



the first sale doctrine in the digital age

Intellectual Property & Technology Law Journal

March 2010

Reprinted with permission from the March 2010 issue of the Intellectual Property & Technology Law Journal.

An English professor purchases an original edition of *Rabbit Run* from a quaint used bookstore. A newlywed couple holds a yard sale where the wife sells the husband's collection of "National Lampoon" and "American Pie" DVDs. A photography enthusiast purchases new editing software, loads it onto his hard drive, and lends the disc containing the software to his neighbor. An enterprising college student rips her entire CD collection onto an iPod and is inspired to start a business selling ready-loaded iPods. A bookworm purchases a Kindle and dozens of e-books, decides she prefers the touch and feel of paper, and sells her Kindle—e-books and all—to a friend. On their face, these scenarios have little in common. However, each scenario raises questions concerning the applicability of copyright law's first sale doctrine and its contemporary scope.

The First Sale Doctrine: General Background

Under § 106 of the U.S. Copyright Act, copyright owners have six exclusive rights: (1) reproduction; (2) preparation of derivative works; (3) distribution; (4) public performance; (5) public display; and (6) digital public performance of sound recordings. The third right gives copyright owners the exclusive right to distribute copies of their works to the public, including by offering copies for sale, lease, or auction. Under the first sale doctrine, however, in most circumstances the distribution right is extinguished when a copyright owner transfers ownership of a particular legal copy of a work to another person. Specifically, § 109(a) of the Copyright Act provides:

Notwithstanding the provisions of section 106(3), the owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord.

attorneys

Robert H. Rotstein

practice areas

entertainment & ip litigation



the first sale doctrine in the digital age

The first sale doctrine provides a defense to copyright infringement. A defendant may rely on the first sale doctrine as a defense to an alleged violation of the distribution right if he overcomes the burden of proving that he lawfully owned the copy that he distributed. The first sale doctrine, however, is not universally applicable. Section 109(a) provides that the defense extends only to "the owner of a particular copy[.]" This language is clarified in § 109(d), which states, "The privileges prescribed by subsection[] (a) . . . do not, unless authorized by the copyright owner, extend to any person who has acquired possession of the copy or phonorecord from the copyright owner, by rental, lease, loan, or otherwise, without acquiring ownership of it." Under this provision, it is clear that Congress intended to allow copyright owners to enter transactions that do not involve transfers of ownership and therefore do not constitute "first sales." Moreover, Congress expressly stated in § 109(b) that there is no first sale right to rent, lease, or lend phonorecords embodying sound recordings or to rent, lease, or lend copies of a computer program for direct or indirect commercial gain.

The overall first sale scheme "rest[s] on the principle that the copyright owner is entitled to realize the full value of each copy or phonorecord upon its disposition." The theory is that the price charged for the initial sale of a copyrighted book will account for the purchaser's ability to subsequently resell the book. Thus, if a book's resale value is \$5, the book's initial price point can be set \$5 higher, such that a book with an initial value of \$7 can be sold for \$12. The author captures the value of both the initial sale and the resale in the initial value, and the purchaser is then free to dispose of his or her copy as the purchaser sees fit.

Historical Antecedents

The first sale defense originated as a judge-made doctrine intended to prevent a copyright owner from placing restrictions upon copies of copyrighted works "after the owner had parted with the title to one who had acquired full dominion over it and had given a satisfactory price for it[.]" In the 1908 Supreme Court case *Bobbs-Merrill Co. v. Straus*, the plaintiff publisher included the following language in its books: "The price of this book at retail is \$1 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." Defendant sold the book at a price less than \$1, and the plaintiff sued for copyright infringement, specifically an infringement of its right to "vend." The Court held:

In our view the copyright statutes, while protecting the owner of the copyright in his right to multiply and sell his production, do not create the right to impose, by notice, such as is disclosed in this case, a limitation at which the book shall be sold at retail by future purchasers, with whom there is no privity of contract.

This principle was reaffirmed in the Copyright Act of 1909 and in the current Copyright Act.

Historically, the first sale doctrine's concern has been balancing the right of the copyright owner to freely enter contracts with customers and to receive a fair return for a sale against the dangers of restraints on alienation. The practical market effects of the first sale doctrine traditionally have been felt by entities such as: (1) libraries, (2) used book stores, (3) video rental companies, and (4) used CD and DVD sellers.

Three Contemporary First Sale Paradigms



the first sale doctrine in the digital age

With the advent of modern technology, the *use* of many copyrighted works, such as software, has become intertwined with the *reproduction* of these works. This poses a challenge for the first sale doctrine, which applies to the *distribution* right but not to the *reproduction* right. Thus, today the first sale doctrine is best understood in terms of three paradigms:

1. Traditional: cases in which transfer of possession of the physical copy of a copyrighted work does not implicate the reproduction right;
2. Transfer of tangible/intangible property: when reproduction is necessary to attendant use of technology; and
3. Transfer of intangible property only.

In each instance, the Copyright Act allows copyright owners to license, rather than sell, copies of their works. Thus, through contracts with customers, copyright owners should be able to limit the applicability of the first sale defense. However, setting that issue to the side, the latter two paradigms call the relevance of the first sale defense completely into question due to the necessity of copying works in order to access them. Nevertheless, digital technology is rapidly increasing the availability of copyrighted material, thereby decreasing the practical need for a first sale defense in many contexts.

Traditional

Even today, there are still traditional applications of the first sale doctrine in which the transfer of possession of the physical copy of a copyrighted work does not implicate the reproduction right. For example, whether a hard copy book was sold or lent would not ordinarily implicate the reproduction right because one does not have to reproduce a book to use it for its primary purpose. The same is true with more advanced technology, such as a DVD. In these situations, to determine whether the first sale doctrine applies, the inquiry should generally focus on the contractual relationship between the transferor and transferee.

The traditional inquiry is illustrated by a series of film print licensing cases. In a trilogy of criminal copyright infringement cases in the 1970s, led by *United States v. Wise*, the Ninth Circuit confronted the question whether motion picture studios relinquished ownership of film prints provided to exhibitors, television stations, individuals involved in the films, and salvage companies. The defendants were charged with distributing film prints without authorization. The government bore the burden of proving beyond a reasonable doubt that the film prints distributed by the defendants had never been sold by the studios in order to prove that the first sale defense was inapplicable. The studios generally executed written agreements with the recipients of the prints prior to parting with possession. The Ninth Circuit concluded that all of the agreements that expressly retained ownership of the prints to the studios resulted in the recipients receiving only licenses to possess and use the prints. Where the agreements did not expressly reserve title to the studios, the court looked to the other terms of the agreements (e.g., up-front payments or restrictions on further transfer of possession) to determine the intent of the parties, usually concluding that these terms indicated that the copies were only licenses but in a few instances concluding that terms indicated sales of the prints may have taken place.



the first sale doctrine in the digital age

More recently, in *UMG Recordings, Inc. v. Augusto*, Judge James Otero the Central District of California analyzed first sale in the context of an individual who repeatedly acquired and sold on eBay "promotional" copies of music CDs without authorization. Judge Otero concluded that the individual's resale of these promotional copies was protected by the first sale doctrine; the case is currently on appeal to the Ninth Circuit. For years, record labels have provided music industry insiders, such as radio disc jockeys, with free access to promotional copies of upcoming releases. These copies contain licensing agreements on the jewel cases that read:

This CD is the property of the record company and is licensed to the intended recipient for personal use only. Acceptance of this CD shall constitute an agreement to comply with the terms of the license. Resale or transfer of possession is not allowed and may be punishable under state and federal laws.

The defendant did not receive promotional CDs directly from record labels but acquired them in some other fashion. He never explained precisely where he obtained the CDs at issue. Nevertheless, Judge Otero concluded that the defendant did not infringe UMG's distribution rights because UMG allowed the music industry insiders to "indefinitely possess" the CDs, indicating that UMG parted with ownership of the copies. Although Judge Otero cited *Wise* for support, his application of *Wise* is suspect. The *Wise* opinion focused far more on whether the contracts at issue reserved title in the film prints to the studios than it did on whether the contracts required return of the prints to the studios. UMG has appealed the decision to the Ninth Circuit, arguing, *inter alia*, that possession of the promotional CDs was clearly transferred pursuant to express licenses and that the defendant had failed to satisfy the burden of providing chain of title, which is necessary to assert the first sale affirmative defense. The appeal has been fully briefed, and the parties await oral argument.

Transfer of Tangible/Intangible Property

The second modern first sale paradigm involves situations in which reproduction is necessary to attendant use of technology. The classic example is software, because the user not only needs the physical medium of copyrighted expression (e.g., a disc) but also must copy the intangible work of copyrighted software to another medium (e.g., a hard drive). Consequently, software transfers implicate at least two separate rights: (1) distribution, to which the first sale doctrine is relevant, and (2) reproduction, to which the first sale doctrine has no relevance. Sorting out the scope and applicability of these two rights can be difficult.

There is extensive case law from district and appellate courts across the country analyzing whether consumer transactions involving software resident on discs constitute sales or licenses for the purpose of the first sale doctrine. Two frequently cited district court cases within the Ninth Circuit, both involving Adobe software products, illustrate the issues involved.

First, in *Adobe Sys. Inc. v. One Stop Micro, Inc.*, a Northern District of California court concluded that the first sale doctrine did not apply. Judge Ware considered whether defendant One Stop Micro infringed Adobe's distribution rights by acquiring educational copies of Adobe software that sell at a discounted price from authorized Adobe distributors, repackaging the software to remove the "educational" labels from the products, and reselling the software. One Stop Micro argued that it was protected by the first sale doctrine because Adobe's agreements with its authorized educational distributors included words such as "purchase," "own," and "resell." Judge Ware disagreed, however, and concluded, based on "undisputed evidence submitted by Adobe regarding the intent of



the first sale doctrine in the digital age

the parties in entering into the agreement, trade usage, the unique nature of distributing software, as well as the express restrictive language of the contract," that Adobe's end user license agreement, which was incorporated into Adobe's agreements with its distributors, clearly provided purchasers with a mere license, rather than ownership, of the software.

By contrast, in *Softman Products Co. v. Adobe Sys. Inc.*, a Central District of California case very similar to *One Stop Micro*, Judge Pregerson concluded that the first sale doctrine applied. Softman Products Company bought "collections" of Adobe software products that were bundled together at a discount. Softman then sold the individual products from the collections separately and made a profit. As in *One Stop*, the Adobe agreements at issue stated that Adobe was only licensing the software involved. However, Judge Pregerson concluded that these licensing agreements were mere "labels" and that "the reality of the business environment [] suggests that Adobe sells its software to distributors." He also distinguished *One Stop* as a case that was more about removing the "educational" stickers from the software than anything else. Summarizing the core issue involved, Judge Pregerson stated: "Adobe frames the issue as a dispute about the ownership of intellectual property. In fact, it is a dispute about the ownership of individual pieces of Adobe software."

More recently, two cases (both of which are currently on appeal to the Ninth Circuit) involving what it takes to qualify as an "owner" of a copy under the Copyright Act have garnered attention. First, in *MDY Industries, LLC v. Blizzard Entm't, Inc.*, Judge David Campbell of the U.S. District Court for Arizona considered a case involving the scope of the § 117 limitation on exclusive rights in computer programs (which is analogous to § 109 in that both exceptions apply only to owners of copies). Judge Campbell concluded that recent Ninth Circuit cases applying § 117, such as *Wall Data Inc. v. Los Angeles County Sheriff's Dep't*, *Triad Sys. Corp. v. Southeastern Express Co.*, and *MAI Sys. Corp. v. Peak Computer, Inc.*, compelled him to hold that the videogame company Blizzard does not sell copies of its extremely popular game, "World of Warcraft." Instead, Judge Campbell concluded that Blizzard licenses the game and that therefore the § 117 defense is unavailable to "World of Warcraft" players. Thus, unless a "World of Warcraft" player acts within the scope of the licensing agreement that accompanies the game, the player cannot reproduce the game while playing it.

In *Vernor v. Autodesk, Inc.*, Western District of Washington Judge Richard Jones reached the opposite conclusion and held that the old film print cases such as *Wise* conflict with the more recent cases, such as *Wall Data*. Judge Jones read *Wise* to say that a copyright owner must require return of the physical copy of a work at some point in order to prevent a transaction from becoming a sale, and he thus held that Vernor could resell copies of Autodesk's AutoCAD software on eBay despite contractual provisions clearly reserving title to the copyright owner and restricting transfer of the software. Judge Jones based his conclusion on the rule that the earliest of conflicting appellate court opinions must be followed. However, the authors submit that there is no conflict between *Wise* and the later Ninth Circuit cases given that all of the opinions focus primarily on whether copyright owners reserve title to copies in binding agreements.

Setting aside the dueling *MDY* and *Vernor* opinions, software cases—and other instances in which reproduction and use are intertwined—present the following conundrum: If the Copyright Act limits the right to reproduction to the original possessor of the physical property, why is the right to dispose of the property for further reproduction not likewise limited, notwithstanding the first sale doctrine? The tangible medium on which software exists has a



the first sale doctrine in the digital age

different function from a book: to effect the reproduction of the copyrighted work. In other words, with current software technology, one does not use the software through the medium on which it is initially fixed. Instead, the user is required to copy the software onto another location, like a hard drive. Consequently, the danger of viral infringement is manifest: A user can easily copy the work on to a hard drive and then give the physical medium, such as the CD or DVD containing the software, to another for free. Put differently, there is a borrow/copy problem.

Transfer of Intangible Property Only

The third contemporary first sale scenario arises when there are multiple copyrighted works on one device, but the physical copy of each copyrighted work need not be transferred each time. This paradigm is exemplified by the Kindle and the iPod. In theory, first sale should not apply to an individual work contained on one of these devices. Some advocates, however, argue that the first sale defense applies to all copies, no matter what form. Such arguments completely ignore the fact that the reproduction right, not simply the distribution right, is implicated by the transfer of intangible property.

An interesting question is whether the sale of the Kindle itself containing lawfully downloaded material would be subject to the first sale doctrine. In this scenario, a user's right to sell a lawfully loaded Kindle might be limited because of the copyright owner's ability to limit the reproduction right. This relates to the technology used to view books on a Kindle; presumably the Kindle user makes a digital copy each time a book is loaded for reading. These digital copies, in turn, are covered by the reproduction right, which is not governed by the first sale doctrine. Courts have held that copying software from a storage medium onto hardware causes a copy to be made, and "in the absence of ownership of the copyright or express permission by license, such acts constitute copyright infringement." Thus, because viewing books on a Kindle requires making a digital copy, there is no legal reason why the copyright holder cannot limit that reproduction right to the original Kindle owner and effectively bar the sale of a legally loaded Kindle.

Finally, as discussed in the context of software, ripping CDs onto an iPod and then selling the CDs and/or the iPod poses a variation of the borrow/copy problem. A user who rips all his or her CDs and loads them onto an iPod now possesses copies of the songs and can sell the CD, the physical medium containing these songs. It seems logical that, in this scenario, the user's sale of the CDs should not be covered by the first sale doctrine. *First sale* is premised on the user's right to dispose of his or her *particular copy* of a copyrighted work as the user sees fit, but it should not extend to the situation in which the user has made another copy of the work to keep and now seeks to dispose of the original copy of the work.

Conclusion

As society's media consumption continues to shift from traditional to digital formats, the issues raised by the transfer of intangible property will likely become more prevalent, and courts and lawmakers will have to wrestle with the incidental reproduction that is often necessary for the use of digital content. In doing so, judges and legislators should keep the threats posed by piracy and the benefits of business models dependent upon licensing in mind.



the first sale doctrine in the digital age

Notes are found on the attachment.