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What Modern Antitrust Law Can and Cannot Teach about the First Sale Doctrine

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Modern Antitrust Approach to Vertical Restraints

- Sherman Act, § 1:
  - "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce … is declared to be illegal."
- But not all contracts are equal;
  - Horizontal
    - Suspicious
  - Vertical
    - Presumptively benign

Vertical Restraints

- Restrict what a buyer can do with purchased goods:
  - where can be resold;
  - to whom;
  - at what prices;
  - will buyer have to provide pre- or post-sale services, repairs, warranties, etc.
- Efficient (sometimes? Often?), e.g.,:
  - Increase output through price discrimination
  - Encourage specific investment by local dealers
- Not illegal per se

Enforcing VRs

- No IP:
  - Enforced by contract and/or threat of termination
  - No recourse against 3rd parties
- With IP:
  - Potentially more effective enforcement of VR:
    - IP remedies > contractual remedies;
    - Can bind third parties (if IP not exhausted).

Hurried antitrust view of FSD

- FSD is a spoiler!
  - Limits the ability of enforcing efficient restraints;
  - Anachronistic antitrust implant within IP;
  - Should be abolished; if not
  - Workarounds should be valid, e.g.,
    - License restrictions, notice, contract.

Origins

- ***Bobbs-Merrill Co. v. Straus,*** 210 U.S. 339 (1908)
  - Conventional wisdom: a resale price maintenance (RPM) case - vertical;
  - Therefore, outdated.
  - Yes, but not only.
    - RPM was the means to enforce an industry-wide publishers and booksellers cartel;
    - Exclude "discounters", (*Bobbs-Merrill Co. v. Straus,* 139 F. 155 (C.C.N.Y. 1905).

First Antitrust Lesson

- **Children! Beware of un-exhausted IP rights!**
- ***Proposition 1***
  - Un-exhausted IP rights can support cartels, and facilitate tacit collusion. They are more effective (dangerous) than contractual mechanisms.
- Relevant to many oligopolistic IP industries
  - Music, film, pharma, tech
  - (but actually to shampoos, watches, chocolate bars…)
  - Beware!

The Parallel Imports Flaw (national vs. intl. exhaustion debate)

- Common argument: "parallel trade should be banned (and intl. exhaustion rejected)" because:
- It undermines cross-country price discrimination
  - therefore harms the poor countries;
- Discourages local dealers from investing in, developing and servicing the market in target (high price) countries
  - Therefore harms consumers in high price markets;
- Reduces IP appropriability and incentives to create
  - Therefore harms everybody.

Main Flaw

- Proves a trivial point (arbitrage can have some negative effects on distribution systems and appropriability);
- Explains very little;
  - But how seriously?
  - Should we worry about it?
  - Is legal intervention needed?

Even if arbitrage has negative effects

- Why ban only intl. arbitrage, but not:
  - Inter-state/province
  - Inter-city
  - Inter-personal?
- Indeed, no-exhaustion should be the rule!
- ***Proposition 2***
  - Antitrust insights do not actually prove that national exhaustion is superior to intl. exhaustion.

2nd Flaw: Recognizing that Some Vertical Restrictions are Efficient Doesn't Mean They Should be Part of the Property Bundle

Thinking seriously about VR

- Efficient VR:
  - Organizing efficient distribution systems when producers aren't fully integrated into distribution and retail.
  - More generally,
- ***Proposition 3***
  - When parties participate in a collaborative productive enterprise that requires specific investments and is prone to opportunism, various restrictions may be necessary for its success.
  - As a corollary, extending such restrictions to third parties (e.g., end users) is seldom necessary.

- ***Proposition 4***
  - exhaustion should be the default rule, but parties should be permitted to workaround it **in situations described in *Proposition 3*.**
  - **Note:** emphasis on "in situations described in *Proposition 3*", not on "permitted to workaround"

3rd flaw: "not taking Coase seriously"

- The *ProCD* move:
  - Property is property, contract is contract;
  - Copyright defines only default property entitlements, but parties can always deviate from them to realize gains from trade.
  - Exhaustion can be the default, but workarounds generally welcome.
- **Children! Beware of the *ProCD* move!**

Coasean logic in a non-Cosean world

The world of IP is non-Coasean

- If it were, there would be no need for IP rights:
  - Prospective authors/inventors and prospective users would contract *ex ante*;
- There would be no need for limited IP rights:
  - Users would demand permission and owners would be happy to grant them *ex ante* or *ex post*.
- The *ProCD* move inconsistent with these assumptions.

- ***Proposition 5***
  - IP theory implies that exhaustion should be a sticky default rule.
  - Workarounds should be presumptively invalid, unless plaintiff persuades that:
    - Defendant participated in a collaborative productive enterprise that requires specific investments and is prone to opportunism, and
    - The workaround is necessary for its success (see *Proposition 3*).

Justifying exhaustion: IP Neutrality

- But what about: "exhaustion makes it more difficult for IP owners to fully appropriate the value of their works, and therefore reduces the incentives to create"?
  - Fits producer-centric innovation model;
  - Assumes that users are couch potatoes;
  - Ignores and taxes other sources of innovation:
    - User-innovation
    - Open-collaborative innovation

Justifying exhaustion: IP neutrality

- IP-neutrality:
  - Designing an IP system that, as far as possible, does not support one model of innovation at the expense of others.
- Exhaustion: crucial element of IP neutrality
  - Enables users to explore, adapt, modify, integrate and improve.
  - And if they can't do that, it allows them to transfer possession to other users who might.
- Crucial for the "Progress of Science and the Useful Arts."

The Peace and Love Bomb

Components

- Transgenic dove from Israel
- Patented genetically modified olive branches - for sale in Palestine
- John Lennon songs (on vinyl) – available in flea markets in the UK
- Windows 95 (never sold, only licensed)
- A 2G iPhone (incl. its 200+ patents) – for sale in Thailand

Conclusion

- What antitrust can teach us?
  - Beware of un-exhausted IP rights!
  - Allow workarounds when necessary for collaboration;
- What antitrust *cannot* teach us?
  - That national exhaustion is superior to intl. exhaustion;
  - That there should be no exhaustion; or
  - Workarounds are presumptively efficient;
- What IP-assumptions-taken-seriously teach us?
  - Exhaustion should be sticky.
  - That universal exhaustion is necessary for promoting the Progress of Science and the Useful Arts.