

Explaining Exhaustion: Commercial Law's Constraints on Contract

John F. Duffy

Armistead M. Dobie Professor of Law, University of Virginia School of Law
jfduffy@virginia.edu | [Bio](#)

Richard Hynes

Professor of Law & Director, John M. Olin Program in Law and Economics
University of Virginia School of Law
rmh2u@virginia.edu | [Bio](#)

Once intellectual property owners have licensed a use, manufacture, sale or other activity covered by their exclusive rights, the doctrines governing exhaustion of intellectual property rights protect parties downstream from the licensed activity against additional assertions of the same exclusive rights. While such exhaustion doctrines are now part of the accepted canon of intellectual property law, the theoretical basis for these doctrines has remained controversial. Exhaustion doctrines are frequently justified as necessary to limit the market power of intellectual property owners or to ensure intellectual property owners do not collect double or excessive royalties from more than one party in the stream of commerce. Such rationales, however, have many recognized shortcomings, including that exhaustion doctrine typically applies without any proof of the parties' market power and that creative licensing arrangements may be incapable of evading the modern "one monopoly rent" theorem of economics, which generally posits that only a single rent can be extracted from any particular monopoly. An alternative explanation for intellectual property exhaustion can be found in the more fundamental limitations that commercial law doctrines impose on contractual freedom. Parties to a contract do not necessarily have the freedom to restructure property rights in any way they see fit. Such limits on contractual freedom are pervasive throughout commercial law and are especially visible in cases of insolvency, where bankruptcy courts must frequently distinguish between property interests and mere contractual claims. This paper examines the exhaustion case law and determines the degree to which more general commercial law limits on contractual freedom have influenced the historical development of exhaustion law and whether those doctrines provide a more accurate and rigorous explanation for the specific contours of modern exhaustion doctrine.