Circuit's framework, licensing and DRM can be employed in tandem as "mutually reinforcing" strategies. McIntyre, *supra* note 127, at 42–43. DRM technologies can serve as enforcement mechanisms for use and transfer restrictions contained in the license, and reciprocally, the license agreement may contractually prohibit circumvention of the DRM controls in order to mitigate concerns over the applicability of the DMCA anti-circumvention provisions. *Id.*

restrictions and accompanying DRM enforcement measures are, the more likely a supplier could avoid first sale under *Vernor*.

3. *Shifting Toward Distribution via Download*

Finally, rights holders seeking to avoid the first sale doctrine may hasten the transition to distributing digital media via internet download as opposed to encoding digital works in physical media such as CDs, DVDs, or Blu-ray discs. The essential advantage to suppliers of distribution via download, at least with respect to downstream control, rests on the proposition that any transfer of files over the Internet must at some point involve copying of the original files.[165] Thus, any redistribution by an initial purchaser of a downloaded digital work would implicate the rights holder's exclusive *reproduction* right under § 106 of the Copyright Act.[166] In effect, if this proposition is accepted, the first sale doctrine's limitation of the exclusive right to distribute copyrighted works is irrelevant in the world of distribution via download because the reproduction right indirectly grants the copyright holder absolute control over distribution of her work.

Although case law addressing such a sweeping abrogation of the first sale doctrine for downloaded media is scarce, the Southern District of New York endorsed its approach to digital first sale in *Capitol Records, LLC v. ReDigi Inc.* a mere eleven days after the Supreme Court issued its opinion in *Kirtsaeng*.[167] The case concerned an online marketplace for used digital music files run by defendant ReDigi Inc. ("ReDigi").[168] The marketplace at issue is an example of a so-called "forward-and-delete" system, which attempts in the digital environment to simulate the transfer of physical goods by ensuring that no copy of the digital good is retained by the transferor upon completion of the transaction.[169] The ReDigi service seeks to achieve this simulation by having

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165. *See* 2 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 8.12[E] (2013); Reese, *supra* note 130, at 612; Perzanowski & Schultz, *supra* note 17, at 938.

166. *See* 17 U.S.C. § 106(1) (2012).

167. *See* Capitol Records, LLC v. ReDigi Inc., 934 F. Supp. 2d 640 (S.D.N.Y. 2013).

168. *Id.* at 645.

169. *See id.* at 645–46; U.S. COPYRIGHT OFFICE, DMCA SECTION 104 REPORT 81–82 (2001), *available at* http://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf (defining forward-and-delete systems). However, ReDigi itself does not characterize its online marketplace as a "forward-and-delete" system, contending that its system "pick[s] up those bits that are moving around on your hard drive and . . . move[s] them, literally, a portion at a time, so that what's in the cloud is never at the same time on your device." Matt Peckham, *ReDigi CEO Says the Court Just Snatched Away Your Right to Resell What You Legally Own,* TIME (Apr. 25, 2013), http://techland.time.com/2013/04/25/redigi-ceo-says-the-court-just-snatched-away-your-right-to-resell-what-you-legally-own/ (interviewing the CEO of ReDigi); *see also ReDigi*, 934 F. Supp. 2d at 645 ("ReDigi asserts that the process involves 'migrating' a user's file, packet by packet—'analogous to a train'—from the user's computer

users upload digital music files to a remote server, called the "Cloud Locker," and scanning the users' hard drives to ensure that no copies of the uploaded files remain.[170]

Plaintiff Capitol Records, LLC ("Capitol") holds copyright in numerous recordings sold through ReDigi's service.[171] In granting Capitol's motion for partial summary judgment and finding direct and secondary infringement of its reproduction and distribution rights, Judge Sullivan held in particular that the first sale doctrine did not apply to ReDigi's distribution of Capitol's works.[172] Having held that "the unauthorized transfer of a digital music file over the Internet—where only one file exists before and after the transfer—constitutes reproduction within the meaning of the Copyright Act,"[173] he found that "as an unlawful reproduction, a digital music file sold on ReDigi is not 'lawfully made under this title.'"[174]

Judge Sullivan further noted that the first sale doctrine grants only "the owner of a *particular* copy or phonorecord" the right to redistribute "*that* copy or phonorecord."[175] Since, according to Judge Sullivan, the copy of a music file resting in ReDigi's Cloud Locker for resale was distinct from the copy a user originally purchased and downloaded from iTunes, use of the ReDigi system did not actually constitute resale of the user's particular copy.[176]

Thus, under the *ReDigi* framework, "the first sale defense is limited to *material items*, like records, that the copyright owner put[s] into the stream of

to the Cloud Locker so that data does not exist in two places at any one time."). Thus, it seems that ReDigi contests the basic proposition that distribution via download necessarily involves copying.

170. More specifically, to sell music through ReDigi's service, a user would first download a "Media Manager" application to his computer. Media Manager would then scan the hard drive of the user's computer for music files that were originally purchased either from Apple's iTunes store or from another ReDigi user. *ReDigi*, 934 F. Supp. 2d at 645. Media Manager would populate a list with these files, and no other files on the user's hard drive would be eligible for sale through ReDigi's service. *Id.* The user could then upload any eligible file to ReDigi's "Cloud Locker," a remote server, at which point he could choose either to leave the file accessible for his personal use or to offer it for sale. *Id.* at 645–46. If the music file were purchased by another ReDigi user, the original user would lose access to it, with Media Manager continually scanning his hard drive to ensure that he had not retained a copy. *Id.* The new user could then choose to stream the file from the Cloud Locker, resell it, or download it. *Id.* at 646. It is valuable to note that ReDigi's "Cloud Locker" server stores actual media files, whereas servers in rights locker architectures store only information specifying a user's access rights. *See supra* notes 135–139 and accompanying text.

171. *ReDigi*, 934 F. Supp. 2d at 646–47.

172. *Id.* at 655–56.

173. *Id.* at 648.

174. *Id.* at 655 (quoting 17 U.S.C. § 109(a) (2012)).

175. *Id.* (quoting 17 U.S.C. § 109(a)).

176. *Id.*

commerce,"[177] and the doctrine is a practical nullity in the context of copyrighted works distributed via download. Under Judge Sullivan's analysis, the only avenue open for resale of downloaded digital works is the sale of a physical device—for example, a computer hard drive, mp3 player, or e-book reader—onto which the work was lawfully downloaded.[178] Thus, the *ReDigi* holding may have established a kind of "legal tethering" that can be accomplished without the use of DRM. Just as with tethering through technological measures, this legal tethering can drastically curtail downstream redistribution and thereby enable suppliers to engage in price discrimination.[179]

177. *Id.* (emphasis added).

178. *Id.* at 656 (presenting the resale of tangible memory devices as a rebuttal to ReDigi's "feebl[e]" argument that "the Court's reading of Section 109(a) would in effect exclude digital works from the meaning of the statute"). This outcome is not particularly shocking and was predicted in legal scholarship well before the *ReDigi* decision. *See, e.g.*, NIMMER & NIMMER, *supra* note 165, § 8.12[E]; Reese, *supra* note 130, at 612–13; Perzanowski & Schultz, *supra* note 17, at 904.

179. *See* discussion *supra* Section IV.B.1 (addressing tethering via DRM). Judge Sullivan acknowledged that limiting the purview of the first sale doctrine to redistribution of physical media "clearly presents obstacles to resale that are different from, and perhaps even more onerous than, those involved in the resale of CDs and cassettes," but he opined that the limitation is "hardly absurd." *ReDigi*, 934 F. Supp. 2d at 656. However, commentators have disagreed and characterized this limitation on resale as "burdensome and unrealistic." Perzanowski & Schultz, *supra* note 17, at 904. U.S. case law on the status of the first sale doctrine in the context of forward-and-delete redistribution on the Internet is not well developed. *See ReDigi*, 934 F. Supp. 2d at 648 (noting that "courts ha[d] not previously addressed whether the unauthorized transfer of a digital music file over the Internet—where only one file exists before and after the transfer—constitutes reproduction within the meaning of the Copyright Act").

Furthermore, at least one European Union decision has held that "intangible copies of computer programs downloaded from the internet" lie within the purview of copyright exhaustion. Case C-128/11, UsedSoft GmbH v. Oracle Int'l Corp., 2012 E.C.R. I-00000, ¶¶ 53–61, *available at* http://curia.europa.eu/juris/document/document.jsf?docid=124564&doclang=en. This distinction from the approach of *ReDigi* is of particular relevance to suppliers seeking to implement geographic price discrimination schemes including European market segments.

As of this writing, ReDigi's service is still functioning, and Amazon has obtained a patent for a "[s]econdary market for digital objects." REDIGI, http://www.redigi.com (last visited Feb. 18, 2014); U.S. Patent No. 8,364,595 (filed May 5, 2009) (issued Jan. 29, 2013). But, in spite of the uncertainty surrounding digital resale of downloaded goods, *ReDigi* provides a highly encouraging counterpoint to *Kirtsaeng* for suppliers seeking to fend off the threat of the United States' new international first sale regime, and it raises possibilities of downstream control extending considerably farther than current geographic price discrimination schemes. Indeed, some industry commentators have speculated that, *Kirtsaeng* notwithstanding, the *ReDigi* decision could "portend[ ] a future without a used textbook market." Albanese, *supra* note 126.

V. THE PARADE OF HORRIBLES MARCHES ON: PERSISTING FIRST SALE POLICY CONCERNS AFTER *KIRTSAENG*

Given the wealth of available strategies for the exertion of downstream control, especially in the context of digital distribution, suppliers' efforts to engage in market segmentation will likely continue largely unabated, even after *Kirtsaeng*'s supposedly crippling blow to geographic price discrimination. In the post-*Kirtsaeng* landscape of price discrimination, many of the already complex social welfare considerations surrounding the practice as discussed in Part III are still in play. Moreover, many of the "digitally amenable" price discrimination strategies discussed in Part IV operate by severely limiting *all* secondary markets—as opposed to the gray market alone—or by eliminating them altogether. Thus, these strategies strike at the core of the first sale doctrine, not only with respect to international trade, but also with respect to the distribution of goods within the United States itself. Accordingly, industry responses to the new international first sale regime will likely increase the focus on a host of additional policy issues surrounding first sale in the digital context. Any impression that *Kirtsaeng* has established lasting certainty regarding the fates of either the first sale doctrine or geographic price discrimination is premature; the decision will most likely serve as a catalyst for more intense debate.

Many of the policy considerations highlighted by Justice Breyer in his opinion for the Court in *Kirtsaeng* will come to the fore as suppliers implement alternative downstream control strategies in response to the decision.[180] Indeed, it is hardly surprising that the parade of horribles feared to result from a geographic limitation on the first sale doctrine could march on even more ominously if rights holders are successful in employing distribution tactics that circumvent the doctrine altogether.[181]

Restrictive licensing practices have come under particular fire as posing a significant threat of negative externalities. Proponents of the license-versus-sale distinction in the first sale context have characterized the ability to contract around the first sale doctrine as allowing the market to settle efficiently on optimal distribution models.[182] However, particularly if the

180. *See supra* notes 73–77 and accompanying text.

181. *See* discussion *supra* Section II.B.3; *cf.* Kirtsaeng v. John Wiley & Sons, Inc., 133 S. Ct. 1351, 1386–90 (Ginsburg, J., dissenting) (arguing that the *Kirtsaeng* majority's policy concerns are sufficiently mitigated by existing copyright law and precedent).

182. *See, e.g.*, ProCD, Inc. v. Zeidenberg, 86 F.3d 1447, 1453 (7th Cir. 1996) ("Terms of use are no less a part of 'the product' than are the size of the database and the speed with which the software compiles listings. Competition among vendors, not judicial revision of a

license-versus-sale distinction is applied to physical goods after gaining traction in the digital context, the potential for high transaction costs calls this theory sharply into question.[183] Indeed, even if licenses are configured so as not to bar downstream redistribution completely and destroy secondary markets altogether, consumers may face "[t]he prospect of having to trace 'chain of title' before purchasing a book or record at a secondhand store."[184]

Libraries, which were a particular source of policy concern in *Kirtsaeng*,[185] face significant threats as publishers shift toward digital distribution of books under a licensing model.[186] Given the high degree of downstream control afforded to publishers by digital distribution, libraries could face significant losses in access to secondary markets for books, a traditional source for building their collections.[187] Furthermore, libraries face the prospect of not being able to preserve their digital collections, for publishers can license e-

package's contents, is how consumers are protected in a market economy."); Raymond T. Nimmer, *Copyright First Sale and the Over-Riding Role of Contract*, 51 SANTA CLARA L. REV. 1311 (2011) (arguing in favor of the license-versus-sale distinction); Jonathan C. Tobin, *Licensing As a Means of Providing Affordability and Accessibility in Digital Markets: Alternatives to a Digital First Sale Doctrine*, 93 J. PAT. & TRADEMARK OFF. SOC'Y 167, 184–87 (2011) (arguing that licensing practices are more efficient than would be adoption of a "digital first sale doctrine").

183. *See* Perzanowski & Schultz, *supra* note 17, at 896 (hypothesizing complex individualized contractual restraints placed on physical copies of CDs and DVDs, noting that "[t]he costs of understanding these offers and obligations would be exorbitant not only for the initial purchaser but also any subsequent recipient, often exceeding the cost of the desired item"); Molly Shaffer Van Houweling, *The New Servitudes*, 96 GEO. L.J. 885, 932–39 (2007) (discussing notice and information costs flowing from servitudes attached to chattels); Katz, *supra* note 91, at 37–44 (arguing that the view of contracting around intellectual property limitations as presumptively socially efficient is flawed because transaction costs must be taken into account, so much so that "[c]ontracting around the first sale doctrine should be presumptively invalid").

184. McIntyre, *supra* note 127, at 20. As early as 2005, the Maryland State Bar Association distributed physical copies of its member directory under a shrinkwrap license prohibiting copying except for individual use. George H. Pike, *Licenses Under Wrap*, 22 INFO. TODAY, no. 9, Oct. 2005, at 17, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1640109. On the other hand, proponents of the market efficiency of contracting around copyright limitations might argue that the market would simply reject distribution under licenses it finds unduly restrictive. *See* Nimmer, *supra* note 182, at 1319 ("The choice resides in the copyright owners' marketing decision as to whether to convey or authorize conveyance of copy ownership, and in the market's reaction to that decision."). Whether the threat of draconian shrinkwrap licenses applied to physical goods will extend far beyond the efforts of enterprising lawyers to prevent copying of directories, or whether it is simply a paper tiger, remains to be seen.

185. *See Kirtsaeng*, 133 S. Ct. at 1364.

186. *See* Rachel Ann Geist, Note, *A "License to Read": The Effect of E-books on Publishers, Libraries, and the First Sale Doctrine*, 52 IDEA 63, 92–95 (2012).

187. *Id.* at 93.

books to libraries on a time-limited basis, and when these licenses are enforced by DRM, "the publisher gets to choose when the book falls apart."[188] Finally, licensing may allow publishers to override the fair use exemptions for libraries provided by § 108 of the Copyright Act.[189] Even though copying portions of works for patrons and interlibrary loan programs is explicitly protected by § 108, those exemptions do not supersede "any contractual obligations assumed at any time by the library . . . when it obtained a copy or phonorecord of a work in its collections."[190] Thus, publishers licensing e-books to libraries under license agreements could apparently restrict such previously permissible copying if they so pleased.[191]

Both DRM and restrictive licensing also raise general concerns regarding copyright law's central goal of promoting innovation. Most obviously, as with any curtailment of the first sale doctrine, these strategies arguably impede the dissemination of existing innovations.[192] From a more nuanced perspective, DRM and distribution via license are particularly problematic because the restrictions they impose on distributed copies are not constructed with potential unforeseen beneficial uses in mind.[193] Accordingly, these strategies may act to hamper follow-on innovation, as well as preservation of access to existing innovations.[194]

Most fundamentally, the *ReDigi* holding calls into question the aptitude of the current copyright law framework in the Internet age. Employing a

188. *Digital Goods Moving to Licensing Model, Especially After 'Kirtsaeng,' SIIA Official Says*, *supra* note 157 (quoting Nancy Sims, University of Minnesota copyright program librarian); *see* Geist, *supra* note 186, at 92–93 ("A budget cut to a library in the digital age may render it unable to pay its licensing fees and, as a result, cause the loss of fifty percent or more of the library's 'collection' overnight.").

189. *See* 17 U.S.C. § 108 (2012).

190. *See* 17 U.S.C. § 108(f)(4).

191. *See* Geist, *supra* note 186, at 94–95.

192. *See* Perzanowski & Schultz, *supra* note 17, at 899.

193. *See* Van Houweling, *supra* note 183, at 939–46 (discussing the "problem of the future"—that "even running restrictions that are well understood and efficient when first imposed can, over time, cause underuse or inefficient use of the resources subject to the restriction"); Burk, *supra* note 129, at 545 (arguing that positive externalities such as preservation of works and unforeseen beneficial uses should be taken into account when using "regulatory design[s]" such as DRM to effect price discrimination); *id.* at 550–51 (noting that "there is no incentive for the promulgators of DRM to even attempt to foresee usage with highly diffuse but positive social externalities: [n]either the copyright holder nor the purchaser of a copyrighted work are the direct beneficiaries of such external effects, and so have no reason to take them into account").

194. *See* Perzanowski & Schultz, *supra* note 17, at 907 (noting the negative effects of use restrictions on user innovation).

"narrow, technical, and purely legal" application of current copyright law,[195] the *ReDigi* court reached a result in which the reproduction right effectively nullifies the first sale doctrine for works distributed via download.[196] This raises concerns that fundamental aspects of U.S. copyright law may be inapposite as works are increasingly disseminated over the Internet, where "copying is the architecture of being."[197]

By eliminating suppliers' most direct means of segmenting markets for geographic price discrimination, *Kirtsaeng* may well have the unintended effect of driving suppliers to employ price discrimination strategies that exacerbate the concerns central to its policy analysis.[198] As debates over the legal status of those strategies continue, whether in the courts or before Congress, suppliers will likely continue to advance the ability to price discriminate as a policy argument for legal approval of those strategies.[199] In short, the Supreme Court's decision in *Kirtsaeng* has not provided a final word on either price discrimination or the status of the first sale doctrine. The clash between suppliers' desire to engage in market segmentation on the one hand and the policy motivations underlying the first sale doctrine on the other demonstrates the basic tension at the heart of U.S. copyright law. The conflict between price discrimination and the first sale doctrine is fundamental, and it may not be significantly easier to resolve than the more general, foundational tension between incentives and access.

195. Capitol Records, LLC v. ReDigi Inc., 934 F. Supp. 2d 640, 645 (S.D.N.Y. 2013) ("Because this is a court of law and not a congressional subcommittee or technology blog, the issues are narrow, technical, and purely legal.").

196. *See* discussion *supra* Section IV.B.3.

197. Ned Snow, *Copytraps*, 84 IND. L.J. 285, 286 (2009). As just one example—apart from the difficulties surrounding the first sale doctrine—of copyright's uneasy transition into the Internet age, commentators have expressed concern over the application of strict liability for infringement in the cyberspace context. *See generally id.*; Jacqueline D. Lipton, *Cyberspace, Exceptionalism, and Innocent Copyright Infringement*, 13 VAND. J. ENT. & TECH. L. 767 (2011).

198. *See* Meurer, *supra* note 90, at 104 ("The danger inherent in a policy that discourages price discrimination by making arbitrage easier is that it might displace benign price discrimination into other more pernicious forms.").

199. *See, e.g.*, Nimmer, *supra* note 182, at 1320 (advancing facilitation of price discrimination as a justification for the license-versus-sale distinction); Andi Sporkin, *AAP Statement on Supreme Court Decision*, ASSOC. OF. AM. PUBLISHERS (Mar. 19, 2013), http://www.publishers.org/press/98/ (expressing disappointment with the *Kirtsaeng* decision, asserting that the decision "will discourage the active export of [U.S.] copyrighted works" and "reduce the ability of educators and students in foreign countries to have access to [U.S.]-produced educational materials," and stating that "AAP will be prepared to participate on behalf of publishers in whatever process Congress undertakes to consider and address these issues"); Grimmelmann, *supra* note 12 ("However one comes out on first sale and imported textbooks, the issue, in books and beyond, is too significant to end [with the *Kirtsaeng* decision]. . . . Ladies and gentlemen, start your lobbyists.").