The End of Ownership

Personal Property in the Digital Economy

The title-level DOI for this work is:

doi:10.7551/mitpress/10524.001.0001

2 Property and the Exhaustion Principle

In order to make sense of our changing relationship with digital goods, we need to start with a basic understanding of our system of property rights. This chapter should make a few things clear. For one, defining consumer rights through licenses rather than the default rules of ownership is a significant departure from the way we typically treat personal property. For another, despite common misconceptions, property rights are rarely absolute. Instead, they often have to accommodate the interests of others. The law has developed ways of resolving those competing claims. Who wins and who loses in those struggles for control over valuable resources tells us something about our priorities, about what sorts of uses and what sorts of users we think should be privileged under the law. When it comes to goods subject to intellectual property protection, the principle of exhaustion is the primary tool for resolving disputes between IP holders and personal property owners. The shift away from exhaustion and toward licensing is an effort to take power away from individuals in favor of copyright holders and their retail partners. Because this power grab reduces efficiency, creates harmful externalities, and interferes with individual autonomy, we should find it troubling.

A Property Law Primer

To begin, we should distinguish between four basic types of property: real, personal, intellectual, and intangible. Most of us associate the term "property" with land—your home or the proverbial family farm. In the law, we call this real property, as in real estate. Real property stands apart from other kinds of property in a number of ways. First, each piece of real property, defined by the physical space it occupies, is unique. Theoretically, each parcel of land can be clearly defined and distinguished from all others. Second, because real property is tied to physical space, it stays put. Setting aside

things like tectonic shifts, landslides, and rivers changing course, your real property will remain exactly where you left it. Third, real property is comparatively expensive. As a result, most of us engage in only a handful of real property transactions in our lives. Compare the number of homes you've bought to the number of socks, books, or cell phones you've purchased.

Another key distinguishing characteristic of real property is the relative flexibility the law affords owners of land to define and rearrange their rights. Interests in real property can take a number of forms. The most familiar is what lawyers call the fee simple. The owner of a fee simple interest has the right to use the land, to possess it, to exclude others, to sell it, to give it away, and to collect profits from it. But there are other ways to own real property. A life estate, for example, is a right to possess and use land, but only for the duration of a person's life. Tenancy in common allows two or more owners to possess land at the same time, each having equal rights to occupy and use the property. Timeshares, in contrast, make it possible for several owners to use the property, but each for only a set amount of time each year. And condominiums provide for individual ownership of each unit in a building, but joint ownership of common areas like lobbies and hallways.[1]

Not only can real property owners choose from these and other ready-made forms of ownership, they can further customize their property rights using legal tools called real covenants and equitable servitudes.[2] With these tools, property owners can craft limitations or obligations on future use of the property; they can attach strings that dictate what can be done with the property. These strings are said to "run with the land," binding all subsequent owners of the property. Through these legal devices, owners can impose a wide range of restrictions on future generations. They can limit a piece of land to a particular purpose—a single family home, for example. Or they can forbid certain uses—no lighthouses or organic supermarkets. They can prohibit pets. They can insist on green lawns and gardeners to tend them. They can require that you choose from an approved palette of paint colors. They can ban holiday decorations. In short, through property law, owners can fashion their own bespoke sets of rights, imposing their preferences and whims on everyone who encounters a particular parcel of real property.[3]

When it comes to personal property, the rules are not nearly as customizable.[4] Property interests in chattels—legal-speak for your personal possessions—are far more prosaic. You can own a tuxedo; you can rent a tuxedo; and you can borrow a tuxedo. But the law of property doesn't recognize timeshares in tuxedos.[5] Nor does the law recognize servitudes on chattels;

personal property doesn't come with strings attached. Although some English courts in the mid-1800s toyed with the idea of applying servitudes to movable property, they quickly corrected course. And U.S. courts followed suit.[6] As a result, your tuxedo can't be burdened by an obligation to wear a particular brand of shoes or a prohibition on wearing it two weekends in a row. Of course, you could agree to those limitations in a contract, but only the parties to a contract are bound by its terms. Those obligations would not "run with the tuxedo" to bind future owners.

Maintaining clear and simple rules for personal property serves a couple of related purposes. First, it helps keep information costs in check. We may be willing to carefully investigate each real estate transaction for idiosyncratic property obligations. After all, we don't buy homes all that often, and a lot of money is at stake. But when it comes to donuts, staplers, and books, such effort hardly seems worth it. The cost of determining the precise contours of the property rights in these sorts of purchases could easily exceed the value of the good itself.[7] Second, clear property rights make sure that common items of everyday commerce can be freely bought and sold. If tuxedo manufacturers could customize the rights that buyers obtain, they might be tempted to protect themselves from competition by prohibiting rental or controlling resale prices. As one court put it, efforts to attach strings to personal property are "obnoxious to public policy, which is best subserved by great freedom of traffic in such things as pass from hand to hand."[8]

Our personal property rules place a high value on alienability—the right of an owner of an item to resell it, give it away, or otherwise transfer it. But it doesn't have to be that way. We can imagine other property systems that would lead to very different outcomes. Consider goblin property. In J. K. Rowling's *Harry Potter* series, goblins are skilled metalsmiths. And they are deeply attached to the items they craft, regarding themselves as the true owners of those items, even after their sale. As Rowling explains: "Goblin notions of ownership, payment, and repayment are not the same as human ones. ... To a goblin, the rightful and true master of any object is the maker, not the purchaser. All goblin-made objects are, in goblin eyes, rightfully theirs. ... They would consider it rented by [a purchaser]. ... They consider our habit of keeping goblin-made objects, passing them from wizard to wizard without further payment, little more than theft."[9]

But we are not goblins, at least not yet. When you sell your used Prius, you don't owe Toyota a percentage of the sale price. When you die, Samsung doesn't get to reclaim your TV. Once you've purchased an item, it belongs to you.

So far we've considered property interests that relate to physical assets. With intellectual property, our focus shifts from the physical to the incorporeal. IP encompasses a cluster of legislative and judicial rules that grant property-like rights in the intangible creations of human ingenuity. Patent law rewards inventors with exclusive rights in their novel innovations; copyright law provides rights to creators of original expressive works; and trademark law protects distinctive symbols from confusingly similar uses. These and other related legal regimes fall under the broad umbrella of intellectual property.

Although patents will play an important role later in our story, our primary focus is copyright law.[10] Copyright is concerned with works of creative expression. Books, music, film, visual art, and software all fall within its broad subject matter. In order for a work to qualify for copyright protection, it must be original—it must reflect a modicum of creativity, and it can't be copied from an existing work.[11] To be protected by copyright, a work must also be recorded in some physical form.[12] This fixation requirement is satisfied when a writer jots down a story in a notebook, or when a photographer saves an image to a memory card.

If a work qualifies, the copyright holder is granted a number of valuable exclusive rights. They include copying the work, selling or otherwise transferring copies of the work, publicly performing or displaying the work, and making new works based on it.[13] Only the copyright holder is legally entitled to engage in these behaviors without permission. To take a more concrete example, let's say you buy a copy of a film on Blu-ray. Unless you have permission from the copyright holder, you can't make copies of that film; you can't play it for a roomful of strangers; and you can't make an unauthorized sequel. This ability to control how the work is used by others accounts for the property-like nature of copyright interests. Since copyrighted works are often sold in physical form, IP rights enable a degree of ongoing control by copyright holders over the tangible products we buy. But as we will describe later in this chapter, that control is constrained in crucial ways by the principle of exhaustion.

Although IP shares some characteristics with more familiar forms of property, it differs from them in a number of respects. In fact, many question whether the term "intellectual property," despite its wide usage, overstates the connection between IP and other more familiar forms of property. Unlike most forms of tangible property, patents and copyrights expire. Indeed, the U.S. Constitution requires that they last for only "limited times." Initially, the term was fourteen years. Today, patents expire

after twenty years, and copyrights expire an astounding seventy years after the death of the author.[14]

More fundamentally, the mental creations of interest to IP law are what we call public goods; they exhibit two characteristics that set them apart from traditional property. First, ideas and expression are nonrivalrous. Use of an intellectual resource by one person doesn't interfere with its use by another. If I am driving my car, you can't. And no matter how hard you try, you can't fit two people into a single tuxedo. But millions of people can watch the same television show, sing the same song, or read the same novel without depleting the underlying intellectual resource. As Thomas Jefferson explained it, "He who receives an idea from me, receives instruction himself without lessening mine; as he who lights his taper at mine, receives light without darkening me."[15] Second, information is nonexcludable; it is difficult to maintain control of intellectual resources once they have been disclosed. You can put a fence around your land to keep out intruders. You can lock your jewels in a safe. But controlling the use and spread of information is like trying to construct a fence around your own personal supply of air. For these two reasons, intellectual resources are distinguishable from other kinds of property.

Good ideas—like a new way of treating a deadly disease or the perfect breakup song—have the potential to improve lives. We want them to spread. So we should celebrate the fact that information goods, unlike arable land or iPhones, don't run out or wear down. But the public-goods characteristics of information resources create a potential problem. Although a groundbreaking treatment or a heartbreaking song can be freely shared and enjoyed, making something new requires investments of time, effort, and money. If creators cannot recover those investments, plus a reasonable profit for their trouble, some will be dissuaded. In a world where creating new works is expensive and copying them is cheap and easy for the public, poets will become accountants, and inventors will become plumbers. IP law is meant to remedy this public goods problem—the feared undersupply of creative investment—by creating legal barriers to competition by prohibiting copying. IP rights are an effort to overcome the inherent characteristics of intellectual resources and force them to behave more like tangible property.

Importantly, not all intangible resources fall under the IP umbrella. Interests in debts, securities, and government franchises—think liquor licenses or taxi medallions—all concern intangible assets rather than tangible objects, but they aren't regulated by IP law. Likewise, we can think

of assets like digital currencies and virtual objects—a powerful weapon in your favorite video game, for example—in terms of property. The rules surrounding these relatively new intangible assets remain largely undefined.[16] Digital objects don't easily fit into either the IP or the personal property frameworks. Consider a digital movie you purchase from Apple. You browse on iTunes, find a movie that looks promising—we recommend Shane Carruth's *Upstream Color*—and buy it for $12.99. You can stream that movie to your TV from Apple's servers, you can download it to your laptop, or you can come back to it another day. But what set of rules defines your rights in that digital asset? Is it the rules of personal property or the rules of intellectual property and, by extension, the iTunes license agreement? The question at the heart of this book is whether digital goods—both media content and devices with embedded software—play by the familiar rules of personal property or the more flexible but often opaque rules of IP licenses. In short, do we own our digital goods?

Understanding Ownership

What does it mean to own property? That's a surprisingly hard question to answer. Legal scholars, economists, and philosophers have debated the fundamental nature of property for centuries. And we can't hope to button up that long-running dialogue here. Our more modest goal is to convince you to reconsider some of your own preconceptions about ownership.

Most people think of property ownership as bestowing an absolute right to an individual owner of a tangible thing. If you know a single adage about the law of property, it is probably William Blackstone's oft-quoted reference to property as "that sole and despotic dominion which one man claims and exercises over the external things of the world, in total exclusion of the right of any other individual in the universe."[17] But our discussion already suggests what Blackstone knew very well: that this absolutist view of property is an oversimplification.[18]

Over the last century or so, a more nuanced understanding has gained prominence among property experts. Under this view, property ownership is comprised of a bundle of distinct and separable interests. Consider the owner of a piece of land. We can break the concept of ownership down into a number of discrete rights that the owner might enjoy: the right to possess the land, to have physical control over it; the right to use the land, for picnics or kite flying for example; the right to manage the land, to decide who else can have picnics and fly kites; the right to income from the land, to charge rent for picnics and kite flying; and the right to alienate the land,

to sell it or give it away. Each of these rights, among others, contributes to the owner's property interests. But no single right is essential to ownership. The owner could lease their land, but their lack of possession doesn't mean they no longer own it. They could sell mineral rights in the land to an energy company, but the company's use and profit are not inconsistent with individual ownership.

This understanding of property as a bundle of related but separable rights helps us account for the complexity and flexibility of property interests, especially interests in land. It is a less useful metaphor when it comes to personal property, where the law insists on less complex arrangements of rights in order to limit information costs, ensure the free movement of goods, and protect consumer welfare. When it comes to your tuxedo, the law doesn't permit this sort of slicing and dicing. But copyrights, in contrast, lend themselves to the bundle-of-rights model by congressional design. The rights of a copyright holder are an explicitly enumerated bundle—to reproduce, distribute, publicly display and perform, and make adaptations of the work. And each of those rights is divisible by time, geography, medium, or any other limitation dreamed up by a rights holder. A playwright, for example, can transfer the right to publicly perform their latest play but, if they so choose, only on alternating Tuesdays in Wisconsin. In practice, this can easily lead to dozens of owners of copyright interests in a single work. In theory, the number is infinite.

These two conceptions of property—one emphasizing simplicity, the other embracing flexibility—are in tension. On the whole, we think the bundle-of-rights view is a more accurate description of how property works. But we also recognize the importance of placing limitations on the flexibility that the bundle enables. Particularly when it comes to consumer goods—characterized by their low cost and high volume compared to real property—we think the information costs and other negative externalities that flow from customized bundles of rights make the case for a limited menu of standard transactions.

Let's say you decide to take us up on our recommendation of *Upstream Color*. For the sake of simplicity, let's also stipulate that you prefer hard copies. You have four basic options. You can buy the film on Blu-ray. You can rent it from Redbox or a local video rental store, if you can find one. You can get it from a subscription service like Netflix's vestigial DVD-by-mail service. Or you can borrow it from a friend or the local library. That short list of familiar transactions would satisfy the needs of most people.

We could come up with other fanciful alternatives. They might even end up looking something like the Apple or Amazon EULAs. Taken to its

extreme, the bundle-of-rights view would allow for the creation of any bespoke assemblage of rights and restrictions we can imagine. And while there might be some people who prefer these innovative transactions, we think that degree of flexibility imposes costs on individuals and society without a corresponding increase in consumer satisfaction. Flexibility is valuable, but only up to this point of diminishing returns.

The second widely held belief we want to challenge concerns the subject matter of property rights. Most of us think about property as conferring rights over things, typically tangible things. But we've already seen how the law extends some property concepts to intangibles. So if property rights don't define an owner's relationship to an object, what do they define? For many legal scholars, the answer is that property rights actually define relationships between people. To say I own a parcel of land, or a tuxedo, or a song is to say that I have the power to control, to varying degrees, your behavior in connection with the thing I own. I don't control the thing, but the ways in which others interact with it.

From this perspective, property law is just one of many tools that allow us to structure our relationships with others and influence their behavior. Contracts are another. But again, contractual rights are only enforceable against the parties to an agreement. Property rights in contrast don't require negotiation, mutual agreement, or assent. Your property rights apply to everyone, whether they like it or not. Property and contract can also differ in the sorts of remedies they provide. For example, infringement of a copyright can lead to tens or even hundreds of thousands of dollars in damages, regardless of any measurable harm suffered by the copyright holder. But a claim based purely on a contract would be limited to actual provable losses caused by the breach.

Third, we should say a bit about the source of property rights. Some see property as a natural right—one that exists independently of any legal rule and rooted in some deeper philosophical foundation. John Locke famously argued that property is a natural right that arises out of labor. According to Locke, we acquire property rights by exerting effort to gather resources, cultivate land, or develop new ideas.[19] Hegel offered another view on the foundations of property. He argued that property is necessary for individual self-actualization. Unless we can exert control over objects in the world, we cannot express our will, achieve our goals, or thrive as individuals.[20]

But regardless of its foundation, property is deeply contingent on the law as a practical matter. Property rights exist by virtue of the willingness of the government to recognize and ultimately enforce them. Imagine you encounter trespassers on your land. What do you do? Perhaps you call the

police. Under some circumstances, you might file a lawsuit. If the legal system refuses to deal with the trespassers, your property rights have very little value. Even a property owner's self-help remedies depend on legal recognition. Physically removing someone from your property is lawful only to the extent the legal system favors your interests over those of the trespassers.

IP rights are even more obviously contingent on legal recognition. Copyright and patent rights in the United States simply wouldn't exist without legislation. There is no recognized natural right to such protection. Instead, the law protects authors and inventors in order to promote the creation of valuable intellectual resources for society at large to use and enjoy. And Congress and the courts tweak those property interests—adding new rights, expanding or limiting existing ones—when they are persuaded that changes would yield a better outcome.

The existence and specific contours of property rights are dictated by our legal system. So by calling something property and calling someone its owner, the law is using a sort of shorthand. Those labels identify the winner of a contest for control over the behavior of others with respect to some valuable resource. At this point, our claim about the future of ownership should start to take on a somewhat clearer meaning. When we say that personal property rights are being eroded or eliminated in the digital marketplace, we mean that rights to use, to control, to keep, and to transfer purchases—physical and digital—are being plucked from the bundle of rights purchasers have historically enjoyed and given instead to IP rights holders. That in turn means that those rights holders are given greater control over how each of us consume media, use our devices, interact with our friends and family, spend our money, and live our lives. Cast in these terms, it is clear that there is a looming conflict between the respective rights of consumers and IP rights holders. The next question is how do we resolve it?

Property Conflicts

In the public imagination, property rights definitively resolve conflicts in favor of property owners. But that's not how property actually works. What happens when your interests are at odds with those of your neighbor? Or more pointedly, what happens when the personal property interests of purchasers are at odds with the intellectual property rights of copyright holders? Property rights—of all varieties—are limited in their scope. They have baked-in constraints that prevent owners from disregarding the interests of others. In real property, eminent domain and nuisance ordinances are useful reminders that the power of property owners is finite. Title to your

property will not excuse excessive noise or pollution that harms your neighbors, for example. Similarly, personal property owners have to comply with all sorts of generally applicable laws that restrain use of their property. You can't park your car on the sidewalk or swing your favorite ax in a crowded park, even though you own them.

IP rights feature their own inherent limits. Copyright, for example, extends only to the particular expression used by an author, not to the ideas that underlie their work. So the copyright in *Star Wars* protects the film, script, plot, and even specific characters from copying, but it does not give George Lucas, or now Disney, exclusive rights to the hero's journey.[21] And the fair use doctrine sometimes permits copying of the author's expression if it serves the public interest and poses limited risk of economic harm to the copyright holder. For example, our copying of a short quote from *Harry Potter and the Deathly Hallows* to illustrate a point about property law a few pages back is a fair use that doesn't require permission from the copyright holder.

Conflicts between the property interests of copyright holders and consumers are central to our story. For creators, intellectual property law is primarily concerned with intangible creations—who owns them, how to exploit them, and whether one creation treads too closely to another. But for most of us, copyright law is a set of rules that tells us what we can and can't do with our stuff. Can you copy your Blu-ray movies to your laptop? Can you share a favorite new album with a friend? Can you sell your used books? How many people can you invite into your home to watch the Super Bowl? And if you watch it at the local bar, how big can the TV be?[22] In this sense, copyright law constrains how we use our property on a daily basis.

So there is a tug of war going on between purchasers and IP holders. If the law strengthens IP rights, it narrows personal property rights. And if the law gives us more latitude to do what we want with the things we buy, IP holders sacrifice some control over us. This tension is an inevitable feature of a system that accounts for the interests of both creators and consumers. From a policy perspective, intellectual and personal property rights function as stand-ins for a broad range of concerns—creative incentives, information costs and other externalities, deception, and autonomy. Since the law creates and defines the contours of those rights, the question of how best to balance them is inevitable. For well over a century, copyright law has provided a transparent and predictable answer to that question through the principle of exhaustion. That principle is the legal backdrop against which the rest of the developments we describe take place.

The Exhaustion Principle

Exhaustion is the notion that an IP rights holder relinquishes some control over a product once it sells or gives that product to a new owner. We say those IP rights have been exhausted because the rights holder can no longer control many of the uses the new owner may make of that product. The power to prevent distributing, displaying, and sometimes reproducing a work gives way to the personal property interests of the owners. This principle is expressed in a number of copyright rules, the most important of which is the first sale doctrine. The Copyright Act prohibits unauthorized distribution—the selling, renting, leasing, or giving away—of protected works. Without some exception or limitation, we would have no right to donate our used books or sell our used video games or even give a newly purchased CD to a friend on their birthday.[23] The first sale doctrine steps in to prevent that absurd result. It allows copy owners to sell, give away, lend, or rent their copies even when the copyright holder objects.

Here's one recent example of the first sale doctrine at work. In 1982, Atari released *E.T. the Extra-Terrestrial*, a video game based on the hit movie, for its 2600 home console. The game bombed and today is widely regarded as the worst video game ever made. In 1983, Atari shipped as many as twenty semitrucks loaded with unsold copies of the game to Alamogordo, New Mexico, where they were promptly buried. Atari reportedly chose that particular landfill because no scavenging was allowed. It wanted to erase all evidence of this embarrassing creative misstep. Decades later, the city decided the games were worth more above ground than below it. The city dug them up and auctioned off nine hundred surviving *E.T.* cartridges for more than $100,000.[24]

But first sale isn't copyright's only exhaustion rule. The Copyright Act also prohibits unauthorized public displays of protected works. Again, without some exception, that means that a museum that paid millions of dollars for a painting would need the copyright holder's permission before hanging it on the wall. Luckily, the Act makes clear that the owner of a painting or other work is free to display it.[25] Another provision gives owners of copies of software the right to make copies necessary to run, back up, or modify it.[26] And long before exhaustion was written into the Copyright Act, courts recognized the rights of owners of copies of books and other works to resell them, to copy portions of them, and to create new works from them. What all of these exhaustion rules have in common is that they privilege the property interests of copy owners over those of copyright holders.

Exhaustion is copyright law's main tool for mediating the tension between intellectual and personal property rights. For more than a century, this cluster of exhaustion-based rules struck a balance that gave purchasers and other owners considerable, but not unlimited, rights to use and enjoy their copies. But at the same time, those rules have helped protect the financial interests of copyright holders in two ways. First, they limit the rights that flow from exhaustion to owners of lawful copies of a work. So if the copy you bought is an infringing one, exhaustion would not entitle you to resell it. Second, even an owner of a copy can't do whatever they want with it. For example, you can't buy a copy of the latest bestselling young adult novel and make copies for all of your friends. Exhaustion doesn't go that far. Nor should it.

Exhaustion is so deeply engrained in our experience of the copyright economy and such a fundamental part of our property rules that most of us barely notice it at work. But that doesn't mean it isn't important. Exhaustion is the reason we have used record stores and bookstores. It's the reason we have public libraries and eBay. It's the reason we can lend a novel to a friend and leave our record collections to loved ones in our wills. It's the reason museums can display their paintings and you can back up your software. But the rules that permit these uses are not a given. They were established by the courts and Congress, and their survival depends on continued legal recognition.

The first cases in the United States to recognize the exhaustion principle date back to the nineteenth century. For example, Mark Twain's plan to market *The Adventures of Huckleberry Finn* exclusively through a high-priced subscription service was thwarted when book distributors sold copies to bookstores. When Twain sued the distributors, the court reasoned that since they owned the books they bought from Twain, the distributors were free to sell them to whoever they chose.[27] Subsequent courts went even further. They decided that fire-damaged pages of books sold as wastepaper could be bound and resold over the objections of copyright holders;[28] that booksellers could repair and resell used copies of children's schoolbooks, even if that meant reproducing missing or damaged parts;[29] and that the purchaser of loose pages of Rudyard Kipling poems could bind them together with other works to create a new collection.[30] Although courts were not unanimous in embracing this burgeoning exhaustion principle, the majority agreed that ownership of a copy entitled the owner to make a variety of uses that otherwise would have been illegal.

Eventually, copyright exhaustion made its way to the Supreme Court in a case that pitted a publisher against the retailer Macy's.[31] In 1904, the

Bobbs-Merrill Company published the novel *The Castaway*. Like many publishers at the time—and today—Bobbs-Merrill was deeply interested in controlling retail prices of its books. In an effort to inflate those prices, Bobbs-Merrill printed the following notice, an early ancestor of today's EULAs, in each copy of *The Castaway*: "The price of this book is one dollar net. No dealer is licensed to sell it at a less price, and a sale at a less price will be treated as an infringement of the copyright."

Macy's sold copies of the book for a mere eighty-nine cents, and Bobbs-Merrill promptly sued for copyright infringement. Bobbs-Merrill argued that since it had the right to choose whether to sell the book to the public or not, it could sell it with conditions attached that would bind all subsequent buyers. But the Supreme Court recognized this theory as the literary equivalent of servitude on a tuxedo. And it wasn't buying it. According to the justices, once Bobbs-Merrill sold copies at its chosen wholesale price, its right to control the further distribution of those copies came to an end. Copyright law does not recognize that sort of ongoing control over the personal property of another.

Almost immediately, Congress embraced the first sale rule. It passed the Copyright Act of 1909 just a year later, which provided that "nothing in this Act shall be deemed to forbid, prevent, or restrict the transfer of any copy of a copyrighted work the possession of which has been lawfully obtained."[32] And when Congress overhauled the Copyright Act in 1976, it retained the first sale rule in a slightly modified form that remains in effect today.[33] Because *Bobbs-Merrill Co. v. Straus* was concerned with resale, the rule recognized by the Court, and subsequently by Congress, was silent on the kinds of copying and alteration endorsed in earlier decisions. Nonetheless, the exhaustion principle was firmly established.

For well over a century now, exhaustion has been the law of the land in the United States. And it has proven good public policy. Individuals and society more broadly benefit from rules that allow owners to exercise property rights in their purchases of copyrighted materials. By opening up secondary markets, the exhaustion principle promotes access to cultural works. More people can read books, watch films, and play games when used copies, rentals, and lending drive down the cost of access. Exhaustion is also central to securing the benefits of privacy, preservation, innovation, and competition that flow from consumer ownership of products that contain copyrighted works.

And exhaustion—as an example of a clear property rule—helps keep information costs in check. The rules of exhaustion are simple, intuitive, and familiar. They largely track the rules that apply to other forms

of tangible property. As a result, we don't have to engage in painstaking research to determine our rights in each book, movie, or game we buy. We already know the rules. That makes life easier and markets more efficient. From the perspective of the average person, exhaustion is an easy sell.

Resisting Exhaustion

But copyright holders have resisted exhaustion at nearly every turn. Many seem to regard it as some sort of loophole that allows owners to make uses that should require permission or additional payment. Although these misgivings about exhaustion have been around for decades, rights holders have started to take particularly aggressive steps to circumvent exhaustion and weaken consumer property interests in recent years.

The efforts of book publishers to restrain the free alienability of private property were responsible for the explicit recognition of the exhaustion doctrine. The restrictions Bobbs-Merrill tried to impose on owners of copies of *The Castaway* were themselves a rejection of the idea that buyers of products can control whether and at what price they can be resold. Bobbs-Merrill, of course, lost that battle. But one hundred years later, publishers are still filing copyright suits in an effort to control resale prices for books.

In 2008, John Wiley & Sons, a multibillion-dollar publisher of college textbooks, sued a USC graduate student for reselling textbooks on eBay. Supap Kirtsaeng emigrated to the United States from his native Thailand to study math. For those of you who haven't set foot in a college bookstore recently, a single required textbook can cost as much as $300. But as Kirtsaeng understood, publishers sell those same books overseas at far more sensible rates, sometimes as much as 90 percent lower. Knowing an opportunity when he saw one, Kirtsaeng began importing books bought in foreign markets and selling them online to eager students at U.S. universities. This looks like just the kind of free alienability that the exhaustion principle is meant to enable.

But Wiley saw things differently. It argued that because these books were printed outside of the United States, the first sale doctrine didn't apply, and therefore Kirtsaeng's resales were illegal. In 2013, the Supreme Court rejected that contention.[34] The Court held if the books were sold by the publisher, exhaustion applied regardless of where they were manufactured. In part, the Court was worried that to rule otherwise could mean that any product manufactured overseas that included a copyrighted work couldn't be sold, rented, or given away without permission.[35] Those works would

include not only the novel you bought on vacation, but also your smartphone and your car—devices that integrate copyrighted software essential to their operation.

John Wiley & Sons and its supporters warn that preventing international price discrimination—the practice of charging high prices in the United States and lower prices in developing countries—will ultimately harm the most vulnerable readers. Publishers like Wiley say that if they can't segment markets, they will be forced to either raise prices in countries like Thailand or stop selling products there altogether. But there are good reasons to be skeptical about these threats. First, publishers can prevent imports without eliminating first sale. They could make books in developing economies available through rental or subscription models, for example. Second, the impact of market segmentation on price is a thorny question with no clear answer. Pricing decisions involve a number of variables that make predictions and generalizations difficult.[36] So while the net global effect of exhaustion is likely to reduce cost, its impact in any given geographic market is hard to predict. For every country like Thailand that benefits from low book prices, there's one like South Africa, where even before *Kirtsaeng* an overwhelming number of citizens reported that books were too expensive to buy.[37] Or consider India, where academic publishers tend to supply outdated editions, and the latest versions cost just as much as they do in Western countries.[38]

There's another strategy that publishers like Wiley should consider—admittedly, one they won't like. They could make less money. The average U.S. college student spends about $900 a year on textbooks.[39] A recent Bureau of Labor Statistics report reveals that textbook prices have gone up over 1,000 percent in the past three decades. That's three times more than the increases for medical services, new home prices, and the consumer price index.[40] Not surprisingly, textbook publishers have been highly profitable. McGraw-Hill's profit margin in 2012 was 25 percent; Wiley's was 15 percent.[41] The year before, the margins for Wiley's scientific, medical, technical and scholarly division were a staggering 42 percent.[42] In comparison, "Big Oil" sees profits around 5 percent, and Walmart's hover near 3 percent.[43]

Given the gouging of U.S. students, the college textbook market was ripe for an enterprising importer like Kirtsaeng.[44] If publishers lowered their prices in the United States, demand for imports would decrease significantly. That might lower publisher profits. But we are confident they could make do. Copyright law is designed to ensure sufficient incentives for the production of new works, but it should not be a license to print money. As the Supreme Court has explained, "Creative work is to be

encouraged and rewarded, but private motivation must ultimately serve the cause of promoting broad public availability of literature, music, and the other arts."[45]

Book publishers aren't the only ones to push back against exhaustion. In the early 1990s, record labels worried that used CDs would harm their bottom line. CDs, after all, were different from vinyl records or cassettes since digital copies don't deteriorate with age or use. Or so the worry went.[46] So the major labels were openly hostile to used CD sales and plotted ultimately unsuccessful strategies to undermine the practice. They tried to crack down on stores that sold used CDs by refusing returns on opened merchandise and withholding millions of dollars of customary underwriting for print and radio ads.[47] They even threatened to boycott stores that sold used CDs, turning away orders for the new album from then-megastar Garth Brooks.[48]

Hollywood demonstrated its own antipathy to exhaustion. In the late 1970s, when the home video market was first emerging, videocassettes of Hollywood films were designated as "sold for home use only" in an effort to dissuade both public performance and rental. In fact, contracts with retailers explicitly prohibited rental of the tapes they purchased. Video rental pioneer George Atkinson faced mixed signals from the movie industry as he tried to build his business. Finally, after receiving a legal threat for renting tapes he purchased lawfully, Atkinson consulted a lawyer who informed him that thanks to the first sale rule, he was free to rent the tapes he owned. Although the studios required retailers to promise not to rent tapes and refused to sell directly to rental shops, the free alienability of personal property ensured a steady inventory for Atkinson and his contemporaries,[49] leading major studios like Warner Brothers, Disney, and MGM to lobby for the doctrine's repeal.[50]

More recently, a video producer of a different sort has adopted a firmly anti-exhaustion posture. Beachbody, maker of the popular P90X home workout videos, insists that its customers do not own the DVDs they purchase from the company's website, but merely license these physical purchases.[51] Beachbody has aggressively targeted individuals who resold legitimate copies of its DVDs on eBay, threatening litigation and demanding exorbitant compensation. It is easy to understand why Beachbody would want to prevent customers from reselling their workout videos after their New Year's resolve runs out. As reasonable as three easy payments of $39.95 may be, used DVDs could decrease sales and put pressure on the company to lower prices. What's harder to see is how this strategy can be squared with the principle of exhaustion, personal property rights, or the best interest of consumers.

The computer software industry has been waging its own war on exhaustion practically since its inception. In the next chapter, we will discuss the licensing practices of software companies in greater detail. For now, it's enough to note that the industry pioneered the widespread use of license agreements as a strategy for undermining end user ownership and exhaustion. Other innovations in the software industry, from digital rights management to the software-as-a-service business model, have helped developers put even greater distance between software transactions and the traditional rules of private property. Legislatively, the industry successfully lobbied Congress to pass the Computer Software Rental Amendments Act, which prevents the rental of most software programs.[52]

Today, the video game industry is the fiercest opponent of exhaustion. Its relationship with exhaustion has been contentious since at least the 1980s. Unlike other kinds of software, Congress did not carve out an exception to exhaustion that prevented rentals of console games. Despite the clear legality of video game rentals, companies like Nintendo saw rentals as a threat to game sales and characterized the rental shops as copyright infringers. Nintendo even sued Blockbuster. But because of the first sale doctrine, the game giant was forced to settle for claims that Blockbuster unlawfully photocopied the instruction manuals packaged with its games.[53] Although game rentals continue through subscription services like Gamefly, the industry has turned its focus to what it deems a bigger economic threat: used game sales.

At $2 billion per year, the used game market represents a significant portion of gaming industry revenue. Video game retailer GameStop has been the leader in this space, but used gaming has attracted the attention of Amazon and Walmart among others. Leading game developers have called the used market a "bigger threat than piracy."[54] Others have prophesied the industry's undoing if gamers continue to resell their $60 video games after finishing them. But resale has killed gaming the same way it killed the market for new music, movies, cars, and sofas. That is to say, it hasn't. In fact, GameStop reports that 70 percent of trade-in value—the money gamers get for selling their used titles—goes to the purchase of new games. That's well over $1 billion per year.[55]

Nonetheless, in response to the used game threat—real, imagined, or invented—the gaming industry has been hard at work on strategies to reduce or eliminate used sales. Most controversially, console makers have developed technologies to prevent the use of pre-owned games. Sony filed a patent application on technology that would tie individual game discs to particular users or consoles, though it hasn't yet deployed it.[56] And when

Microsoft initially announced its Xbox One console, it unveiled plans to restrict secondhand games. But after persistent and overwhelmingly negative feedback from customers, Microsoft was forced to relent.[57] As we will discuss in the next chapter, however, the gaming industry's most effective gambit against exhaustion has been the shift to digital game distribution. As one developer put it, "digital distribution stabs the used games market in the heart."[58]

If the used market directs so much revenue back into new game sales, why are publishers trying to snuff it out? One possibility is that they overestimate the losses due to used games. Not every used game translates into a lost sale. Without the used market, some gamers would simply buy fewer titles or none at all. This is the same faulty logic that led record labels to overstate the impact of file sharing a decade ago.[59] Another answer is that copyright holders are not always particularly skilled at recognizing the potential value of markets they don't control. After Hollywood lost its legal battle against the VCR, home video became a bigger source of revenue than the box office. And the music industry, after years of resisting, was dragged kicking and screaming into the era of digital distribution only after Napster threatened CD sales. Since then, Apple alone has sold over thirty-five billion songs.[60] A third explanation has less to do with miscalculation and more to do with principle. Again, the movie studios' attitude toward the VCR is instructive. When pressed in *Universal City Studios, Inc. v. Sony Corporation of America* to identify how the VCR hurt their bottom line, the studios admitted it didn't cause "a great deal of harm." Instead, their chief concern was "a point of important philosophy that transcends even commercial judgment." Their worry was that the VCR crossed "invisible boundaries" and that copyright holders "lost control."[61]

We think this focus on absolute control is shortsighted. There are good reasons to think exhaustion helps game makers, just as home video helped movie studios. Exhaustion broadens markets and expands audiences. Used games drive demand for consoles and build the community of gamers. Today's used game buyers—once they finish school and get a job—might very well start purchasing new games. The used game market also trains gamers to pay someone—even if it isn't the publisher—for their games rather than getting them for free. And it exposes them to new titles and publishers, potentially creating valuable lifelong fans in an era of long-running game sequels. These are all reasons to doubt that the used market is harmful to publishers on the whole.

Regardless, many copyright holders still see exhaustion and, by extension, personal property rights as an unfortunate legal loophole to be closed

at the first opportunity. And really, what business wouldn't eliminate competition if it could? Ford dealers would happily ban used car lots and Craigslist ads. Levi's would do away with vintage shops, garage sales, and sewing machines. And restaurants would declare leftovers contraband. But of course, we'd never let them. Nor should we let copyright holders eliminate resale and lending. Exhaustion and the personal property rights it recognizes are an inherent part of copyright law's balance between the rights of creators and the rights of the public.

Of course, that is not to say that the particular balance exhaustion has struck in the past is a perfect fit for the digital economy. The exact contours of those rules, what rights they reserve for consumers and what rights they grant copyright holders, are not set in stone. That balance can and should adapt over time in response to changing conditions, like the emergence of digital distribution that we describe in chapter 3. But there are good reasons our legal system has recognized the personal property interests of consumers who buy tangible goods. And there are good reasons to retain the basic framework of personal property—one that allows for flexibility but places limits on customization—when it comes to digital goods. The standard menu of transactions—buy, rent, borrow, and give—and the default rules of ownership serve the needs of readers, viewers, and users pretty well. But a system that allows licenses to redefine those standard transactions in whatever way best serves the interests of rights holders imposes real costs. So we favor exhaustion not because *property* is a label with talismanic properties, but because it is smart policy. The basic principle of exhaustion—the notion that owners have rights that are not contingent on copyright holder permission—can and should survive the transition to a digital copyright economy. Rights holders have always fought against this principle, but the digital marketplace gives them their best chance to kill it.