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The Economics of Kirtsaeng v. John Wiley & Sons, Inc.: The Efficiency of a Balanced Approach to the First Sale Doctrine

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THE ECONOMICS OF *KIRTSAENG V. JOHN WILEY & SONS, INC.*: THE EFFICIENCY OF A BALANCED APPROACH TO THE FIRST SALE DOCTRINE

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INTRODUCTION

Can a buyer of copyrighted works abroad import them to the United States? Can the owner of such items resell them domestically? Does the answer to the first inquiry dictate the answer to the second? These important questions, which relate to the scope of the first sale doctrine in copyright law, are currently pending before the Supreme Court in *Kirtsaeng v. John Wiley & Sons, Inc*.[1]

The parties' positions in this case as well as the Justices' questions during oral argument included an extensive inquiry into the significant economic effects of the Court's potential rulings. This Essay shows that the economic analysis to date, however, is seriously incomplete. This Essay will suggest that the defendant's and plaintiff's positions are economically unsound and that a more balanced approach—possibly the one offered by the Solicitor General—would better promote the public welfare.

The defendant-petitioner urges the Supreme Court to adopt a rule that allows buyers of copyrighted works abroad to freely import and resell these works in the United States.[2] After a short background on the significance of *Kirtsaeng*, Part II analyzes the undesirable economic effects of this position, if adopted. These effects, that to date have not been fully considered, include a material decrease in the incentives to create copyrighted works and a potential for severe harm to buyers in developing countries.

The plaintiff-respondent, by contrast, seeks a rule, adopted by the Second Circuit,[3] which prohibits the unlicensed importation and resale of copies of

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1. Kirtsaeng v. John Wiley & Sons, Inc., No. 11-697 (U.S. argued Oct. 29, 2012).
2. *See* Brief for Petitioner at 5–6, *Kirtsaeng*, No. 11-697 (U.S. July 2, 2012) [hereinafter Petitioner's Brief].
3. *See* John Wiley & Sons, Inc. v. Kirtsaeng, 654 F.3d 210, 224 (2d Cir. 2011), *cert. granted*, 132 S. Ct. 1905 (2012).

copyrighted works manufactured abroad.[4] During oral argument, the economic impacts of this rule were referred to as a "parade of horribles," but the analysis of these effects was lacking.[5] A closer analysis, offered in Part III, reveals that while the adverse economic impacts of this position are not as severe as first thought, the concerns in some cases are real. This analysis shows that adopting this rule would further increase the already high transaction costs in resale markets and, thus, would create a chilling effect on these markets.

This Essay fills an important gap in the economic analysis to date. Once the adverse economic effects of the defendant's and plaintiff's positions are appreciated, the economic significance of *Kirtsaeng* becomes clearer.

Part IV explains why a balanced approached, which would impose a license requirement for importation of copyrighted works but not for their resale in the United States, might be a preferable solution. A somewhat similar outcome was favored by the Solicitor General and by the Ninth Circuit, although both justified their positions on other grounds and did not fully appreciate the economic principles at play. With the support offered by this new economic insight, the Solicitor General's position deserves even closer attention by the Court.

I. BACKGROUND: THE FIRST SALE DOCTRINE AND THE IMPORTANCE OF *KIRTSAENG V. JOHN WILEY & SONS, INC.*

Supap Kirtsaeng moved from Thailand to the United States to attend Cornell University. In order to finance his studies Kirtsaeng asked his friends and family to buy English textbooks in Thailand and send them to him. These books, sold in Thailand for a fraction of their price in the United States, were sold by Kirtsaeng on websites such as eBay. Kirtsaeng's proceeds in the two years in which he was in business exceeded $1 million.[6]

Kirtsaeng was sued by John Wiley & Sons, a publisher of textbooks, for copyright infringement.[7] The Copyright Act grants several exclusive rights to copyright owners including the exclusive rights to distribute copyrighted works and to import them into the United States[8]—rights that were allegedly infringed by Kirtsaeng. Kirtsaeng based his defense on section 109(a) of the Copyright Act, which codifies the principle known as the first sale doctrine.[9] According to section 109(a), notwithstanding the exclusive

4. *See* Brief for Respondent at 6, *Kirtsaeng*, No. 11-697 (U.S. Aug. 31, 2012) [hereinafter Respondent's Brief].

5. *See, e.g.*, Transcript of Oral Argument at 28–32, 36–39, *Kirtsaeng*, No. 11-697 (U.S. Oct. 29, 2012) [hereinafter Transcript], *available at* http://www.supremecourt.gov/oral_arguments/argument_transcripts/11-697.pdf.

6. The facts of the case are drawn from and explored in greater detail in the Second Circuit's opinion. *See Kirstaeng*, 654 F.3d at 213–14.

7. John Wiley & Sons, Inc. v. Kirtsaeng, CIV.A.08CIV.7834DCP, 2009 WL 3364037 (S.D.N.Y. Oct. 19, 2009).

8. 17 U.S.C. §§ 106(3), 602(a) (2006).

9. *Id.* § 109(a).

rights of the copyright owner, an owner of a copy of copyrighted work (e.g., the owner of a CD or a book) "lawfully made under this title" is allowed "to sell or otherwise dispose of the possession" of that copy.[10] In *Quality King Distributors, Inc. v. L'anza Research International, Inc.*,[11] the last Supreme Court opinion dealing with the first sale doctrine, the Court held that this defense also applies to the importation of copyrighted goods.[12] Thus, if the conditions of section 109(a) are met, importation of copyrighted goods does not require a license.

The trial court rejected Kirtsaeng's attempt to use the first sale doctrine as a defense.[13] The Second Circuit affirmed and held that the term "lawfully made under this title," as used in section 109(a), means manufactured in the United States.[14] Because the items imported and resold by Kirtsaeng were manufactured in Thailand, the defense did not apply and thus he was found liable for copyright infringement and was ordered to pay $600,000 in statutory damages.

The main question before the Supreme Court is whether the first sale doctrine defense applies to copies manufactured abroad. If, as the defendant argues, it does, then arguably the importation and resale of goods manufactured abroad and protected by copyright is legal, and Kirtsaeng is not liable. If, as suggested by the plaintiff, the defense does not apply to goods manufactured abroad, then both the importation and resale of those goods require a license from the copyright owner, and therefore Kirtsaeng, who did not secure such a license, is liable.

The Solicitor General's position is more complex. On one hand, he argues that the first sale doctrine defense should not apply with respect to importation of goods manufactured abroad into the United State, and therefore, unless another defense applies, the importer of copyrighted works must secure a license.[15] In addition, however, the Solicitor General claims that Supreme Court precedent[16] provides a broad defense from copyright infringement once items are being sold domestically.[17] This outcome is similar to the rule adopted by the Ninth Circuit.[18]

10. *Id.*

11. Quality King Distrib., Inc. v. L'anza Research Int'l, Inc., 523 U.S. 135 (1998).

12. *Id.* at 151–52.

13. *See* John Wiley & Sons, Inc. v. Kirstaeng, 654 F.3d, 210, 214 (2d Cir. 2011).

14. *See id.* at 224.

15. Brief for United States As Amicus Curiae Supporting Respondent at 27–29, Kirtsaeng v. John Wiley & Sons, Inc., No. 11-697 (U.S. Sept. 7, 2012) [hereinafter Brief for the United States].

16. *See* Bobbs-Merrill Co. v. Straus, 210 U.S. 339 (1908).

17. Brief for the United States, *supra* note 15, at 27–29.

18. *See, e.g.*, Omega S.A. v. Costco Wholesale Corp., 541 F.3d 982 (9th Cir. 2008), *aff'd by an equally divided court*, 131 S.Ct. 565 (2010).

II. WHAT IF THE DEFENDANT'S POSITION IS ADOPTED? LIMITATIONS ON MARKET SEGMENTATION AND REDUCTION IN THE INCENTIVES TO CREATE

The defendant in *Kirtsaeng* argues that adopting the plaintiff's position will cause "a parade of horribles."[19] Can the plaintiff offer his own parade of horribles if the defendant's position is adopted? I believe that to a degree it can, because such a ruling might make geographic market segmentation difficult. This part of the Essay presents the practice of geographic market segmentation and explains why the defendant's position is inconsistent with it. Next, it analyzes the complex and mostly adverse effects of eliminating geographic market segmentation, which include reducing the incentives to create and harming buyers in developing countries.

A. The Defendant's Position Is Inconsistent with the Practice of Geographic Price Discrimination

Market segmentation, which is also called price discrimination, is a pricing scheme by which the seller of a good (in this case, a copyrighted work) attempts to use the heterogeneity in her buyers' attributions—and in particular in their willingness to pay—and offer the product at different prices to different buyers.[20]

There are several ways to achieve such market segmentation. One way, called a third-degree price discrimination, separates the buyers based on some exogenous attributions. An example for this scheme is charging a lower movie ticket price to senior citizens. In *Kirtsaeng*, the practice at question is a third-degree price discrimination that is based on geographic location. More specifically, the practice is to charge a lower price to buyers in developing countries and a higher price to buyers in developed countries.[21] Such a scheme can work only as long as arbitrage between those two markets—buying items in developing countries and reselling them in a developed country—is limited in scope. The defendant, Kirtsaeng, engaged in such international arbitrage. Therefore, when deciding whether the plaintiff has a valid copyright cause of action against Kirtsaeng, the Court will rule on the effectiveness of geographic market segmentation.

At the outset, it is important to note that a win by the defendant will not necessarily eliminate geographic market segmentation altogether. It is more

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19. See Petitioner's Brief, *supra* note 2, at 55–59. It was however the plaintiff who first referred to this argument a "parade of horribles." Respondent's Brief, *supra* note 4, at 49. The term was later used during oral argument. *See* Transcript, *supra* note 5.

20. I explored the practice of price discrimination in copyrighted works, at length, in the context of contracts and copyright, in Guy A. Rub, *Contracting Around Copyright: The Uneasy Case for Unbundling of Rights in Creative Works*, 78 U. CHI. L. REV. 257 (2011).

21. *See* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-05-806, COLLEGE TEXTBOOKS: ENHANCED OFFERINGS APPEAR TO DRIVE RECENT PRICE INCREASES 21–25 (2005), *available at* www.gao.gov/new.items/d05806.pdf. Geographic market segmentation is especially valuable internationally (as compared to within one country) because the differences in the demand and market size between various countries might be significant.

likely that it will incentivize some copyright owners to use less efficient ways to achieve market segmentation. One way to do this is to switch to a second-degree price-discrimination scheme (also called versioning) in which the seller offers various versions of the product, hoping that buyers with high willingness to pay will voluntarily choose to buy the more expensive one.

In this case, it is not difficult to imagine ways in which the plaintiff will implement such market segmentation. For example, John Wiley & Sons can offer different versions of a casebook for different prices. The most up-to-date versions will be offered for a higher price and will naturally be sold for that price in developed countries, including the United States. Older versions will be sold for a cheaper price in developing countries, such as Thailand. This scheme (and many other similar schemes can be envisioned, including licensing nontransferable digital versions of textbooks instead of selling actual books) might put the likes of Kirtsaeng out of business: practically all students in the United States need the newest version of the books used by their professors, and thus, the demand for cheaper old textbooks, sold abroad, will be low.

Switching to new distribution models, however, has real costs beyond the elimination of arbitrage. For example, the scheme suggested above adds administrative costs for keeping two versions in print and causes disutility to students in developing countries who will use old versions of textbooks. Overall, while John Wiley & Sons can maintain some market segmentation even if it were to lose in *Kirtsaeng*, it clearly prefers the current scheme to create such segmentation.

In other cases, implementing an alternative market segmentation scheme might be even more difficult. This is especially true in those common cases in which the seller finds it difficult to create a cheap version of the product that buyers in developed countries are not interested in buying. Music and software CDs are two good examples.

B. Is Geographic Market Segmentation Socially Desirable?

What are the implications of seriously limiting or even eliminating geographic market segmentation? In *Quality King* the Court noted that prohibiting unlicensed importation (in that case, of copyrighted works manufactured in the United States and first sold abroad) "would merely inhibit access to ideas without any countervailing benefit."[22] This supposition is clearly wrong. Nobody can reasonably argue that there are absolutely no advantages to geographic market segmentation. In fact, a closer look reveals that while the cost-benefit analysis of this practice is complex, in the long run it is probably socially desirable.

As I have shown elsewhere,[23] the economic impacts of eliminating market segmentation vary from one market to another. In many cases, if

22. Quality King Distrib., Inc. v. L'anza Research Int'l, Inc., 523 U.S. 135, 151 (1998).
23. Rub, *supra* note 20, at 266–71.

forced to charge a uniform price, the copyright owner will need to decide whether to sell the work for a cheaper price to a larger market or for a higher price to a smaller market. Sellers actually make those choices routinely.

If the result of eliminating market segmentation is a cheap uniform price, then buyers in developed countries will be much better off, while buyers in developing countries will be slightly worse off (as it is almost certain that the uniform price will be at least somewhat more expensive than the price in developing countries under a well-functioning market segmentation scheme). Total buyers' surplus will likely increase. If the result of eliminating market segmentation is a high uniform price, then buyers in developed countries will be only marginally better off—if at all—while the buyers in developing countries will be completely priced out of the market. The deadweight loss—the waste that results from pricing out of the market those buyers who are willing to pay more than the marginal cost of production but less than the uniform price—as well as the harm to third-world buyers will therefore be significant. Total buyers' surplus will decrease.

In both cases, if geographic market segmentation is eliminated, the producer's surplus—the surplus of the copyright owner—will decrease. This result is certain because the copyright owner otherwise would not have implemented a market segmentation approach in the first place.

Several conclusions can be drawn from this analysis. The first conclusion, and probably the most significant one, is that as the producer's surplus shrinks so do the incentives to create.[24] The copyright owner is denied a revenue stream that the market segmentation gives her, and thus those creators whose expected revenues can barely cover the cost of creation might decide not to create. Eliminating market segmentation might therefore adversely affect the number and quality of works created.

Another interesting result is that, in the short run, eliminating market segmentation can severely harm buyers in developing countries who will face a price increase. The parties in *Kirtsaeng*, as well as the panels of the Second and Ninth Circuits, questioned what interpretation of the first sale doctrine would result in extraterritorial expansion of U.S. copyright law.[25] The analysis in this part provides an interesting angle as to the international impact of a possible win by the defendant: as the United States is a major market for copyrighted goods, a decision by the Supreme Court that would make importation and resale of copyrighted goods in the United States easier might severely harm buyers in developing countries.

The final conclusion has to do with buyers in the United States. In many cases, the total effect of eliminating geographic market segmentation on

24. *See id.* at 273–75.

25. *See, e.g.*, John Wiley & Sons, Inc. v. Kirtsaeng, 654 F.3d 210, 219 (2d Cir. 2011); Omega S.A. v. Costco Wholesale Corp., 541 F.3d 982, 987–88 (9th Cir. 2008), *aff'd by an equally divided court*, 131 S.Ct. 565 (2010); Petitioner's Brief, *supra* note 2, at 46–48; Respondent's Brief, *supra* note 4, at 16–17.

U.S. buyers—and in particular whether they can expect a price decrease—is unclear. In some other cases, the results might be more obvious. The market at issue in *Kirtsaeng* (i.e., textbooks in English), might be one such example. It is extremely unlikely that the size of this market in developing countries will cause John Wiley & Sons or other publishers to choose a uniform cheap price for those textbooks. It is far more likely that, as the majority of native English speakers in the world live in the United States[26] (and more than 90 percent in developed countries),[27] the publishers will choose a high price—similar or maybe identical to the current price in the United States. This high uniform price would make the purchase of new English language textbooks in developing countries impractical. Therefore, while the defendant in *Kirtsaeng* seems to suggest that his position helps students in the United States overcome the rising costs of college education,[28] winning the case is unlikely to provide much help to those students: if massive international arbitrage is allowed, the price will probably be high worldwide.

III. WHAT IF THE PLAINTIFF'S POSITION IS ADOPTED? THE PARADE OF HORRIBLES AND THE HARM TO RESALE MARKETS

During oral argument, several of the Justices focused on what the parties referred to as a "parade of horribles."[29] The parade of horribles includes a long list of allegedly absurd outcomes that will result from limiting the first sale doctrine to goods manufactured in the United States, as suggested by the plaintiff. Many believe that this argument might play a significant role in the Court's eventual reasoning.

Is the parade of horribles really that troubling? Closer analysis reveals that these concerns are real, although probably exaggerated. The concerns are exaggerated for two reasons: Some of the scenarios described are not really horrible but are just a cost of market segmentation. Other suggested horrible outcomes are unlikely in a market economy. However, the analysis shows that adopting the plaintiff's position can create some "horrible" results by increasing the already high transaction costs in resale markets.

A. Are All the Horribles Really That Horrible? The Cost of Market Segmentation

Some of the alleged horribles are not self-evidently horrible but seem more like a reasonable cost of the copyright system and, in particular, market segmentation. The issue before the Court is how broadly to interpret a certain exception to some exclusive rights of copyright owners. This decision will naturally affect the so-called "delicate balance" between

26. DAVID CRYSTAL, THE CAMBRIDGE ENCYCLOPEDIA OF THE ENGLISH LANGUAGE 109 (2d ed. 2003).

27. *Id.*

28. Petitioner's Brief, *supra* note 2, at 7.

29. *See* Transcript, *supra* note 5.

incentives and access—but many copyright cases do just that.[30] If a court decides to interpret an exclusive right broadly or to interpret a defense narrowly, the copyright owner will naturally gain a benefit over the copyright users. That, in itself, might not be horrible. It is true that those who currently engage in international arbitrage—for example, Kirtsaeng and his family or Costco, which buys goods, sometimes protected by copyright, for a cheap price abroad and sells them in the United States—will obviously be adversely affected by a ruling for the plaintiff. Nevertheless, at the same time, copyright owners—like John Wiley & Sons or software companies—will experience an increase in their profits. Does that tradeoff clearly make this result "horrible"? I argue no.

For example, the fact that Kirtsaeng supplies cheap textbooks to students that might be struggling with the high cost of college education does not necessarily mean, as the defendant implicitly argues, that the law should protect such an activity. First and foremost, as mentioned above,[31] even if Kirtsaeng wins, it is unlikely that it will allow many students in developed countries to buy cheap textbooks in English. Moreover, taken to the extreme, this line of argument can logically justify abolishing copyright law altogether, because this will clearly and quite dramatically reduce the price of textbooks. This is, of course, a silly argument. Most will agree that without copyright law the long-term incentives to create textbooks will be inefficiently too low. The issue, therefore, is one that is at the heart of copyright law itself—the tradeoff between incentives and access. It is thus not self-evident that strengthening the copyright owner's control over her work, which sometimes might cause a price increase and a reduction in access to existing copyrighted works, is undesirable.[32] By the way, the same can be said with respect to those companies that facilitate the resale markets, such as eBay. Of course eBay prefers a broad first sale defense,[33] as it will increase the volume of transactions on its site. But wouldn't abolishing copyright altogether increase, in the short run, the volume of trades too?

B. The Market Ability To Resolve Some Horrible Results

The second problem with the parade-of-horribles argument is that it fails to take into account the ability of the market to fix some legal predicaments. This is best explained with the following example, first mentioned in the

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30. *See generally* Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417, 429 (1984); Glynn S. Lunney, Jr., *Reexamining Copyright's Incentives-Access Paradigm*, 49 VAND. L. REV. 483, 492–98 (1996).

31. *See supra* Part II.B.

32. For an interesting analysis of how some of the basic questions in copyright law can be framed in terms of fostering and limiting price discrimination, see Wendy J. Gordon, *Intellectual Property As Price Discrimination: Implications for Contract*, 73 CHI.-KENT L. REV. 1367 (1998).

33. *See* Brief for eBay, Inc. et al. As Amici Curiae Supporting Petitioner at 5–6, Kirtsaeng v. John Wiley & Sons, Inc., No. 11-697 (U.S. July 9, 2012).

defendant's briefs[34] and later raised during oral argument in a question by Justice Breyer to Ted Olson, plaintiff's counsel: "[I]magine Toyota . . . . They have copyrighted sound systems. They have copyrighted GPS systems . . . . now, this is one of their [i.e., the defendant's] horribles . . . . Under their reading, the millions of Americans who buy Toyotas could not resell them without getting the permission of the copyright owner of every item in that car which is copyrighted."[35] Olson replied that those buyers might have other defenses, although he did not mention any of them.[36]

There is clearly a better answer. It is quite obvious that regardless of the Court's holding, buyers of Toyota will be able to resell their cars. Without such a resale right these cars will lose much of their market value, and Toyota should certainly be aware of that. For a somewhat similar reason, Toyota makes its long-term warranty transferable,[37] although it probably has no legal obligation to do so. If the Court holds that a license is required to resell a Toyota, it is highly likely that the company will provide such a transferable license to every buyer.

Indeed, the discussion of the parade of horribles seems to sometimes miss one of the insights of Coase's "the problem of social costs"[38]—in many cases, the market can fix legal inefficiencies. Coase showed that while "[i]t was of course the view of the judges that they were affecting the working of the economic system,"[39] in many instances that is not the case. Sometimes legal rules are just the starting point for another economic interaction—in this case, steps to be taken by Toyota to protect its customers' rights.

C. How High Transaction Cost in Resale Markets Can Cause a Real Parade of Horribles

If the parade of horribles argument identifies some natural cost of the market segmentation system as "horrible" and ignores, in some other cases, the market ability to fix some unfortunate situations, is there anything left of that argument? The answer is yes. From an economic perspective the main problem with the plaintiff's argument is that it will increase the transaction costs in resale markets.

Consider, for example, a library that just received a donation of books and needs to decide if lending them to its patrons constitutes an infringement of copyright. It might be very difficult to verify where the books were printed. The analysis will suggest that, unlike the case of Toyota, it is not clear that the publisher will make sure that the buyers have

34. Petitioner's Brief, *supra* note 2, at 4, 59.
35. Transcript, *supra* note 5, at 28–29.
36. *Id.* at 29.
37. *Used Toyota Warranty*, TOYATA CERTIFIED USED VEHICLES, http://www.toyotacertified.com/warranty.html (last visited Feb. 12, 2013) (stating that the seven-year warranty is "transferable at no cost, for added resale value").
38. R. H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 8–15 (1960).
39. *Id.* at 10.

a license to transfer the book and/or to lend it. Verifying the exact rights or negotiating a license might be expensive. The same is true for Goodwill when it receives donations or when any individual sells copyrighted goods in a yard sale.

This increase in transaction costs can create several "horrible" situations because high transaction costs are already a severe problem in our copyright system that the Copyright Act does not properly address. The transaction costs problem represents a real economic waste that the market cannot easily solve.

This part explains how the core doctrinal structure of copyright law seems to assume that transaction costs are low and that users can easily negotiate licenses with copyright owners. It will show that these assumptions were never accurate and that in recent years transaction costs have risen even more. This creates real difficulties in reaching license agreements as well as problems with innocent infringers. This part will then show that the rule proposed by the plaintiff further increases transaction costs by placing a heavier burden on users and by weakening the ability of the first sale doctrine to reduce transaction costs.

1. The Problem of High Transaction Costs in Copyright Law

Copyright law creates broad property rights in intangible goods protected by strict liability rules. A copyright owner can enforce her exclusive rights without the need to prove intent or negligence by the alleged infringer.[40] Indeed, copyright infringement can occur even if the infringer took all reasonable steps to avoid infringement and even if the infringement was subconscious.[41] The law also provides the copyright owner with a powerful set of remedies including statutory damages, impoundment, and injunctions.[42]

Economic analysis of law literature has explored the conditions under which such strong mechanisms should be used. This literature suggests that entitlements should be protected by property rules when low transaction costs allow the parties to reach voluntary transactions.[43] Strict liability

40. CoStar Grp., Inc. v. LoopNet, Inc., 106 F. Supp. 2d 780, 787 (D. Md. 2000); David N. Weiskopf, *The Risks of Copyright Infringement on the Internet: A Practitioner's Guide*, 33 U.S.F. L. REV. 1, 13 (1998).

41. The most famous example of this kind of infringement is George Harrison subconsciously copying The Chiffons's *He's So Fine* when composing *My Sweet Lord*. ABKCO Music, Inc. v. Harrisongs Music, Ltd., 722 F.2d 988 (2d Cir. 1983).

42. 17 U.S.C. §§ 502–504 (2006). It should be noted that this full set of strong mechanisms apply only with respect to direct liability. The liability regime with respect to secondary infringers, such as those who provide a marketplace for secondary sellers (e.g., eBay) is more flexible. Indeed, in secondary liability cases, courts regularly consider issues such as the reasonableness of the actions taken by the defendant. *See, e.g.*, Perfect 10, Inc. v. Amazon.com, Inc., 508 F.3d 1146, 1172–73 (9th Cir. 2007) (instructing the district court to explore whether Google had "reasonable and feasible means" to stop infringements by its users).

43. Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1106–09 (1972).

should be used primarily where the injurer/infringer has close to complete control over the happening of the undesirable result[44]—in this case, the infringement.

Copyright law does not fit this mold. On the one hand, in many cases it is quite difficult for the users to figure out when a license is needed and, therefore, innocent infringement is not uncommon. In addition, even if a user believes that a license is needed, the transaction costs in securing such a license might be significant. While some of those problems are inherent to any property rights system in intangible goods,[45] the elimination of many copyright formalities in the United States and the extension in the length of copyright protection, not only inflated the number of copyright protected works but also increases the transaction costs in securing a license.[46] Some of the most difficult and pressing questions in copyright law nowadays, including the problem of orphan works,[47] result, to a large extent, from this increase in transaction costs.

2. The Plaintiff's Position, if Adopted, Is Expected To Exacerbate the Problem of High Transaction Costs

Adopting the plaintiff's position is expected to increase the transaction costs in the resale market for two reasons. One is quite obvious: the plaintiff's position gives the copyright owner substantial control over resale of copyright works manufactured abroad. Thus, the users of copyrighted goods will need to waste transaction costs in verifying whether the good, or any part of it, if protected by copyright, was manufactured abroad. The second reason is that this position, by requiring a license, weakens one of the mechanisms used by the Copyright Act to reduce transaction costs: the first sale doctrine.

The first sale doctrine seems to promote efficiency and save transaction costs by bundling together two rights that, in most cases, the parties, if asked, would have chosen to buy and sell together: the personal property right in the copy, including, for example, the right to destroy it, to store it, or to mortgage it, and the right to transfer the copy. Exercising the right to resale by the owner of the copy (e.g., by having a yard sale of the owner's book and CD collections) typically involves minimal transaction costs. Exercising the right to resale by the copyright owner might entail substantial costs because it will necessarily require cooperation between the owner of the copy and the copyright owner, cooperation that will involve

44. Steven M. Shavell, *Strict Liability Versus Negligence*, 9 J. LEGAL STUD. 1 (1980).

45. Thus, it is inherently more difficult to define borders (between the property of one owner and another or the public) with respect to intangible goods (such as copyrighted goods) than with respect to tangible goods such as land or personal property.

46. *See generally* Christopher Sprigman, *Reform(aliz)ing Copyright*, 57 STAN. L. REV. 485 (2004).

47. Orphan works are those works whose copyright owner is unknown or difficult to locate. Using these works in a way that requires a license is extremely difficult. *See, e.g.*, Authors Guild, Inc. v. HathiTrust, No. 11 CV-6351(HB), 2012 WL 4808939 (S.D.N.Y. Oct. 10, 2012); Authors Guild v. Google Inc., 770 F. Supp. 2d 666, 671 (S.D.N.Y. 2011).

transaction costs.[48] In other words, in most cases, the copyright owners will prefer to sell the copies of the work, in the initial sale, together with the right of resale, because she can charge a higher price for such a product.[49]

Therefore, the plaintiff's position, which limits the first sale doctrine and places the burden of verifying the product's origin on the user, increases transaction costs even further. The market cannot typically fix this problem, and this is where the buyers of Toyota and books depart. The buyers of Toyota, who are about to spend a substantial amount, can probably afford the transaction cost in verifying that they will be able to resell their car before they purchase it. Car dealers will probably make sure that this is possible, and they will be quick to point out to potential car buyers if a certain car manufacturer will not guarantee this right. It is unreasonable to expect a buyer of a book, a CD, or a T-shirt to spend a few minutes exploring whether, in the future, she would be able to resell the goods in a yard sale or donate them.[50] Therefore, the plaintiff's position, if adopted, will hurt users and will create a harmful chilling effect on resale markets and on public and nonprofit entities such as libraries.

IV. THE VIRTUES OF THE SOLICITOR GENERAL'S BALANCED APPROACH

The previous parts of this Essay explored the weaknesses in the positions of the defendant and the plaintiff in *Kirtsaeng*. The defendant's position, if adopted, will make geographic market segmentation difficult and thus decrease the incentives to create. The plaintiff's position, if adopted, will increase transaction costs in resale markets, which will create an inefficient chilling effect on these markets.

Therefore, this analysis seems to support a more balanced approach, and it thus provides an economic justification to the position of the Solicitor General. The Solicitor General urges the Court to adopt a position that would allow the copyright owner to control importation of copyrighted goods to the country but that would also limit such control once the items

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48. A funny and effective example of such a negotiation was presented in a segment on *The Colbert Report* in which Stephen Colbert and Elvis Costello agreed, after several minutes of negotiation, that if Colbert sells a Costello record for one dollar in a garage sale, he would pay Costello fourteen cents and a dented muffin tin. *Judge, Jury & Executioner—Copyright Law*, COLBERT NATION (Nov. 26, 2012), http://www.colbertnation.com/the-colbert-report-videos/421501/november-26-2012/judge--jury---executioner---copyright-law.

49. *See generally* PAUL GOLDSTEIN, GOLDSTEIN ON COPYRIGHT 7:131 (3d ed. 2005 & Supp. 2011) (suggesting that "[i]n the usual case, the copyright owner will have no interest in undertaking the expense of . . . negotiations [every time the owner of a copy wishes to resell it]"). In some cases, however, copyright owners do want to exercise control over the resale market, usually in order to facilitate domestic market segmentation. These attempts, typically accomplished by using certain licensing arrangements, sometimes result in legal disputes. *See, e.g.*, Vernor v. Autodesk, Inc., 621 F.3d 1102 (9th Cir. 2010). A full analysis of these scenarios is beyond the scope of this Essay.

50. *See generally* Molly Shaffer Van Houweling, *The New Servitudes*, 96 GEO. L.J. 885, 914–15 (2008).

are being sold in the United States.[51] The Solicitor General justified this result, which is similar to the result reached by the Ninth Circuit,[52] by relying on the language of the Copyright Act and Supreme Court precedents but without fully appreciating its strength from a public policy perspective.

The distinction between the copyright owner's control over importation and her control over resale is economically justified. On one hand, controlling importation is required in order to limit international arbitrage, and thus it is crucial to the copyright owner's ability to implement effective geographic market segmentation. The increase in transaction costs from this type of control is insignificant: most importers know that the goods being imported are manufactured abroad and, in fact, there is a reasonable chance that they are aware that their actions conflict with the copyright owner's attempt to segment the market. Moreover, importation is typically not done in small quantities by uninformed laymen and the well-informed professional importers typically know their legal rights and, as repeat large players, can negotiate a license if needed. Therefore, high transaction costs are typically not a major issue.

When it comes to resale markets the balance is different. These resale markets include goods manufactured domestically and abroad, as well as goods that include multiple parts manufactured in different countries. In addition, many of the participants in these markets are individuals who are engaged in this activity sporadically and on a small scale. Therefore, the increase in transaction costs that would result from legally requiring a license when reselling items manufactured abroad might be significant. Moreover, if the copyright owner is granted control over importation, efficient geographic market segmentation can be achieved without necessarily controlling resale markets. Therefore, having a broad first sale doctrine in this stage makes economic sense.

Thus, the interpretation of the Solicitor General and the Ninth Circuit make sense from a public policy perspective: geographic market segmentation should be allowed but not if it means outlawing the innocent resale of products manufactured abroad. Requiring a license from importers but not from resellers achieves this goal.[53]

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51. It is important to note that the Solicitor General did not argue that every resale in the United States of items manufactured abroad is legal. Instead, he argued that "a copyright owner who authorized the importation of foreign-made copies into the United States, and/or authorized a first sale of the copies within this country, had exhausted his exclusive statutory right to control the distribution." Brief for the United States, *supra* note 15, at 27 (citations omitted). Thus, this position does not eliminate the problem of innocent infringement in resale markets, but it significantly mitigates it.

52. *See* Omega S.A. v. Costco Wholesale Corp., 541 F.3d 982, 983 (9th Cir. 2008), *aff'd by an equally divided court*, 131 S. Ct. 565 (2010).

53. Congress might be able to better address the issue, and it might be asked to do so by the side that loses in the Supreme Court. There are many ways for Congress to do so. For example, it can give copyright owners control over importation of items purchased abroad but limit liability to defendants who knew or should have known that their actions defeat a market segmentation plan. Such a solution, or a similar one, while not without difficulties, will place liability on the likes of Kirtsaeng but not on innocent buyers. This solution, by

departing from the strict liability framework of the Copyright Act, will also incentivize copyright owners to convey valuable information to buyers, which in many cases will be cheap to do (for example, the cover of John Wiley & Sons's textbooks were marked with a legend stating that they are to be sold only in a particular country or geographic region), and which will allow buyers to accurately assess the value of the copies she is purchasing. A full analysis of these possibilities is beyond the scope of this Essay.