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Kara J. Bloomer

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Intellectual Property in E-Commerce Retail Arbitrage: An Analysis of the Legality of Using Intellectual Property in Drop-Shipping

Kara J. Bloomer[*]

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[*] Kara Bloomer is a Patent Attorney with experience in patent prosecution, copyrights, trademarks, and data analytics. After working as a process engineer in semiconductors, Ms. Bloomer attended law school to study the intersection of evolving technology and the law. She began her law practice in patent prosecution working with inventors and creators. She currently supports data analysts with issues regarding intellectual property, privacy, competition, and contract law. Ms. Bloomer would like to thank Professor Stephanie Bair for her advice and encouragement to pursue publication, Brittany Frandsen and David Johnson for inspiring and supporting this work, and the Editors of the BYU Law Review for their industrious care.

INTRODUCTION

This Note explores the use of intellectual property in a form of e-commerce retail arbitrage sometimes called "drop-shipping." Specifically, the Note explores potential copyright, trademark, and patent claims that might arise through this business model.

The retail market of large e-commerce websites, such as Amazon, eBay, Alibaba, and Wayfair have changed the way businesses operate. More and more, customers choose the ease and convenience of online shopping over traditional methods without any thought as to where the item originated or who the seller might be.[1] Many buyers are under the impression that the searchability of the internet will guarantee a low price for an item because retailers would be required to sell for the lowest prices to make a sale on the internet.[2] However, this is not necessarily true, and because many buyers do not compare prices, they do not always get the lowest price for internet purchases.[3] As a result, the internet creates a prime market for e-commerce arbitrage businesses to look for price discrepancies and use these differences for a profit—this is called drop-shipping. This new business model has impressive popularity, and it is used by tens of thousands of businesses.

Drop-shipping has many allusive names. It is sometimes called drop-shipping, product fulfillment services, order fulfillment, shipping fulfillment services, supply chain solutions, and so on. "Drop-shipping" is the most common label, though it is a misnomer because "drop-shipping" originally referred to a business agreement between a manufacturer and a distributor. The original "drop-shipping" business model is similar to e-commerce arbitrage, but different in important ways. First, under traditional drop-shipping, the manufacturer and distributor are aware of each other and have negotiated the terms of their arrangement. Second, the terms of traditional drop-shipping have been agreed to in advance of any sales transactions. All of that said, I will refer

1. *See generally* J. Yannis Bakos, *Reducing Buyer Search Costs: Implications for Electronic Marketplaces*, 43 MGMT. SCI. 12 (1997), http://people.stern.nyu.edu/bakos/emkts.pdf (last visited Mar. 15, 2022) (suggesting that the electronic marketplace is expanding because of reduced search costs for buyers).

2. *See generally id.*

3. *Id.*; Jason Feifer, *Why It's Nearly Impossible to Stop this Amazon and eBay Scheme*, ENTREPRENEUR (July 27, 2016), https://www.entrepreneur.com/article/278622.

to e-commerce arbitrage businesses as "drop-shipping" or "drop-shippers" because it is the most recognized term.

Drop-shipping is a fairly standard application of retail arbitrage: buy something cheap, take it to a market where it sells for more, and resell it for a profit. What is interesting and novel is that many drop-shippers do not warehouse the products they sell, nor do they have agreements with the distributors and manufacturers to act as drop-shippers. The following example demonstrates how drop-shipping works: an item listed on Home Depot's website for $100 is also listed on Amazon for $150.[4] Without purchasing the item, the drop-shipper will create a virtual store on Amazon and list the item for $140, overselling the Home Depot listing, but undercutting the Amazon listing. When a buyer purchases the item at the reduced cost on Amazon, the drop-shipper will then purchase the item from Home Depot's website, as a gift, and have it shipped directly to the buyer. [5] The drop-shipper will earn a $40 profit while the Amazon seller loses out on a sale of the item.

Unauthorized drop-shippers are problematic for IP owners and manufacturers in at least two ways. First, drop-shipping causes increased product returns.[6] The exact reason for this is unknown, but one theory is that the drop-shipped products alert customers to the possibility that the item could be purchased for less somewhere else. For example, when a buyer orders a product from Amazon, but the shipment arrives in a box with a Home Depot label, a customer may look up the item on Home Depot's website and find the cheaper listing. After discovering the price difference, a disappointed customer may return the item and repurchase it for a lower price.[7] Distributors and manufacturers have seen returns increase dramatically because of this phenomenon.[8]

4. Brittany Frandsen, *Online Arbitrage: Why Amazon Orders Sometimes Come from Walmart,* WORKMAN NYDEGGER (Oct. 22, 2018), https://www.wnlaw.com/blog/online-arbitrage-why-amazon-orders-sometimes-come-from-walmart/.

5. *Id.* The price discrepancy utilized in this example is exaggerated for the purpose of clarity in describing the business model. Most drop-shippers have smaller profit margins.

6. Reply All, *The World's Most Expensive Free Watch,* GIMLET (Mar. 1, 2018), https://gimletmedia.com/shows/reply-all/dvhe3l.

7. In fact, most drop-shippers charge a "restocking fee" for product returns, and they also make money on the return of the product even though they are not actually restocking the item.

8. Planet Money, *Cat Scam*, NATIONAL PUBLIC RADIO, at 07:22 (Mar. 13, 2019, 11:49 AM), https://www.npr.org/templates/transcript/transcript.php?storyId=703017193

Second, manufacturers face problematic contractual obligations with e-commerce platforms when drop-shippers intermingle with the transaction. In some instances, manufacturers guarantee a sale price to fulfillment centers on an e-commerce platform. If the product is sold for less than that price, the fulfillment center charges the price difference to the manufacturer. Prices can drop significantly when drop-shippers begin selling the product for a lower price because fulfillment centers often have automatic pricing. For example, take a manufacturer who has arranged for an Amazon Fulfillment Center to sell an item for $150. When a drop-shipper lists the item for $140, the Amazon Fulfillment Center will automatically update its listing to $139. When a buyer purchases the item for $139, the manufacturer will owe the fulfillment center $11 for the sale of the item. This can potentially devastate the manufacturer's profits, especially when large numbers of sales aggregate together.

In addition to the two harms listed above, manufacturers and distributors are also concerned with brand consistency,[9] trademark dilution,[10] and client experience. Many manufacturers strive to control every piece of distribution in order to drive sales through positive interactions. Drop-shippers are an additional, unknown distributor that manufacturers find threatening because they are uncontrollable. Furthermore, when a listing appears from an unknown seller, an IP owner may be suspicious that the drop-shipper is selling counterfeits. Thus, even where the drop-shipper is selling a legitimate product, manufacturers are wary because (short of purchasing the product from the drop-shipper) the manufacturer has no way of identifying counterfeit listings.

On the other hand, drop-shipping is also beneficial. The drop-shipper may increase sales for the manufacturers and distributors because drop-shipping activities maximize the market. The drop-shippers essentially work as a low-cost marketing team and encourage more products to be sold in presumably new markets (i.e., on a different platforms).[11] Drop-shipped products are eventually purchased from the original manufacturer or distributor

(patent owner alleging that his returns have increased to 200 due to ecommerce arbitrage, then falling to 2 returns after the drop-shipping stopped).

9. Feifer, *supra* note 3.

10. Planet Money, *supra* note 8.

11. Feifer, *supra* note 3.

and therefore, also increase the sales to the original owners. In addition, this business model provides home-bound people an ability to earn money where they might not otherwise have the opportunity.[12] Lastly, drop-shipping is available to poor populations because the startup costs of drop-shipping are low and virtually anyone can start a drop-shipping business.[13]

Conflicts over drop-shipping have not been litigated in the courts for several reasons. First, many drop-shippers are judgment proof. The typical drop-shipper is a low-income earner who started drop-shipping as an alternate source of income.[14] Second, the defendants are difficult to identify because e-commerce platforms do not require that sellers disclose any of the identifying information necessary to file a complaint. Furthermore, e-commerce platforms carefully guard the personal information of each seller.[15] It can be difficult, or even impossible, to identify a single drop-shipper who has made enough profit from drop-shipping to justify litigation to recover those lost profits.[16] And finally, each individual drop-shipper may use dozens or even hundreds of virtual stores, each set up under separate LLCs.[17] Thus, cases against drop-shippers have the added difficulty of piercing the corporate veil in order to conglomerate enough transactions to justify a law suit.

Another hurdle to litigation is the minimal damages that can be collected from any single drop-shipper. While the occasional drop-shipper may collectively have lucrative earnings, the individual transactions earn only small profits. The IP owner may not have enough damages from a single drop-shipper to justify a suit. The difficulty of litigation increases in complexity and cost with each drop-shipper that must be identified. The problem is a systematic issue, where individual IP owners are being harmfully affected by

12. *Id.*

13. Though it has not been proven, journalists allege that the drop-shippers who make the most money do not make the money through drop-shipping but through related products, such as classes, access to materials for drop-shippers, and software services. *See e.g* Jake Tran, *Dropshipping is a HORRIBLE Business & You Shouldn't Do It*, YOUTUBE (Dec. 11, 2019), https://www.youtube.com/watch?v=FDkn9dDuJfM.; Planet Money, *supra* note 8.

14. See Feifer, *supra* note 3; *see also* Planet Money, *supra* note 8.

15. Map Cop, *Anonymity and The Amazon Marketplace,* MAPCOP, https://www.mapcop.com/blog/anonymity-and-the-amazon-marketplace (last visited on Mar. 16, 2022).

16. *Id.*

17. *See generally* Planet Money, *supra* note 8 (explaining the mechanics of drop-shipping).

many drop-shippers and the IP owner does not have an effective way to recover from that harm. For this reason, intellectual property owners must seek a systematic solution.

The application of intellectual property rights against drop-shippers has many unanswered questions. Nonetheless, the legal questions are interesting to consider because the drop-shipping business model is a unique creation of the modern-day e-commerce marketplace. This Note attempts to summarize relevant law and identify the key issues that a court would consider in resolving an infringement conflict between an intellectual property owner and a drop-shipper.

Notably, drop-shippers sell a large array of products, offering almost any product where a price difference on the internet can be exploited. Although some of the drop-shipper's products may be protected by intellectual property laws, many products are not. This Note is limited only to drop-shippers' use of intellectual property and not to other issues that may be associated with the business model (i.e., unfair competition). Specifically, this Note seeks to determine whether the activities of drop-shippers constitute infringement of the intellectual property and propose how drop-shippers can avoid IP infringement. However, the Note does not explore the remedies available to an IP owner if infringement is found. Future research may include causes of action outside of intellectual property and remedies available to IP owners where infringement occurs.

I will begin in Part I by exploring the issues that arise under 35 U.S.C. § 271(a) for patent infringement by way of an unauthorized offer to sell, or a sale, of a patented item. This analysis will include the limitations posed by patent exhaustion and limited case law. It seems that most likely, the activities of drop-shipping do not infringe as an unauthorized sale but do infringe as an unauthorized offer to sell. Next, in Part II, I will examine the possibility of trademark infringement under the Landham Act, including a trademark owner's right to quality control and trademark dilution, where likely the drop-shippers do not infringe trademark. Thirdly, in Part III, I will explore the possibility of copyright infringement, which exists in certain cases but has largely been eliminated by the e-commerce platforms. Finally, I will propose a solution to the systematic issue between drop-shippers and IP owners.

I. PATENT INFRINGEMENT

A. Background of Patent Infringement Laws

35 U.S.C. § 271(a) states: "[W]hoever without authority makes, uses, offers to sell, or sells any patented invention, within the United States or imports into the United States any patented invention during the term of the patent therefor, infringes the patent."[18] Essentially, a patent owner is given the right to a temporary monopoly of the invention. A patent owner may sell or license their intellectual property, but absent those authorizations, anyone who makes, uses, sells, or offers to sell the patented item has infringed on the monopoly and is liable to the patent owner.

Originally, U.S. patent law limited patent infringement to activities in the United States and the "threat of a sale" was not considered patent infringement.[19] However, growing pressure arising from international infringement and an effort to bring U.S. patent law into compliance with the TRIPS Agreement motivated Congress to an amendment in 1994 which added the "offer to sell" language to 35 U.S.C. § 271(a).[20] "The 1994 amendment to § 271 significantly expanded the scope of protection offered by U.S. patent law, allowing the patentees to act against threats to its monopoly even when no actual sale had occurred within the United States."[21]

Traditionally, patent infringement cases are brought against manufacturers who are making counterfeit products. However, the prominence of e-commerce today has shifted the dynamics, and more often patent owners are bringing infringement cases against retailers as well.[22] One cause of this shift is the ability of the patent owners to find the infringing retailers easily through an internet

18. 35 U.S.C. § 271(a).

19. Yan Wang, *"Offer to Sell" Infringement Involving Crossborder Transactions: Lessons from* Transocean, 10 NW. J. TECH. & INTELL. PROP. 579, 581 (2012).

20. *Id.*

21. *Id.*

22. Herbert J. Hammond & Justin S. Cohen, *Intellectual Property Issues in E-Commerce*, 18 TEX. WESLEYAN L. REV. 743, 746 (2012) ("Today's Internet retailers may list and sell products from a far wider variety of sources than ever before. But such freedom comes with consequences. One such consequence is that the Internet makes it easy for a patent owner to find potential infringers selling a product or service and to target them in a lawsuit. *Patent owners who traditionally sued only the manufacturer of such products are now targeting retailers,* especially where the manufacturer is offshore or does not have the financial wherewithal to be responsible for its infringing acts.") (emphasis added).

search.[23] Patent owners can more easily target a retailer for a lawsuit than ever before.[24] Retailers must be more careful to protect themselves against infringement lawsuits by selling patented items legally.[25]

Although retailers selling counterfeit products is clearly infringement, whether drop-shipping also qualifies as patent infringement is less obvious. From here, we turn to the court's interpretation of 35 U.S.C. § 271(a) to consider the legality of drop-shipper's activities.

B. Unauthorized Sale as a Form of Patent Infringement

Whether or not drop-shipping is patent infringement is wrought with legal ambiguity. Drop-shipping is a new type of business model which operates in a way that was not possible prior to the internet. It is difficult to fit the facts of drop-shipping to the laws of patent exhaustion that were developed long before the advent of e-commerce platforms. The policy arguments (which probably favor the drop-shipper) will play an important role in these cases.

1. The Ability of a Patent Owner to Recover from an Unauthorized Sale Is Limited by Patent Exhaustion

The most important issue in determining if drop-shipping is patent infringement is whether or not the patent over an item has exhausted. Patent owners have the right to prohibit others from selling their patented invention. "A defendant may be guilty of invading the monopoly, which includes the exclusive right to sell, by selling articles which had not been freed from the

23. *Id.*

24. *Id.*

25. A manufacturer can identify which items are being sold by unauthorized dealers because a drop-shipped item will arrive with identifying markers on the box, showing where the item originated. For example, a product purchased from Amazon will arrive in a Walmart shipping box (or with a shipping label or receipt). The IP owners can also identify this by tightly controlling the licensee activity. That way, activity which does not conform to the license agreement is likely a drop-shipper. For example, an IP owner can forbid a licensee from selling product on an e-commerce platform, therefore any seller of that licensed product is potentially a drop-shipper. Finally, the IP owner can communicate with its licensees when a suspicious seller is discovered. If the licensed retailer disowns the seller on the e-commerce platform, the sale of this item is likely unauthorized and constitutes patent infringement. That is, of course, as long as the item does not fall within the second-hand market.

monopoly . . . ."[26] Furthermore, the patent owner can license, sell, or otherwise grant their exclusive right to others. When a third-party chooses to sell the invention without permission from the patent owner they have violated this exclusive right and the patent owner may seek damages or an injunction against the party.

The relevance of a second-hand market is key because a patent owner's monopoly over an item is limited by the doctrine of patent exhaustion. Patent exhaustion is described as follows:

> [W]hen the [patented item] passes to the hands of the purchaser, it is no longer within the limits of the monopoly. It passes outside of it, and is no longer under the protection of the act of Congress. . . . [The patented item] becomes his private, individual property, not protected by the laws of the United States, but by the laws of the State in which it is situated.[27]

In other words, once the patent owner has sold a particular patented item, her control over it no longer exists and the buyer is free to modify, use, or resell the item. "The longstanding doctrine of patent exhaustion limits the patent rights that survive the initial authorized sale of a patented item."[28] A patent owner cannot sue the buyer for patent infringement after an authorized sale.

a. Patent exhaustion cannot be limited for price discrimination in the primary market. Patent exhaustion becomes problematic for patent owners who are trying to use price discrimination to increase market size and profits. Price discrimination provides a mechanism for patent owners to reach additional markets that were unavailable at a certain price point. For example, pharmaceuticals can be afforded at a higher price in the United States than they can be afforded in other countries. By charging a higher price in a more developed country, a pharmaceutical company can recoup research and development costs for the drug, while also expanding its market to countries and clients that are unable to pay the higher costs. In this way, a pharmaceutical company can be incentivized

26. Bassick Mfg. Co. v. Auto Equip. Co., 13 F.2d 463, 464 (7th Cir. 1926).

27. Bloomer v. McQuewan, 55 U.S. 539, 549–50 (1852); *see also* Impression Prods., Inc. v. Lexmark Int'l, Inc., 137 S. Ct. 1523, 1523 (2017).

28. Quanta Comput., Inc. v. LG Elecs., Inc., 553 U.S. 617, 617 (2008).

to invest money into research and development of new drugs, and simultaneously the drug is more widely available to poorer countries. However, this capability provides an adverse incentive for a pharmaceutical company to charge a higher price in a market simply because the market can afford to pay a higher price.

The result of price discrimination is a second-hand market which engages in retail arbitrage. This market takes advantage of these price differences by purchasing an item in one market and transporting the item to a second market to be resold at a higher price. In the past, intellectual property owners would maintain these price differences by setting geographical limitations on an IP license so that an item sold in one location could not be resold in another location. This practice has been limited by recent Supreme Court decisions which uphold international exhaustion after the first sale.[29]

Similarly, IP owners also practice price discrimination on the internet by offering the same products for difference prices on different e-commerce platforms. Drop-shippers use this type of market expansion to their gain. However, this arbitrage reduces the capability of an IP owner to price discriminate. The consumer (and the drop-shipper) view this as a positive effect of arbitrage. In fact, price discrimination is more often viewed as a dishonest business practice.[30] Under this paradigm, the drop-shippers counteract the price discrimination and bring equality to markets where consumers are paying a higher price. However, an IP owner would argue that the right to price discrimination is the right of an IP owner that has been granted exclusive rights over the primary market of the intellectual property.

Recent Supreme Court decisions have severely limited the capability of an IP owner to price discriminate.[31] As explained in *Impression Products, Inc. v. Lexmark International, Inc.*, the Patent Act does not guarantee the patent owner a price for the item.[32] What is protected, is the opportunity for a patent owner to give up her patent rights over an item for whatever he "deems to be

29. *Impression Prods., Inc.*, 137 S. Ct. at 1523; *see also* Kirtsaeng v. John Wiley & Sons, Inc., 568 U.S. 519, 538 (2013).

30. Frank R. Lichtenberg, *Pharmaceutical Price Discrimination and Social Welfare*, 5 CAPITALISM & SOC'Y 1, 1 (2010) (corrected version).

31. *Impression Prods., Inc.*, 137 S. Ct. at 1523; *see also Kirtsaeng*, 568 U.S. at 538.

32. *Impression Prods., Inc.*, 137 S. Ct. at 1537.

'satisfactory compensation[.]'"[33] Said another way, the patent owner controls the first sale, or the primary market, and no further. After the first sale the patent over the particular item "exhausts" and the patent owner has given up his rights over the particular item for the agreed upon compensation.[34] After the first sale, the buyer is free to sell the item on a secondary market. A secondary market here does not necessarily mean a "second-hand" or a used market, rather it is defined as a market which is not the primary market where the manufacturer first sold the patented item. Arbitrage activities generally take place on the secondary market and therefore the patent owner cannot control the activities of arbitrage.

b. Patents are enforceable in the primary market and exhausted in the secondary market. The Court limited patent rights in the secondary market in order to balance two important policies: the patent owner's rights to his monopoly and the adverse effect of "extending the patent rights beyond the first sale . . . ."[35] An extension of patent rights "would clog the channels of commerce, with little benefit from the extra control that the patentees retain. And advances in technology, along with increasingly complex supply chains, magnify the problem."[36] In other words, if the patent owner was compensated for the invention, the courts will favor exhausting the patent to keep commerce simple in an increasingly complex market.

So, the ultimate question here is: does a drop-shipper sell patented items as part of the primary or the secondary market? At the time a drop-shipper creates a product listing they have not yet purchased the items they are selling. The drop-shipper begins by creating a listing for an item before the purchase of a particular item. After a buyer has accepted the offer, the drop-shipper will purchase the item and directly ship it to the buyer. It follows that as long as the first transaction (between the retailer and the drop-shipper) has exhausted the patent before the second transaction (between the drop-shipper and the buyer), the patent over the

33. *Id.* at 1528 (internal citation omitted).

34. Quanta Comput., Inc. v. LG Elecs., Inc., 553 U.S. 617, 625 (2008) ("The longstanding doctrine of patent exhaustion provides that the initial authorized sale of a patented item terminates all patent rights to that item.").

35. *Impression Prods., Inc.*, 137 S. Ct. at 1532.

36. *Id.*

particular item will exhaust. If this is the case, the second transaction will be an authorized sale protected by the patent exhaustion doctrine. However, if the patent has not yet exhausted before the second transaction, the drop-shipper may be liable for patent infringement.

The courts have specified that patent exhaustion occurs on transfer of title of a particular item.[37] Transfer of title probably occurs at the completion of the sale.[38] So, when does the transfer of title occur in a drop-shipping transaction? The drop-shipper initiates a transaction by posting a patented product for sale on an e-commerce platform before the drop-shipper has purchased the item. A buyer then purchases the item from the drop-shipper (this is typically the second transaction in patent exhaustion). Afterwards, the drop-shipper purchases the patented product, usually from the IP owner or authorized dealer of the patented product (this is typically the first transaction in patent exhaustion). Thus, the first and second transactions are reversed from a typical set of arbitrage transactions. Finally, the drop-shipper ships the item directly to the buyer, which concludes the drop-shipping activity.

Thus, the question as to whether the drop-shipper is selling in the primary or secondary market comes down to the timing of the first and second transactions. Drop-shipping has two timing issues that the court must answer. First, when is the first transaction complete and the patent exhausts? And second, in determining the "when" of the second transaction, is the court more interested in when the sale initiates or terminates?

To the first issue, case law on the timing of a completed sale is clearly summarized in *Ecodyne Corp. v. Croll-Reynolds Engineering Co.*:

> It is well understood that delivery of the property is one of the elements of a sale and "the transfer of the property in the thing is effected by the transfer of the thing itself to the purchaser."

37. Bloomer v. McQuewan, 55 U.S. 539, 549–50 (1853).

38. "In Benjamin on Sales § 1 the following are listed as elements of a sale: (1) parties competent to contract; (2) mutual assent; (3) a thing, the absolute or general property in which is transferred from the seller to the buyer, and (4) a price in money, paid or promised. "If any one of the ingredients be wanting, there is no sale." Ecodyne Corp. v. Croll-Reynolds Eng'g Co., 491 F. Supp. 194, 197 (D. Conn. 1979) (citing Atkinson on Sales, 5). *See generally* Butler v. Thomson, 92 U.S. 412, 414–15 (1875).

> In sum, a sale is an executed contract, to constitute which delivery in fact or in law is indispensable . . . .[39]

A sale of an item is not complete until the item has been delivered to the buyer and the elements of the contract have been fulfilled.[40] Therefore, it seems likely that a court will view a patent to have exhausted on delivery of the item to the buyer. It logically follows that the court would also be interested in the date of delivery of the second transaction.

Under this reasoning, the first and second transactions are complete at the same moment: when the item is delivered to the buyer. Without drop-shipping case law to view how a court would interpret these two simultaneous transactions, the analysis comes down to predicting the reasoning the court may apply. This could be argued in two possible ways. The first is that the patent exhausts because the second transaction is not after the first transaction. The second is that the patent may not exhaust because the first transaction was not before the second transaction.

That said, it is possible that the court will apply a different reasoning which is focused on initiation of the second transaction. Though not explicitly related, patent law depends heavily on the timing of events, such as a statutory bar for items that have been offered for sale to the public under pre-AIA 35 U.S.C. § 102(b) and AIA 35 U.S.C. § 102(a)(1).[41] In these cases, the court is concerned about the timing of the offer, and not the completion of the sale.[42] The court may be similarly more interested in the initiation of the unauthorized sale.[43] In fact, one court explained that § 102(b) provided a useful guide for determining the date of infringement under § 271(a): "[w]hile recognizing that the two sections of the Patent Act are based on distinct policy rationales, the Federal Circuit has held that because '[b]oth sections invoke traditional

39. *Ecodyne Corp.*, 491 F. Supp. at 197 (D. Conn. 1979) (internal citations omitted). *See generally Butler*, 92 U.S. at 414–15 (1875); Norfolk & W. Ry. Co. v. Sims, 191 U.S. 441, 447 (1903); Clemens v. Davis, 7 Pa. 263, 264 (1847).

40. *Clemens,* 7 Pa. at 264.

41. Transocean Offshore Deepwater Drilling, Inc. v. Stena Drilling Ltd., 659 F. Supp. 2d 790, 797 (S.D. Tex. 2009).

42. Pfaff v. Wells Elecs., Inc., 525 U.S. 55, 67 (1998) ("We conclude, therefore, that the on-sale bar applies when two conditions are satisfied before the critical date. First, the product must be the subject of a commercial offer for sale. An inventor can both understand and control the timing of the first commercial marketing of his invention.").

43. Thomas L. Irving & Stacy D. Lewis, *Proving A Date of Invention and Infringement After GATT/TRIPS*, 22 AIPLA Q.J. 309, 351 (1994).

contractual analysis' it is appropriate to use § 102(b) jurisprudence to interpret the 'sale' and 'offer to sell' phrases in § 271(a)."[44]

The *Transocean* court holds the policies and practices of § 102(b) to be applicable under § 271(a) because they both rely on contract law. Arguably, contract law is not applicable in determining the date of infringement because the policies and outcomes of contract law are different from the policies and outcomes of patent law.[45] However, courts do not favor this argument.[46] Under this reasoning, the timing of the second transaction would be the initiation of the sale, or the date the drop-shipper accepted an offer for the patented item. Because this occurs before the drop-shipper has completed a purchase of a particular item it is not possible for exhaustion to have occurred before the second transaction. Though arguably, it seems inconsistent that a court would resort to an analysis where it is interested in the completion of the first transaction and the initiation of the second transaction. A court may either choose the initiation or completion of both transactions. In this case the court would consider the arguments presented above.

The drop-shipper will undoubtedly argue that the time between the two transactions was small and irrelevant. In some cases, drop-shippers use software to facilitate the two transactions and the time between them can be miniscule. However, a wrong is not made right just because it was righted eventually.[47] In *Honeywell Int'l, Inc. v. United States*, Honeywell sold infringing widgets to the government and later obtained the patent for the widgets.[48] They then sued the government for patent infringement under an

44. *Transocean,* 659 F. Supp. 2d at 797 (citing Rotec Indus., Inc. v. Mitsubishi Corp., 215 F.3d 1246, 1254–55 (Fed. Cir. 2000)).

45. R. CARL MOY, ACTS OF INFRINGEMENT—OFFERS FOR SALE—BASIC DEFINITION, 4 MOY'S WALKER ON PATENTS §14:47 (4th ed., 2017) ("Even more fundamentally, perhaps the strongest argument against adopting the law of contracts in a wholesale fashion is that contract law is concerned with policies and outcomes that are quite different from those involved in the law of patents. In particular, contract law is concerned with matters of formation, breach, and resulting damages, in a transaction between two contesting parties. The law of patent infringement, in contrast, is concerned primarily with the whether the accused infringer has intruded unduly into the patent owner's right to control the patented invention's supply into the marketplace. Notably, in this latter class of situations the person with whom the accused infringer dealt is often not adverse [to] the accused infringer and, in fact, is often not even a party at all.").

46. *Id.*

47. Honeywell Int'l, Inc. v. United States, 609 F.3d 1292, 1304 (2010).

48. *Id.* at 1293–97.

unauthorized use of a patented item.[49] The government argued that they were precluded under patent exhaustion doctrine, because they purchased the widgets from a party who eventually became the patent owner.[50] However, the Federal Circuit decided:

> [The plaintiff's] sale of infringing [widgets] was not authorized because, at the time of the sale, [the plaintiff] had no rights under the '914 patent, which [a third party] owned. The fact that [the plaintiff] now owns the patent does not retroactively authorize the earlier sale. As such, the [patent exhaustion] doctrine does not preclude [the plaintiff] from recovering damages against the [defendant] for use of infringing [widgets] . . . .[51]

The first sale must be an authorized sale at the time of the sale to protect the seller via patent exhaustion. Which brings this analysis full circle in trying to determine how the court will view the "time of the sale" as the initiation or the completion of the second transaction, which exhausts the patent over the item.

2. Policy Arguments in Favor of the Drop-Shipper

Recent Supreme Court decisions prefer policies which limit the influence of the patent owner if the owner is justly compensated. In *Impression Products*, the Court stressed the importance of balancing the rights of the patent owner with the ability of patent monopolies to "clog" commerce and frustrate the market. [52] The Court reasoned that patent owners control the price for which they originally sold the product and therefore, are justly compensated and there is little or no benefit to the economy in protecting their rights beyond that point.[53] IP owners in a drop-shipping scheme have, in fact, received compensation for the patented item. What's more, drop-shippers are probably unaware of when they are selling patented items or not. Allowing the patent owners to restrict drop-shipping may have a chilling effect on the secondary market, which the court would probably view as "clog[ging] the channels of commerce."[54] Therefore, the court would likely not protect the rights of the patent

49. *Id.* at 1296.
50. *Id.* at 1296–97.
51. *Id.* at 1304.
52. Impression Prods., Inc. v. Lexmark Int'l, Inc. 137 S. Ct. 1529, 1532 (2017).
53. *Id.*
54. *Id.* at 1532.

owner who exhausted their patent rights by selling a product for "whatever [they] deem[] to be 'satisfactory compensation.'"[55]

This policy argument is a strong one. Repeatedly, the courts explain that they are very concerned with limiting secondary markets.[56] In fact, where infringement cases are brought over products which are not counterfeits, the courts are much less sympathetic to IP owners.[57] Consider also the optics of a potential drop-shipping case, which are more sympathetic to the drop-shippers. Often, drop-shippers are people who are down on their luck, or limited in their capacity to earn a traditional income. They may be people who are unemployed, disabled, caretakers, or others that are restricted their capacity to earn money. In addition, most drop-shippers do not make as much money as is claimed.[58] Courts do not want to make this class of people liable to large manufactures and patent owners. This policy argument is so strong that it is possibly one of the reasons that drop-shipping cases have not been litigated in court. As a result, the IP owners will need incontrovertible evidence of infringement, and a strong argument of legal reasoning.[59]

Litigation for infringement by unauthorized sale is an uphill battle. Not only do the confusing facts and the lack of case law make it difficult to know whether or not the patent has exhausted, but the policies favored by the courts are against the litigating party. To complicate matters more, complaints against a drop-shipper face several procedural battles for bringing a suit that make it

55. *Id.* at 1537.

56. *Id.*

57. *Id.*

58. Investigative journalists estimate that most drop-shippers lose money or make very little money. *Planet Money, supra* note 8; *see also The World's Most Expensive Free Watch*, REPLY ALL (Mar. 1, 2018), https://gimletmedia.com/shows/reply-all/dvhe3l.

59. Possibly, patent owners have attempted to bring infringement against drop-shippers without alluding to the fact that the products were originally purchased from the patent owners in order to avoid these policy arguments. Several cases in the courts read as if the plaintiff is dancing around this issue. *See* Shane Matherne Enters., Inc. v. Sokolic, No. 04-2140, 2007, 2007 WL 1438736 (E.D. La. May 15, 2007); Mophie, Inc. v. Shah, No.: SA CV 13-01321-DMG (JEMx), 2014 WL 10988347(C.D. Cal. Nov. 12, 2014); Mophie, Inc. v. Shah, No. SA CV 13-01321 DMG (JEMx), 2014 WL 12603184 (C.D. Cal. Aug. 15, 2014); Benchmade Knife Co. v. Benson, No. 08-967-HA, 2010 WL 988465 (Mar. 15, 2010); Pearson Educ., Inc. v. Allen Air Conditioning Co., No. 08 Civ. 6152(KBF), 2014 WL 2506294 (May 5, 2014); Pearson Educ., Inc. v. Allen Air Conditioning Co., No. 08 Civ. 6152(KBF), No. 2014 WL 2154099 (May 22, 2014); Steelcase, Inc. v. Div. of Tax'n, 13 N.J. Tax 182 (1993); Tommy Bahama Group, Inc. v. Sexton, No. C 07-06360 EDL, 2009 U.S. Dist. LEXIS 112452 (N.D. Cal. Dec. 3, 2009); Weifang Tengyi Jewelry Trading Co. v. Intuii LLC, 18 C 4651, 2020 WL 9173089 (N.D. Ill. Feb. 26, 2020).

difficult to know who they are and how much to collect in damages. For this reason, it is unlikely to be litigated, and even if there is infringement under unauthorized sale, it will likely go unenforced.

3. Resellers May Sell Particular Items Only Where the Patent Has Exhausted over That Item

The Supreme Court has held that the doctrine of first sale under copyright is similar enough to patent exhaustion that the principles of each doctrine are interchangeable.[60] Therefore, a good analogy in copyright law is probably applicable to patent law. One such analogy exists in *Capitol Records, LLC v. ReDigi Inc.* There, the court granted rights to the copyright owner past the first sale when a seller was trying to sell used digital music.[61] In this case, Capitol Records sued ReDigi for copyright infringement after ReDigi created a scheme to sell "used" digital music online.[62] The court held that to be protected under the first sale doctrine the seller had to be reselling a "particular" copy of the music.[63] The process of uploading and downloading the music to the ReDigi website, was technically making a copy of the music, and the "used" version for sale on ReDigi's website was a copy, not the particular copy sold to the original buyer.[64] Moreover, 17 U.S.C. § 109(a) protects only distribution by "the owner of a particular copy or phonorecord . . . of that copy or phonorecord."[65] The court explained that the only way to be protected by the first sale doctrine is to sell the original item.[66] Therefore, a seller is not protected by selling even an

60. Impression Prods., Inc. v. Lexmark Int'l, Inc. 137 S. Ct. 1529, 1536 (2017) ("... differentiating the patent exhaustion and copyright first sale doctrines would make little theoretical or practical sense: The two share a "strong similarity . . . and identity of purpose,") (citing Bauer & Cie v. O'Donnell, 229 U.S. 1, 13 (1913)); *see also* Kirtsaeng v. John Wiley & Sons, Inc., 568 U.S. 519, 538 (2013); Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417, 439 (1984).

61. Capitol Recs., LLC v. ReDigi Inc., 910 F.3d 649, 652 (2d Cir. 2018).

62. *Id.*

63. *Id.* at 658.

64. *Id.*; This decision is controversial, especially considering the court suggested that the only way a person could resell digital music would be to sell the original hard drive or device to which the music was downloaded. By similar logic, every time a consumer buys a new device and transfers digital files to the new device, they have committed copyright infringement. Worse still, music saved to a cloud service would also be infringement every time a user accessed it. However, the importance of particularity requirement is still relevant despite the archaic understanding of how digital music is used and stored.

65. *Id.* at 655.

66. *Id.*

identical item. To be protected by the first sale, and patent exhaustion, the seller must have made an authorized purchase of the particular item.[67]

Though a patent case has never turned on a particularity requirement, as it did in *ReDigi*, the courts often use language of particularity in patent exhaustion cases.[68] This supports the underlying legal principle that a buyer cannot thwart the patent rights of the IP owner without compensating the IP owner for the specific article first. Therefore, drop-shippers are potentially unprotected by patent exhaustion because they do not sell a particular item. Rather, they are selling the invention protected by a patent generally and then later obtain title to a particular item. However, at the time of the original offer and acceptance (by the buyer) the drop-shipper has infringed the patent. Despite the fact that drop-shippers are selling an identical product, the drop-shippers do not sell a particular product, so the sale is not protected by patent exhaustion.

While the issue of particularity strengthens the case of IP owners against drop-shippers, it likely does not outweigh the

67. Pearson Educ., Inc. v. Liu, 656 F. Supp. 2d 407, 412 (S.D.N.Y. 2009) (By § 109(a)'s terms, the first-sale doctrine applies if two conditions are satisfied. First, the person claiming the doctrine's protection must hold title to a particular copy—that person must be "the owner" of the copy. And second, the copy must have been "lawfully made under this title.") (emphasis omitted); *see also* Ranieri v. Adirondack Dev. Grp., LLC, 164 F. Supp. 3d 305, 350 (N.D.N.Y. 2016) (quoting Microsoft Corp. v. Harmony Computs. & Elecs., Inc., 846 F. Supp. 208, 212 (E.D.N.Y. 1994); *accord* Mapinfo Corp. v. Spatial Re–Eng'ring Consultants, No. 02–CV–1008 DRH, 2006 WL 2811816, at *20 (N.D.N.Y. Sept. 28, 2006)) ("Furthermore, 'the defendant has the burden of proving that the particular pieces of the copyright work that he sold were lawfully made or acquired.'").

68. Adams v. Burke, 84 U.S. 453, 456 (1873) ("That is to say, the patentee or his assignee having in the act of sale received all the royalty or consideration which he claims for the use of his invention in that particular machine or instrument, it is open to the use of the purchaser without further restriction on account of the monopoly of the patentees."); *see also* Keeler v. Standard Folding Bed Co., 157 U.S. 659, 664 (1895) ("The article, in the language of the court, passes without the limit of the monopoly. That is to say, the patentee or his assignee having in the act of sale received all the royalty or consideration which he claims for the use of his invention in that particular machine or instrument, it is open to the use of the purchaser without further restriction on account of the monopoly of the patentee.); Bloomer v. Millinger, 68 U.S. 340, 351–52 (1863) ("By a valid sale and purchase the patented machine becomes the private individual property of the purchaser, and is no longer specially protected by the laws of the United States, but by the laws of the State in which it is situated. Hence it is obvious, say the court, that if a person legally acquires a title to that which is the subject of letters patent, he may continue to use it until it is worn out, or he may repair it or improve upon it as he pleases, in the same manner as if dealing with property of any other kind."); Bowman v. Monsanto Co., 569 U.S. 278, 284 (2013) ("[T]he [patent exhaustion] doctrine restricts a patentee's rights only as to the 'particular article' sold . . . .").

court-favored policy arguments and legal ambiguity which favor the drop-shipper.

C. Unauthorized "Offer to Sell" as a Form of Patent Infringement

1. The Purpose of the "Offer to Sell" Language in § 271(a)

35 U.S.C. § 271(a) did not originally include a restriction on "offer to sell" patented items. Congress modified § 271(a) by adding "offer to sell" in response to the TRIPS agreements. The courts have repeatedly held this to be a strengthening of patent rights. "The amendment to § 271(a) represents a distinct change to the bases for patent infringement, because liability arose previously only as the result of an actual sale."[69] Now a patent owner does not have to wait for an infringing sell to bring a suit against an infringer.

The court explained in *In re Biogen* that "an offer to sell is a distinct act of infringement separate from an actual sale" and it "differs from a sale in that an offer to sell need not be accepted to constitute an act of infringement."[70] In fact, an "unauthorized 'offer to sell' a patented invention within the United States creates a separate cause of action for patent infringement. . . . The geographic location and physical destination of the subject matter of the 'offer' appear to be immaterial . . . , so long as the 'offer' was made in the United States."[71]

The policy behind the inclusion of "offer to sell" in 35 U.S.C. § 271(a) was explained in *Transocean* "to prevent 'generating interest in a potential infringing product to the commercial detriment of the rightful patentee.'"[72] In other words, the purpose of including "offer to sell" was to dissuade retailers or sellers from having any interest in patent infringement. Under an offer-to-sell analysis, the court will not need to consider the timing or completion of a first and second transaction, because an infringing "offer to sell" occurs before the sale is complete.[73] Thus the right to exclude an unauthorized "offer to sell" more fully protects the

69. 3D Sys., Inc. v. Aarotech Labs., Inc., 160 F.3d 1373, 1378 (Fed. Cir. 1998).

70. In re Biogen '755 Pat. Litig., 335 F. Supp. 3d 688, 745 (D.N.J. 2018) (quoting Transocean Offshore Deepwater Drilling, Inc. v. Maersk Contractors USA, Inc., 617 F.3d 1296, 1308 (Fed. Cir. 2010)).

71. Wesley Jessen Corp. v. Bausch & Lomb, Inc., 256 F. Supp. 2d 228, 233 (D. Del. 2003).

72. *Transocean*, 617 F.3d at 1309 (quoting *3D Sys., Inc.*, 160 F.3d at 1379).

73. *Id.*

rights of the patent owner by expanding infringement to activity which anticipates the sale.

2. Drop-Shippers May Be Liable for Patent Infringement Under an Unauthorized "Offer to Sell"

An understanding of what constitutes an offer to sell is drawn from traditional contract law.[74] An alleged infringer must "communicate[] a 'manifestation of willingness to enter into a bargain, so made as to justify another person in understanding that his assent to that bargain is invited and will conclude it.'"[75] For example, the ability to pre-order an item on a website did not constitute an offer because "pre-orders did not contain a projected delivery date," and "marketing efforts [did not] . . . include specific terms and sufficient definiteness . . . ."[76] Conversely, a "buy now" button was probably enough to constitute an offer because a consumer could expect that by pressing the "buy now" button they were accepting an offer and the terms of the sale were definite and would be completed.[77] It should also be noted that the Federal Circuit has consistently held that activities which would not normally amount to an offer under contract law do, in fact, amount to an offer when the court is considering infringement by an unauthorized offer to sell.[78] Put simply, what may not be an "offer to sell" in contract law, may still be an "offer to sell" under infringement law. This essentially tips the scale of ambiguous infringement cases in favor of the IP owner.

Patent exhaustion also applies to an "offer to sell." A seller who is selling a product from the secondary market is not liable for offering to sell that product. As this applies to drop-shippers, the analysis would be the same as discussed above except that the

74. Moy, *supra* note 45.

75. *In re Biogen*, 335 F. Supp. 3d at 745 (citation omitted).

76. QR Spex, Inc. v. Motorola, Inc. 507 F. Supp. 2d 650, 660 (E.D. Tex. 2007).

77. Altinex Inc. v. Alibaba.com Hong Kong Ltd., SACV 13-01545 JVS (RNBx), 2016 WL 6822235, at *10–11 (C.D. Cal. Mar. 25, 2016).

78. Moy, *supra* note 45 ("What emerges from the Federal Circuit decisions handed down to this point is thus a practice that is undisciplined and to some degree misdescriptive. Nominally the decisions espouse fidelity to contract law; the direct assertion is that only activities that meet the definition of a formal offer will qualify as an infringing offer for sale. In application, however, the decisions insist on a good deal less; speaking generally, a statement that communicates both a description of the infringing good and a price will be taken as sufficient to establish infringement. This is done without any real investigation into how the scenarios under consideration would be treated under specific authorities in contract.").

analysis begins before the drop-shipper has even found a buyer for the product. Before the drop-shipper has a buyer, she has only an offer for sale on an e-commerce website and no question that the drop-shipper has not purchased the product to extinguish the patent over a particular item. In fact, the offer for sale is not tied to a particular item at all. Therefore, the analysis for patent exhaustion is straightforward: no first sale and no exhaustion.

Conversely, drop-shippers could argue that they are not selling an item from the primary market even without having ownership of the secondary market item because they have access to an item on the secondary market. For example, if drop-shippers are aware of a distributor that is selling the item through the secondary market, they might argue they made offers to sell items from the secondary market. However, in patent exhaustion case law it appears that patent exhaustion only applies to the owners of the particular item that the patent has exhausted. In simple terms, the drop-shipper cannot offer to sell someone else's exhausted product; it must be their own. However, it is not without merit to imagine that a seller could obtain the rights to sell an item on the secondary market without actually obtaining title to that product. Therefore drop-shippers may be able to make a convincing claim under this theory.

There are many cases of patent infringement under "offer to sell" for counterfeit products. These cases are analogous to the drop-shipping cases because the offers for sale portray themselves to be authentic products. It is not required for a sale to be complete to constitute patent infringement, and thus, whether the product turns out to be authentic is of little consequence. A person can offer to sell a patented item only if (1) the person is an authorized licensee or (2) the patent has exhausted over the particular item.

Patent infringement cases of unauthorized "offers to sell" are often brought against large e-commerce hosts like Amazon, eBay, and Alibaba, and not against individual drop-shippers or distributors.[79] This is likely because of the difficulty of bringing a suit against individual infringers, discussed above. The courts usually rule in favor of the e-commerce platforms because these hosts are not the actual sellers of the infringing product, nor do they

79. Milo & Gabby, LLC v. Amazon.com, 144 F. Supp. 3d 1251 (W.D. Wash. 2015); Blazer v. eBay, Inc., No. 1:15-CV-01059-KOB, 2017 WL 1047572, at *3 (N.D. Ala. Mar. 20, 2017); Altinex Inc. v. Alibaba.com Hong Kong Ltd., No. SACV 13-01545 JVS (RNBx), 2016 WL 6822235, at *1 (C.D. Cal. Mar. 25, 2016).

portray themselves to be the sellers.[80] That being said, the holding in *Milo & Gabby, LLC v. Amazon.com* suggested that such a lawsuit against an individual seller would be successful, because the sellers do not have the same excuse.[81]

In *Milo & Gabby, LLC*, the plaintiffs brought a suit against Amazon for direct and indirect patent infringement by providing a platform which encouraged its users to infringe patents and because Amazon knew such activities were likely.[82] At the district court level, the plaintiffs argued that patent infringement existed under "offer to sell" but the court denied the pleading because it was obvious to a buyer on Amazon's platform that Amazon was not the seller of the item thereby implying a suit brought against the individual seller might be successful.[83] Following this logic, if a defendant drop-shipper offers to sell a patented product—as did the sellers in *Milo and Gabby, LLC*, *Blazer v. eBay, Inc.*, and *Altinex Inc. v. Alibaba.com*—then a suit against the drop-shipper would likely be successful.

Though the ruling was against the plaintiffs in *Milo & Gabby, LLC*, the court was "troubled by its conclusion" and provided some insightful dicta regarding the current state of patent infringement law.[84] The court was specifically concerned about the impact that a holding in favor of e-commerce platforms has on small businesses.[85] The court recognized that Amazon makes it unbelievably easy for someone to set up a patent-infringing business.[86] While Amazon may try to prevent infringement, it seems that it does not do much. "As a result, Amazon enables and fosters a market place reaching millions of customers, where anyone can sell anything, while at the same time taking little responsibility for 'offering to sell' or 'selling' the products."[87] Evidently, as the court concluded, the law lingers

80. *Milo & Gabby, LLC*, 144 F. Supp. 3d at 1253–54; *Blazer*, 2017 WL 1047572, at *3; *Altinex Inc.*, 2016 WL 6822235, at *10–11.

81. *Milo & Gabby, LCC*, 144 F. Supp. 3d at 1253–54, *aff'd Milo & Gabby LLC v. Amazon.com, Inc.*, 693 F. App'x 879 (Fed. Cir. 2017).

82. *Milo & Gabby, LLC*, 144 F. Supp. 3d at 1251.

83. *Id.* at 1253.

84. *Id.*

85. *Id.*

86. In court, an Amazon representative testified that sellers are able to offer their products on Amazon "by simply filling out an online information form, [agreeing] to Amazon's terms and conditions, and providing certain banking information." *Id.* at 1253.

87. *Id.* at 1253.

behind technology.[88] The purpose of "offer to sell" in § 271(a) was to prevent any interest in patent infringement and protect the patentee, and yet "[i]n this instance, the Court is not convinced that such purpose has been fulfilled. However, that is a subject which must be addressed to Congress and not the courts."[89] It seems the Federal Circuit would have preferred to find e-commerce platforms liable for their part in facilitating patent infringement but was limited by the law that "lags behind technology."[90]

In conclusion, under an unauthorized "offer to sell" a patent infringement case is more likely to succeed because (1) the policies favor the patent owner, and (2) it is not necessary for the court to determine when the sale of the item is complete, like it would under an unauthorized sale infringement analysis. Under this approach a court will not have to decide at which point the sale is complete, nor will a court need to consider whether the patent owner was justly compensated. An unauthorized offer to sell occurs before either of these questions occur. This avenue is a cleaner and simpler approach to patent infringement and plenty analogous case law.[91] A suit against a drop-shipper for patent infringement via an unauthorized "offer to sell" would likely succeed.

II. TRADEMARK INFRINGEMENT

Another legal issue is how drop-shipping relates to trademark infringement. The basis of trademark law is to protect the consumer from product confusion. While other forms of intellectual property are highly concerned with the rights of the IP owner, trademark law is more focused on the consumer. That being said, some rights are reserved for the trademark owner to protect their goodwill and reputation. Therefore, if the actions of drop-shippers cause customer confusion or damage the goodwill and reputation of the trademark owner, they may be liable for trademark infringement.

Trademark owners are concerned with product delivery because distribution can affect the goodwill associated with the trademark. Presumably, a damaged reputation and goodwill causes lost profits. Because drop-shippers interfere with product

88. *Id.*
89. *Id.* at 1254.
90. *Id.* at 1253.
91. *Id.* at 1252–53.

distribution, trademark owners are concerned with drop-shipping activities.

Trademark owners whose products are being sold via drop-shipping are concerned about the quality control of their products. Namely these trademark owners view the shipping time of the product to be inherent to the quality of the product. Often, drop-shippers will increase shipping time of a product because the order is being fulfilled by a different distributor. This is a common problem experienced by drop-shippers.[92] Because most consumers are unaware that they are purchasing from a drop-shipper, the damage to reputation from overly long ship times may be associated with the trademarked product or owner. It follows that trademark owners should be allowed a mechanism to control the delivery parameters of their products. It is possible that that a customer prefers certain distributors, so when the product arrives from a different distributor, the customer may be disappointed, once again risking damage to the trademark's goodwill and reputation.

Another concern is poor customer experience. When a drop-shipper acts as the distributor and customer service representative, the trademark owner has no has no control over customer experiences. For example, a customer may have questions about or may want to return a product sold by a drop-shipper and the drop-shipper would be their point of contact. While a trademark owner has contractual levers over distributors and licensees to control consumer interactions, the trademark owner has no control over drop-shippers.

However, the rights of the trademark owner are limited by trademark doctrines. Two of these trademark doctrines, trademark quality control and trademark dilution, are explained along with their potential application to drop-shipping below.

A. Trademark Quality Control

Although trademark owners are very concerned with the delivery of their products to the consumer, "[t]he general rule is that a trademark owner cannot stop someone from selling genuine goods bearing a true mark, even if the sale is without the mark

92. Alan Young, *How to Deal with Long Shipping Times When Dropshipping with AliExpress*, ITSALANYOUNG.COM (Jan. 3, 2018), https://itsalanyoung.com/deal-long-shipping-times-dropshipping-aliexpress/.

owner's consent."[93] With that said, courts have interpreted the Landham Act to prohibit actions that diminish the trademark owner's ability to control the quality of the products,[94] such as those that are "likely to cause confusion, or to cause mistake, or to deceive."[95] Courts are motivated by giving the trademark owners the rights necessary for them to protect their goodwill and reputation. Therefore, the courts have expanded non-genuine products to include those which "do not conform to the trademark holder's quality control standards . . . or if they differ materially from the product authorized by the trademark holder for sale."[96] In fact, where a material difference exists in the product, the courts will draw an exception to the first sale doctrine and allow the trademark owner to exercise control over the product as part of the secondary market.[97] However, if the trademark owner is able to adequately control the quality through authorized distributors, the courts are less likely to find trademark infringement.[98]

Courts are especially less likely to find trademark infringement in cases where the "material difference" in the final product is not a defect or lack of quality control that might result in a defect.[99] In *Matrix Essentials*, the trademark owner preferred their product to be sold by authorized distributors.[100] However, it was eventually sold by an unauthorized retailer.[101] The court was not convinced that this constituted a material difference because the product was identical in quality to that sold by the authorized distributor.[102] The trademark owner tried to argue that a label explaining

93. CCH INC., DISTR. L. ANTITRUST PRINCIPLES & PRAC. § 4.08 (2021) 2019 WL 4467796.

94. 15 U.S.C. § 1051; J. THOMAS MCCARTHY, 4 MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 25:42 (5th ed. 2021).

95. 15 U.S.C. § 1114(a)–(b).

96. MCCARTHY, *supra* note 94 (quoting Zino Davidoff SA v. CVS Corp., 571 F.3d 238, 243 (2d Cir. 2009)).

97. MCCARTHY, *supra* note 94.

98. *Id.*; *see also* Shell Oil Co. v. Com. Petroleum, Inc., 928 F.2d 104, 108 (4th Cir. 1991).

99. Matrix Essentials, Inc. v. Emporium Drug Mart, Inc., 988 F.2d 587, 591 (5th Cir. 1993) (The "common thread" in the prior cases "is that each involved some defect (or potential defect) in *the product itself* that the customer would not be readily able to detect. The oil, shoes, and beer from *Shell, El Greco,* and *Coors* all contained or could potentially contain a latent product defect due to the unauthorized distributor's failure to observe the manufacturer and mark owner's rigorous quality control standards."); *see also* MCMARTHY, *supra* note 94.

100. *Matrix Essentials, Inc.*, 988 F.2d at 589.

101. *Id.*

102. *Id.* at 590, 593.

"professional dispensing only" would confuse a customer when the product was not being sold by a professional source. However, the court found that this would not cause consumer confusion because the consumer was not confused about what product they were purchasing.[103]

Under this framework, a drop-shipper is likely not liable for trademark infringement. The final product which is delivered to the customer is identical to the products being sold by authorized distributors because it *is* the product being sold by the authorized distributors. Through the same reasoning, the quality control is also within the control of the trademark owner (who controls the authorized distributors). As such, there will be no "material difference" with the final product purchased by a drop-shipper. The trademark owners whose products are sold by drop-shippers will be similarly barred from trademark remedies. If there is a "material difference" between a drop-shipper's product and a distributor's product, such as a difference in ship time, the difference can be easily remedied. As long as the drop-shippers "take the necessary steps to adequately alleviate this confusion and prevent injury to the trademark's goodwill—by, for example, sufficiently disclosing that the product differs from the originally sold product—those differences will be unlikely to trigger the liability. . . ."[104] Even if a court chose to find different ship times to be a "material difference," a drop-shipper would simply need to disclose the difference to a purchaser to avoid liability for trademark infringement.

That said, some courts have found a material difference where the sale lacked the original manufacturer's warranty.[105] Therefore, a trademark owner may be able to claim material difference by offering a warranty for the product among its authorized distributors. Assuming the drop-shippers are unable to offer the same warranty to the buyer, this would qualify as a material difference that would result in trademark infringement liability for the drop-shipper.

103. *Id.* at 591.

104. Beltronics USA, Inc. v. Midwest Inventory Distrib., LLC, 562 F.3d 1067, 1074 (10th Cir. 2009) (Defendant's disclosure on its eBay sales was found to be insufficient.); *see also* MCCARTHY, *supra* note 94.

105. MCCARTHY, *supra* note 94.

B. Trademark Dilution

Another potential trademark doctrine where a trademark owner could reclaim rights after the first sale is trademark dilution. In addition to goodwill and reputation, a trademark owner is also interested in the branding of her product. Often, the price point of a product is an essential element of this branding. Therefore, a trademark owner might try to argue dilution of the trademark by the effect on pricing. Further, increased shipping times could also result in dilution of the trademark (as discussed in detail above). Finally, when a consumer discovers the drop-shipping scheme, it can be a negative experience which might also dilute the trademark. The doctrine of first sale also does not apply to trademark dilution. In other words, a trademark owner can reach beyond the first sale to control the trademark if dilution occurs.

15 U.S.C. § 1125(c)(1) explains the necessary elements of trademark dilution:

> Subject to the principles of equity, the owner of a famous mark that is distinctive, inherently or through acquired distinctiveness, shall be entitled to an injunction against another person who, at any time after the owner's mark has become famous, commences use of a mark or trade name in commerce that is likely to cause dilution by blurring or dilution by tarnishment of the famous mark, regardless of the presence or absence of actual or likely confusion, of competition, or of actual economic injury.[106]

The fame requirement is the narrowest and most difficult step of the dilution analysis.[107] Most cases will be ruled out at this first step because it is a very difficult standard to achieve.[108] "The fame requirement is so important that the Second Circuit advised trial courts to determine the fame question as an initial gateway issue before going further to analyze a dilution claim."[109]

In determining whether or not a trademark is famous, the American Jurisprudence explains "A mark is famous if it is widely recognized by the general consuming public of the United States as a designation of the source of the goods or services of the trademark's owner."[110] The following are factors of a famous

106. 15 U.S.C. § 1125(c)(1).
107. MCCARTHY, *supra* note 94, at § 24:104.
108. *Id.*
109. *Id.*
110. 98 AM. JUR. 3D 313, *Proof of Dilution of a Trademark* § 6 (2007).

trademark: duration and extent of the trademark use; amount, volume, and extent of sales; the actual registration; and whether the mark was registered.[111] Also, the court will not rule a trademark as famous if the mark is only well-known in "'niche' markets."[112]

On another note, the mark must be a household name to be famous enough for trademark dilution.[113] Proving secondary meaning will fall short of the "fame" needed for dilution; the fame necessary is a higher bar than the bar for distinctiveness and "very few are 'famous. '"[114] For example, Coach Handbags filed a suit for trademark dilution against a tutoring business also named "Coach."[115] The court ruled in favor of the defendant because Coach did not qualify as famous and because its name is a common English word.[116] The court explained "[i]t is well-established that dilution fame is difficult to prove."[117]

Most activities of drop-shippers will fall outside the category of trademark dilution automatically because very few trademarks are famous marks. However, if a trademark owner is successful in proving their mark is famous, the court is not likely to find the activities of a drop-shipper to be infringing.

111. *Id.*

112. *Id.*

113. MCCARTHY, *supra* note 94, at § 24:104.

114. *Id.* See *id.* at § 24:108 for examples of marks held famous under 1996 Federal Act : "AOL; ARTHUR THE AARDVARK cartoon character; AUDI vehicles; BARBIE doll; BUDWEISER beer; CAMEL cigarettes; CANDYLAND children's game; CARTIER luxury goods; DON'T LEAVE HOME WITHOUT US slogan for traveler's checks and credit cards; ETCH-A-SKETCH for drawing toy; fish-shaped GOLDFISH brand crackers; FORD motor vehicles; THE GREATEST SHOW ON EARTH slogan for a circus; HOTMAIL e-mail service; INTERMATIC electrical products; JAMES BOND movie character; JEWS FOR JESUS religious organization; LEXINGTON investment advice services; NAILTIQUES fingernail care products; NASDAQ stock market services; NATIONAL BASKETBALL ASSOCIATION logo; NIKE sports shoes and apparel; PANAVISION movie and TV cameras; POLO wearing apparel; PORSCHE autos; PROZAC anti-depression drug; THE SPORTING NEWS newspaper; TOYS 'R US toy stores; TYLENOL analgesic; VELVEETA cheese products; VICTORIA'S SECRET womens' lingerie and wearing apparel; WAWA chain of 500 convenience stores in five eastern states, in use for 90 years; WINSTON cigarettes."

115. Coach Servs., Inc. v. Triumph Learning LLC, 668 F.3d 1356, 1360 (Fed. Cir. 2012).

116. *Id.* at 1373.

117. *Id.*; *see also* Toro Co. v. ToroHead, Inc., 61 U.S.P.Q.2d 1164, 1180 (T.T.A.B. 2001) ("Fame for dilution purposes is difficult to prove."); Everest Capital Ltd. v. Everest Funds Mgmt., LLC, 393 F.3d 755, 763 (8th Cir. 2005) ("The judicial consensus is that 'famous' is a rigorous standard."); MCCARTHY, *supra* note 94, at § 24:104 (noting that fame for dilution is "a difficult and demanding requirement" and that, although "all 'trademarks' are 'distinctive'—very few are 'famous'").

Assuming a trademark owner can show their mark is famous, they will provide evidence of dilution through blurring or tarnishment. Because the drop-shippers are selling actual product, the case will come under tarnishment. Courts are wary of dilution and have limited "tarnishment" to disparaging uses. For example, "Enjoy Cocaine" would be a disparaging use of COCA-COLA's popular "Enjoy Coke" slogan.[118] Dilution does not occur even where "a product whose commercial status, reputation and quality is held in high esteem, or at least is of higher price and quality than plaintiff's product. So long as the defendant's use does not place plaintiff's trademark in a degrading or disparaging context, tarnishment will probably not be found."[119] The activities of a drop-shipping scheme will likely not amount to tarnishment as the drop-shipper is trying to sell product, not disparage against it. As a result, it is unlikely that a drop-shipper will be liable to a trademark owner for trademark dilution.

III. COPYRIGHT INFRINGEMENT

Copyright is an original work of authorship fixed in a tangible medium.[120] Copyrighted materials include literary works, musical works, sound recordings, pictorial, sculptural works, motion pictures, architectural works, or similar works.[121] Infringement of a copyright is an unauthorized copying of these works.[122] Most drop-shippers never personally handle the products they are selling, let alone copy them. The most applicable form of copyright infringement does not directly result from copying the products, but rather copying the marketing materials used to sell the products.

When creating a virtual store, a drop-shipper may copy the photos and product descriptions created by the IP owners to create a product listing. As the simplest form of factual copying, the IP owner must only show access and direct evidence of the copying which has a striking similarity to the original to show direct infringement.[123] Some drop-shippers will try to modify the product images and descriptions as to not directly infringe the copyrights.

118. Coca-Cola Co. v. Gemini Rising, Inc., 346 F. Supp. 1183, 1183 (E.D.N.Y. 1972).

119. J. Thomas McCarthy, *Dilution by Tarnishment*, 4 MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 24:89 (5th ed. 2019).

120. 17 U.S.C. § 102(a).

121. *Id.*

122. 17 U.S.C. § 501(a).

123. Granite Music Corp. v. United Artists Corp., 532 F.2d 718, 721 (9th Cir. 1976).

In this case, the IP owner still has options under reproduction rights or derivative work rights.

The biggest problem that IP owners face in a copyright infringement claim is an organization technique used by large e-commerce platforms. The feature nests similar items offered for sale by different sellers under the same product listing. In other words, the IP owner will create a product listing with their copyrighted images and descriptions. Drop-shippers and other sellers will identify the product listing and list the same product for sale, which the e-commerce host will combine into a single listing. The e-commerce hosts provide a link for a buyer to click which says "see other sellers" or "other seller options" where other sellers and prices are listed. Therefore, a drop-shipper can list an item for sale, including photos and product descriptions, without any actual copying of the copyrighted material.

Where copyright infringement occurs during drop-shipping, it is usually straightforward, but it does not occur often because of the capabilities provided by large e-commerce hosts to sell without infringing a copyright.

IV. PRESCRIPTIVE ACTION

One possible solution is proposed below that would allow the patent owners to have control over the primary market of their intellectual property but would also allow drop-shippers to continue their businesses.

Only the IP owners, and their authorized licensees, should be allowed to sell their items on the primary market in order to preserve their exclusive rights to the primary market. One way this could be achieved is by only allowing the IP owners the right to sell an item as "new" on e-commerce platforms. E-commerce hosts have product distinctions or conditions for new and used items. Typical labels include "new," "like new," "fair," "acceptable," and "poor." The "new" market is representative of the primary market. A drop-shipper, or other second-hand seller, could be required to sell the item as "like new" or the like because it is part of the secondary market. Under this scheme, e-commerce platforms would be required to limit access to and monitor listings or sellers that sell items as "new." For example, a seller may not have access to sell an item as "new" on an e-commerce platform until they have provided evidence to the e-commerce platform that they are an IP owner, licensee, or that the product does not have IP. Similarly, IP owners could be given avenues to list authorized sellers and report unauthorized sellers who are selling their items as "new."

Giving the IP owner, and authorized licensees and distributors, the sole right to sell an item "new" on e-commerce platforms ensures that the owner has control over the primary market of her property. In other words, the IP owner is given the ability to control the rights already given to her under current IP laws. In fact, allowing only the IP owners to list an item for sale as "new" has benefits beyond the issues of drop-shipping because it would inhibit counterfeit markets as well. This distinction also reflects the customer's expectations of what it means to buy an item "new." Most consumers expect that a "new" item will be shipped directly from the original source or an authorized distributor. Often, customers are willing to pay a premium to be assured the item they are purchasing is authentic and directly from the manufacturer.

The drop-shipper will likely argue that this limitation will have a chilling or clogging effect on the drop-shipping business model because a drop-shipper will likely lose customers by not being allowed to sell an item as "new." What's more, this will likely reduce drop-shippers profit margins because "like new" items may have a lower value than "new" items. On the other hand, this requirement will not have the same chilling effect that courts are concerned about. Usually, courts are not concerned about a loss of customers or reduced prices of the secondary market; rather, they are concerned about the liability of sellers on the secondary market to the IP owners (by extending the IP owner's rights beyond the first sale). Requiring that a drop-shipper sell items as "like new" does not completely eliminate the ability of a drop-shipper to continue their business, nor does it increase their liability to an IP owner, but rather helps the drop-shipper to avoid liability. Many customers are willing to take an item that is "like new" for a lower price. Most importantly, by offering a patented item for sale as "like new," it does not appear that the drop-shipper is attempting to sell a patented item during the term of the patent. It signals that the drop-shipper is obtaining title to a product over which the patent has already been extinguished.

The patent owner will likely argue that even under a "like new" listing the drop-shipper has still committed infringement because they have not yet obtained title to a particular item. However, it is important to appreciate the trend of courts to embrace new technologies and markets despite the concerns that IP owners raise. The purpose of IP is to promote progress and often the biggest proponents of limiting progress are IP owners who are concerned about losing their rights. The best way forward is not to eliminate disruptive technologies that encroach on the IP owner's rights, but rather to find a way to use them to the IP owner's advantage.

This solution offers the balance courts are trying to achieve between the rights of the IP owners and a concern for clogging the channels of commerce. It maintains an important right of the IP owner, the right to sell their product for the first time, while also providing an avenue to drop-shippers to continue their businesses.

CONCLUSION

Drop-shipping represents an evolution of the market that is inevitable with the age of the internet. As the business model gains popularity, it will eventually be considered by either the courts or legislators. Therefore, the analysis here will be relevant to those discussions when they occur.

It seems that the activities of a drop-shipper are largely non-infringing activities. Though a drop-shipper can infringe on copyright and trademarks, often they do not. Copyright infringement only occurs where a drop-shipper copies the images and descriptions from an IP owner's marketing tools and uses them in their own virtual store. However, e-commerce platforms have provided a solution for this by nesting "other sellers" under the IP owner's listing. Also, the activities of the drop-shipper likely do not constitute trademark infringement because the drop-shippers do not personally handle (or warehouse) any of the products and the IP owners maintain quality control through their authorized dealers.

However, a drop-shipper may run into trouble with an unauthorized offer to sell a patented item. These activities clearly constitute patent infringement because the drop-shipper does not have title to a particular patented item and therefore has not exhausted the patent over that item. The drop-shippers are offering for sale a patented item during the term of the patent in the United States, which is patent infringement under 35 U.S.C. § 271(a).

One solution to the conflicting interests of IP owners and drop-shippers is to allow only IP owners to sell an item as "new" and require drop-shippers to sell the items as "like new." This signals to consumer which sellers are authorized distributors of a product and allows an IP owner to control the primary market for its products. This solution also allows for a drop-shipper to continue their businesses on the secondary market where the IP owners' rights have extinguished.

This analysis was focused only on the rights and laws regarding IP owners. Many of the products which drop-shippers sell do not have any IP protection at all. This does not mean these activities are lawful and not prime for conflicts in the courts. Because drop-shipping businesses harm IP owners, it is likely that IP owners will continue to try and find an avenue to litigate against drop-shippers. As such, further study needs to be done to examine drop-shipping under unfair competition or privacy rights. But for now, at least patent, trademark, and copyright owners have some grounds for remedy in the courts and drop-shippers have a way of continuing their businesses while reducing the risk of violating the owners' rights.