THE IMPLICATIONS OF LICENSING AGREEMENTS AND THE FIRST SALE DOCTRINE ON U.S. AND EU SECONDARY MARKETS FOR DIGITAL GOODS

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INTRODUCTION

In the United States, the very purpose of affording copyright holders exclusive rights is to "promote the Progress of Science and useful Arts."[1] The European Union justifies copyright protection as something that "helps to ensure the maintenance and development of creativity in the interests of authors, performers, producers, consumers, culture, industry and the public at large."[2] Secondary markets, or markets for used goods, promote these

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1. U.S. CONST. art. I, § 8, cl. 8.
2. Council Directive 2001/29, recital 9, 2001 O.J. (L 167) 10, 11 (EC).

very similar purposes by providing additional opportunities for consumers to obtain copyrighted works, often below the market price for a new version of the work.[3] Currently, secondary markets for digital goods do not exist in the United States, and although the European Union allows software to be sold in the secondary market, it has not extended this opportunity to any other digital goods. Consequently, American and European consumers have been foreclosed from buying and selling used digital music and electronic books.

Technological advancements have created access to digital formats of copyrighted works, which has increased consumer demand for access to secondary markets for digital goods. For example, music sales reached a new peak in 2000, when Americans purchased 943 million CD albums,[4] but with the advent of iTunes in 2003, profits from digital sales outnumbered profits from CD sales by 2011.[5] Over the past eight years, consumers have shown their preference for digital music, due to its easy accessibility on various devices, over physical CDs or records.[6] The electronic book market has had similar popularity and currently comprises roughly 20% of the book sales market.[7] The need for secondary markets has become apparent, however. For instance, in 2013, sales for electronic books only grew 5%, in part due to consumers' inability to give away or resell electronic books.[8]

There are two major reasons that secondary markets for digital goods do not exist: (1) the failure of courts in the United States and the European Union to extend the first sale doctrine[9] (called "exhaustion" in the EU) to

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3. Vernor v. Autodesk, Inc., 621 F.3d 1102, 1115 (9th Cir. 2010).

4. Adrian Covert, *A Decade of iTunes Singles Killed the Music Industry*, CNN MONEY (Apr. 25, 2013, 6:09 PM ET), http://money.cnn.com/2013/04/25/technology/itunes-music-decline/.

5. Laurie Segall, *Digital Music Sales Top Physical Sales*, CNN MONEY (Jan. 5, 2012, 5:47 PM ET), http://money.cnn.com/2012/01/05/technology/digital_music_sales/ ("According to a Nielsen and Billboard report, digital music purchases accounted for 50.3% of music sales in 2011. Digital sales were up 8.4% from the previous year, while physical album sales declined 5%.").

6. *See id*.

7. Andi Sporkin, *Bookstats 2013 Now Available*, ASS'N OF AM. PUBLISHERS (May 15, 2013), http://publishers.org/press/103/ (citing statistics from BookStats, a co-production of the American Association of Publishers and the Book Industry Study Group, which "captures net revenue and units for all key publishing categories, sectors, formats and main genres").

8. Eliana Dockterman, *The Pen is Mightier: E-book Growth Stagnating*, TIME (Oct. 31, 2013), http://business.time.com/2013/10/31/the-pen-is-mightier-e-book-growth-stagnating/ (citing a report from the Book Industry Study Group); *Readers Want More Value for Ebooks, New Study Suggests*, DIGITAL BOOK WORLD (Oct. 30, 2013), http://www.digitalbookworld.com/2013/readers-want-more-value-for-ebooks-new-study-suggests/.

9. Copyright Act of 1976 § 109(a), 17 U.S.C. § 109(a) (2012) (explaining that the first sale doctrine states that a copyright owner's exclusive distribution rights are exhausted after the owner's first sale of a particular copy of the copyrighted work).

digital goods and (2) the restraints that licensing agreements place on the ability to transfer or resell digital goods. Because there is no explicit first sale doctrine in the digital domain, courts have largely been left to navigate on their own its applicability to the ever-expanding digital world. Recently, the United States District Court for the Southern District of New York decided that music downloaded from iTunes could not be resold in a secondary market because the copyright owner's reproduction right had been violated.[10]

Additionally, most, if not all, digital goods are acquired pursuant to a licensing agreement.[11] Licensing agreements prohibit licensees from redistributing, transmitting, assigning, selling, broadcasting, renting, sharing, lending, modifying, adapting, editing, licensing, or otherwise transferring the digital good,[12] which effectively forecloses the use of the first sale doctrine as a defense in suits for copyright infringement. The use of restrictive licensing agreements in connection with obtaining digital goods should be viewed skeptically because the first sale doctrine's application to digital goods has significant implications for the creation and existence of high-demand secondary markets.[13]

The European Union has taken steps towards making digital goods available in secondary markets. The European Court of Justice (ECJ) determined that exhaustion applies to software, which opened the door for consumers to obtain software in the secondary market.[14] The decision's application to other digital goods, however, is uncertain. Recently, a German court determined that exhaustion does not apply to electronic

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10. Capitol Records, LLC v. ReDigi Inc., 934 F. Supp. 2d 640, 655–56 (S.D.N.Y. 2013).

11. Digital goods are accessible on the Internet through downloading services such as iTunes and streaming services such as Spotify and YouTube. All of these services allow users to access music by agreeing to a licensing agreement. *See, e.g.*, *Licensed Application End User License Agreement*, APPLE, http://www.apple.com/legal/internet-services/itunes/appstore/dev/stdeula/ (last visited Feb. 28, 2014); *Spotify Terms and Conditions of Use*, SPOTIFY (Mar. 5, 2014), https://www.spotify.com/us/legal/end-user-agreement/.

12. *See, e.g.*, *Licensed Application End User License Agreement*, APPLE, http://www.apple.com/legal/internet-services/itunes/appstore/dev/stdeula/ (last visited Feb. 28, 2014); *Spotify Terms and Conditions of Use*, SPOTIFY (Mar. 5, 2014), https://www.spotify.com/us/legal/end-user-agreement/.

13. As applied to digital music, the first sale doctrine may be a moot issue. *See* Ben Sisario, *As Music Streaming Grows, Royalties Slow to a Trickle*, N.Y. TIMES, Jan. 28, 2013, http://www.nytimes.com/2013/01/29/business/media/streaming-shakes-up-music-industrys-model-for-royalties.html?_r=0 ("[T]he music industry is undergoing another, even more radical, digital transformation as listeners begin to move from CDs and downloads to streaming services like Spotify, Pandora and YouTube."). If consumers are content with having free access to music rather than paying to download music, the demand for a secondary market in digital music may have ceased to exist.

14. Case C-128/11, UsedSoft GmbH v. Oracle Int'l Corp. (July 3, 2012), *available at* http://curia.europa.eu/.

books.[15] The incongruence between the application of exhaustion to software but not to other copyrighted works has set the stage for the ECJ to determine whether to expand the rule of exhaustion to all digital goods in the European Union.

If secondary markets for digital goods are to exist, it is imperative that either the judicial or legislative system in the United States and abroad determine the applicability of the first sale doctrine to digital goods and place limits on the scope of restrictive licensing schemes. Part I discusses a recent decision from the Southern District of New York about digital secondary markets. Part II discusses the first sale doctrine and its current application to digital goods. Part III discusses the structure and reasoning of the pervasive use of licensing schemes in the digital era. Part IV discusses the intersection of the first sale doctrine and licensing schemes and the implications for digital secondary markets. Part V discusses the European Union's approach to licenses and exhaustion as applied to digital goods. Lastly, Part VI offers potential judicial and legislative solutions so that secondary markets for digital goods can become a reality.

I. *CAPITOL RECORDS, LLC V. REDIGI, INC.*

In *Capitol Records, LLC v. ReDigi Inc.*, the Southern District of New York addressed the issue of whether ReDigi could permissibly enable its users to buy and sell "used" digital copies of songs.[16] ReDigi was a marketplace for digital goods where users could buy and sell "used" music files at a lower price than offered on digital music marketplaces such as iTunes and Amazon.[17] It only allowed "legally owned, lawfully purchased digital works" to be purchased and sold in its marketplace and "reject[ed] pirated or unauthorized versions."[18]

Initially, to access ReDigi's service, a user was required to download the "Media Manager," which identified a digital work's source and confirmed its eligibility for resale.[19] To be eligible for sale, a file had to have been purchased from iTunes or another ReDigi user; files downloaded from CDs or other websites were not eligible for sale.[20] Once verified, the

15. Emma Linklater, *E-books Distinguished from Software, Not Exhausted*, 8 J. INTELL. PROP. L. & PRAC. 685, 686 (2013) (discussing Case 4 O 191/11, Landgericht Bielefeld [LG][Bielefeld Regional Court] Mar. 5, 2013).

16. 934 F. Supp. 2d 640, 645–46 (S.D.N.Y. 2013).

17. *Id.* at 645.

18. Theodore Serra, *Rebalancing at Resale:* ReDigi*, Royalties, and the Digital Secondary Market*, 93 B.U. L. REV. 1753, 1757 (2013).

19. *ReDigi*, 934 F. Supp. 2d at 645.

20. *Id.*

file was then transferred to ReDigi's cloud-based system, and any duplicates were removed from the seller's computer and synced devices.[21] The seller would have access to any song designated for sale until it was purchased, at which time access to the song would cease.[22] The court determined that ReDigi had infringed Capitol Records's copyright because the transfer from the seller's computer to the cloud service had created a copy of the file, which had violated the copyright owner's reproduction right.[23] Because the copy on the cloud service had not been "lawfully made," ReDigi's first sale defense failed.[24]

Given the variation in courts' application of copyright law to digital goods, another court might easily have determined that the transfer of the digital file to the cloud service was lawful under the fair use doctrine because it fulfilled copyright's basic purpose.[25] Additionally, future technology may not require transferring a copy of the file to a cloud service and would therefore not violate the reproduction rights of the copyright owner. Assuming the reproduction right has not been violated, another major hurdle arises for ReDigi: can a download from iTunes or Amazon be lawfully resold since it was obtained pursuant to a licensing agreement? Effectively answering this question requires looking to the history of the first sale doctrine and the use of licenses in an age where digital goods abound.

II. HISTORY OF THE FIRST SALE DOCTRINE

The Copyright Act confers upon copyright owners the exclusive rights

21. *Id.*

22. *Id.* at 646.

23. *Id.* at 650–51.

24. *Id.* at 655–56.

25. *See id*. at 652–53 (quoting 17 U.S.C. § 107 (2012); Castle Rock Entm't, Inc. v. Carol Publ'g Grp., Inc., 150 F.3d 132, 141 (2d Cir. 1998)) ("'The ultimate test of fair use . . . is whether the copyright law's goal of "promot[ing] the Progress of Science and useful Arts" would be better served by allowing the use than by preventing it.' Accordingly, fair use permits reproduction of copyrighted work without the copyright owner's consent 'for purposes such as criticism, comment, news reporting, teaching (including multiple copies for classroom use), scholarship, or research.'" (citations omitted)). Judge Chin, in the Southern District of New York, just granted Google, Inc.'s motion for summary judgment based on a fair use defense in that company's eight-year litigation against the Authors Guild over the service "Google Books." *See* Authors Guild, Inc. v. Google Inc., 954 F. Supp. 2d 282, 284 (S.D.N.Y. 2013). Google made a perfect reproduction of every book contained in a number of libraries across the country in order to digitally display snippets of the books in its online database, Google Books. *Id.* at 286. The court determined that this practice was acceptable under the fair use defense, which "permits the fair use of copyrighted works 'to fulfill copyright's very purpose, "[t]o promote the Progress of Science and useful Arts."'" *Id.* at 289–90 (quoting Campbell v. Acuff-Rose Music, Inc., 510 U.S. 569, 575 (1994)).

to reproduce and distribute their work.[26] In 1908, the Supreme Court of the United States, in *Bobbs-Merrill Co. v. Straus,* limited the copyright owner's exclusive right to distribute by recognizing the first sale doctrine.[27] At issue in *Bobbs-Merrill* was whether a copyright owner could restrict the resale terms of its copyrighted material.[28] The Court interpreted the copyright statute's "sole right to vend" language to prohibit a publisher from restricting future sales of a book by placing a notice on the cover that limits resale to a price of one dollar or more.[29] Specifically, the court found that copyright holders may not "fasten, by notice . . . a restriction upon the subsequent alienation of the subject-matter of copyright 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."[30] One year later, Congress codified the first sale doctrine in section 41 of the 1909 Copyright Act.[31]

The first sale doctrine is an affirmative defense that exhausts a copyright owner's exclusive distribution right after the owner's first sale of a particular copy of the copyrighted work.[32] The doctrine is invoked if the defendant has full ownership of the copy of the work in question and that copy was obtained legally.[33] Therefore, "[i]llegal copies of copyrighted works do not receive the benefit of the first sale doctrine," even if the illegal copy was obtained through seemingly lawful means.[34]

In 1996, the Registrar of the Copyright Office stated that "[t]he first sale doctrine was developed to avoid restraints on the alienation of physical property, and to prevent publishers from controlling not only initial sales of books, but the after-market for resales."[35] Ultimately, the main question under the first sale doctrine can be characterized as "whether or not there

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26. *See* 17 U.S.C. § 106 (2012) (explaining that "the owner of copyright under this title has the exclusive rights to do and to authorize any of the following: (1) to reproduce the copyrighted work in copies or phonorecords; . . . (3) to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending.").

27. 210 U.S. 339 (1908).

28. *Id.* at 343.

29. *Id.* at 349–51.

30. *Id.* at 349–50.

31. Pub. L. No. 60-349, 35 Stat. 1075, 1084 (codified as amended at 17 U.S.C. § 27 (1976)), *repealed by* Copyright Act of 1976, Pub. L. No. 94-553, 90 Stat. 2541 (codified as amended in 17 U.S.C.) (resolving that "nothing in this title shall be deemed to forbid, prevent, or restrict the transfer of any copy of a copyrighted work the possession of which has been lawfully obtained").

32. Vernor v. Autodesk, Inc., 621 F.3d 1102, 1107 (9th Cir. 2010).

33. Rachel Ann Geist, *A "License to Read": The Effect of E-books on Publishers, Libraries, and the First Sale Doctrine*, 52 IDEA: INTELL. PROP. REV. 63, 69–70 (2012).

34. *Id.*

35. Marybeth Peters, *The Spring 1996 Horace S. Manges Lecture – The National Information Infrastructure: A Copyright Office Perspective*, 20 COLUM.-VLA J.L. & ARTS 341, 356 (1996).

has been such a disposition of the copyrighted article that it may fairly be said that the copyright proprietor has received his reward for its use."[36] Furthermore, the Supreme Court has determined that there is no geographical boundary to the first sale doctrine: it applies to copies of copyrighted works manufactured abroad.[37] Therefore, copyright owners cannot prevent a copyrighted work, lawfully manufactured and sold abroad, from being imported and resold in the United States.[38]

In 2001, however, the United States Copyright Office rejected the extension of the first sale doctrine to digital works.[39] It stated that "[b]ecause the underlying purpose of the first sale doctrine is to ensure the free circulation of tangible copies, it simply cannot be said that a transformation of section 109 to cover digital transmissions furthers that purpose."[40]

Furthermore, it noted that the first sale doctrine is "limited in the off-line world by a number of factors, including geography and the gradual degradation of books and analog works" and that "[t]he absence of such limitations would have an adverse effect on the market for digital works."[41] Specifically, the Office noted that such limitations do not distinguish digital secondary markets in the way that they distinguish physical markets:

> Physical copies of works degrade with time and use, making used copies less desirable than new ones. Digital information does not degrade, and can be reproduced perfectly on a recipient's computer. The "used" copy is just as desirable as (in fact, is indistinguishable from) a new copy of the same work. Time, space, effort and cost no longer act as barriers to the movement of copies, since digital copies can be transmitted nearly instantaneously anywhere in the world with minimal effort and negligible cost. The need to transport physical copies of works, which acts as a natural brake on the effect of resales on the copyright owner's market, no longer exists in the realm of digital transmissions. The ability

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36. Burke & Van Heusen, Inc. v. Arrow Drug, Inc., 233 F. Supp. 881, 884 (E.D. Pa. 1964).

37. Kirtsaeng v. John Wiley & Sons, Inc., 133 S. Ct. 1351, 1355–56 (2013).

38. *Id.*

39. U.S. COPYRIGHT OFFICE, DMCA SECTION 104 REPORT 87–88 (2001).

40. *Id*. There are several differences between consumer sales law and copyright law. Consumer sales law originates from an idea of ownership that allows the buyer of any good to use that good as the buyer sees fit. N. Helberger et al., *Digital Content Contracts for Consumers*, 36 J. CONSUMER POL'Y 37, 46 (2013). Conversely, "the basic tenet of copyright law is that ownership of a physical copy of a work does not grant any ownership in the copyright on the work embodied in the physical object"; rather, the purchaser owns the physical copy of the work but is simply a licensee of the copyright contained in the physical good. *Id.* Since digital goods are not embodied in a physical copy, a straightforward application of consumer sales law to digital goods becomes difficult in light of copyright law. *Id*.

41. U.S. COPYRIGHT OFFICE, *supra* note 39, at xi.

> of such "used" copies to compete for market share with new copies is thus far greater in the digital world.[42]

The Copyright Office was also concerned with the use of effective "forward-and-delete" technology.[43] A person who sells a tangible item no longer has access to that item. In the digital age, however, unless the seller's copy is deleted upon resale, the seller can retain a copy of the work. The Copyright Office did not trust that consumers would delete their copies upon resale and, furthermore, that effective technology that would automatically delete the seller's copy existed.[44]

In justifying its position on the first sale doctrine, the Copyright Office stated that "[t]he tangible nature of the copy is not a mere relic of a bygone technology."[45] Eighteen years later, however, physical copies of music and books may be a mere relic since accessing works via digital technology is standard practice. Additionally, the Copyright Office found persuasive that the international community had not yet extended the first sale doctrine to digital goods.[46] Ultimately, due to "potential harm to the market and increased risk of infringement," the Copyright Office determined that the first sale doctrine, as applied to digital goods, "could substantially reduce the incentive to create."[47] Regardless of the Copyright Office's stance on the application of the first sale doctrine to digital goods, most, if not all, digital goods are obtained pursuant to a licensing agreement, which, as detailed below, may currently prevent such application.

III. LICENSING IN THE DIGITAL AGE

Many providers offer digitally transmitted works to consumers pursuant to license agreements.[48] A buyer who purchases a digital song from iTunes, for example, agrees to a license that prohibits not only resale but also any subsequent transfer of the digital file.[49]

There are a number of reasons that companies offer digital goods to consumers pursuant to a license agreement. First, a license agreement "allows for tiered pricing . . . such as reduced pricing for students or

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42. *Id.* at 82–83 (footnote omitted).
43. *Id.* at 83.
44. *Id.*
45. *Id.* at 86.
46. *Id.* at 94–95.
47. *Id.* at 88.
48. *See supra* note 11 and accompanying text.
49. *See supra* note 12 and accompanying text.

educational institutions."[50] Specifically, licensing allows software companies to charge according to the features required by the consumer: software containing "highly technical features that businesses would need" costs more than software encompassing "basic features that students would need."[51] Furthermore, some companies charge more based on the length of access required, allowing users to choose between long-term and short-term licenses.[52] For tiered pricing to be economically feasible, the products must be licensed rather than sold, which "avoids the first sale doctrine and so precludes an aftermarket for software that ultimately would result in higher retail prices for consumers."[53] This argument, however, is less applicable to digital goods, as consumers license songs and books without any additional technical features or restrictions on the length of access.

Second, licenses reduce the number of incidents of piracy by limiting the ability of digital goods to be resold or transferred.[54] The district court in *Vernor v. Autodesk, Inc.* found this argument "unconvincing," however, because "[p]iracy depends on the number of people willing to engage in piracy, and a pirate is presumably just as happy to unlawfully duplicate software purchased directly from [the corporation] as he is to copy software purchased from a reseller."[55] In other words, a person who is motivated to pirate digital goods will do so regardless of whether those goods are sold in a secondary market.

Third, and most relevant to this discussion, licenses enable "distributors to give customers many more options for accessing and using digital content."[56] Specifically, consumers can download songs, films, and eBooks to multiple devices, which enables them to "access that song, film, or eBook from virtually anywhere at anytime, which would not be the case if the customer had purchased a CD, DVD, or paperback book."[57] Access options are particularly relevant to the business models of services like Netflix, Spotify, and Pandora. Netflix offers consumers access to an entire

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50. Vernor v. Autodesk, Inc., 621 F.3d 1102, 1114 (9th Cir. 2010).

51. Gary Donatello, *Killing the Secondary Market: How the Ninth Circuit Interpreted* Vernor *and* Aftermath *to Destroy the First Sale Doctrine*, 22 SETON HALL J. SPORTS & ENT. L. 59, 85 (2012).

52. *Id.*

53. Justin Graham, *Preserving the Aftermarket in Copyrighted Works: Adapting the First Sale Doctrine to the Emerging Technological Landscape*, 2002 STAN. TECH. L. REV. 1, ¶ 22 (2002).

54. *Vernor*, 621 F.3d at 1115.

55. Vernor v. Autodesk, Inc., No. C07-1189RAJ, 2009 WL 3187613, at *14 (W.D. Wash. Sept. 30, 2009), *vacated*, 621 F.3d 1102 (9th Cir. 2010).

56. Brief of *Amicus Curiae* the Copyright Alliance in Support of Affirmance at 18, Adobe Sys. Inc., v. Kornrumpf, No. 12-16616 (9th Cir. July 5, 2013) [hereinafter Brief of the Copyright Alliance].

57. *Id.* at 20–21.

library of movies and television shows for a monthly fee.[58] Spotify offers a number of different licenses to access digital music from which consumers can choose, including a free option that allows consumers to stream an unlimited amount of music that is occasionally interrupted by advertisements and paid options that do not include advertisements.[59] Licensing also allows consumers to "secure a license for the particular song, television episode, or chapter they want, rather than having to buy the whole record album, the entire season of the television show, or the entire book."[60]

Opponents of licensing schemes believe, however, that

> the model for online publishing is shifting from a property-based system of transactions governed by copyright law to a contract-based system of transactions governed by whatever terms the market will bear, even if such terms do not further the pro-dissemination values inherent in the Copyright Clause and in copyright law.[61]

In particular, licenses "do[] not vindicate the law's aversion to restraints on alienation of personal property," and they "ignore[] the economic realities of the relevant transactions, in which the copyright owner permanently released software copies into the stream of commerce without expectation of return in exchange for upfront payment of the full software price."[62]

Most importantly, expansive licensing schemes have the potential to destroy secondary markets.[63] Secondary markets "contribute[] to the public good by (1) giving consumers additional opportunities to purchase and sell copyrighted works, often at below-retail prices; (2) allowing consumers to obtain copies of works after a copyright owner has ceased distribution; and (3) allowing the proliferation of businesses."[64] Therefore, it is important that restrictive licensing schemes be limited so that secondary markets are available for digital goods.

58. *Netflix Terms of Use*, NETFLIX, https://signup.netflix.com/TermsOfUse (last updated Sept. 11, 2013).

59. Brief of the Copyright Alliance, *supra* note 56.

60. *Id.* at 21.

61. Kathleen K. Olson, *Preserving the Copyright Balance: Statutory and Constitutional Preemption of Contract-Based Claims*, 11 COMM. L. & POL'Y 83, 88 (2006).

62. Vernor v. Autodesk, Inc., 621 F.3d 1102, 1115 (9th Cir. 2010).

63. *See* Donatello, *supra* note 51, at 81 ("One of the main arguments in favor of a restrictive interpretation of license agreements is the fear of the destruction of the secondary market. Copyright holders in all industries may wish to destroy the secondary markets for their works. This would force all consumers to purchase directly from the copyright holder, allowing them to reap all of the profits." (footnote omitted)).

64. *Vernor*, 621 F.3d at 1115.

IV. INTERSECTION OF THE FIRST SALE DOCTRINE AND LICENSES IN THE UNITED STATES

This leads to two important and related questions regarding the application of the first sale doctrine to digital goods: (1) is the application of the first sale doctrine to digital goods moot; and (2) if not, does it apply to digital goods obtained pursuant to a license?

With respect to the first question, the first sale doctrine as applied to digital music may be moot. Apple is on track to have its first yearly decline in digital music downloads since it launched iTunes in 2003.[65] According to the tracking service Nielsen SoundScan,[66] as of October 2013, music downloads were down 4% from the same time the previous year.[67] Many music analysts and executives attribute this decline to streaming services such as Spotify and Pandora.[68] Further proof of the increasing preference for streaming services was the September 2013 unveiling of iTunes Radio, Apple's response to streaming services like Spotify and Pandora.[69]

While the ability of services such as Spotify to eventually lead consumers to purchase music remains to be seen, at this juncture, consumers seem content with the ability to immediately access songs rather than having permanent access to digital files stored on their computer.[70] Why would consumers pay to download songs (and receive only a limited license, not ownership) when they can access those same songs for a nominal fee through streaming services? Given that consumers do not own (and perhaps do not care to own) the music that they are accessing through streaming services, there is no demand for a secondary market in digital music. Without demand, the question of the first sale doctrine's applicability to digital music does not even arise. Furthermore, the policy reasons behind secondary markets do not apply when consumers have the

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65. Ben Sisario, *As Downloads Dip, Music Executives Cast a Wary Eye on Streaming Services*, N.Y. TIMES, Oct. 20, 2013, http://www.nytimes.com/2013/10/21/business/media/as-downloads-dip-music-executives-cast-a-wary-eye-on-streaming-services.html.

66. *Audience Measurement*, NIELSEN, http://www.nielsen.com/us/en/nielsen-solutions/audience-measurement.html (last visited June 2, 2014) ("Our audience measurement data and advanced solutions provide a comprehensive picture of how, when and where your consumers are connecting with content. With this insight, you can create programming that viewers love, which will make you a hit with advertisers.").

67. Sisario, *supra* note 65.

68. *Id.*

69. *iTunes Radio*, APPLE, http://www.apple.com/itunes/itunes-radio/ (last visited Nov. 23, 2013).

70. Alan McGlade, *Steve Jobs was Wrong – Consumers Want to Rent Their Music, Not Own It* (Mar. 25, 2013, 1:40 PM), http://www.forbes.com/sites/alanmcglade/2013/03/25/steve-jobs-was-wrong-consumers-want-to-rent-their-music-not-own-it/.

ability to freely access any music they want via Spotify, Pandora, and Youtube.[71] Even assuming that a consumer wants to download music rather than simply have access to streaming music, it is uncertain whether the twenty cents saved by purchasing a "used" song on ReDigi rather than a "new" song on iTunes is enough to create demand in the secondary market for digital music.

Although the demand for secondary markets for digital music may have evaporated since the creation of streaming music, it is still reasonable to believe that secondary markets for other digital goods will continue to be in high demand. Given the decline in sales growth of electronic books, some commentators believe that

> [w]e may be discovering that e-books are well suited to some types of books (like genre fiction) but not well suited to other types (like nonfiction and literary fiction) and are well suited to certain reading situations (plane trips) but less well suited to others (lying on the couch at home). The e-book may turn out to be more a complement to the printed book, as audiobooks have long been, rather than an outright substitute.[72]

Furthermore, while other countries have launched "streaming" electronic book services, such services are currently limited in the United States, and the prominent option for obtaining electronic books is through "ownership": downloading the book, pursuant to a license, from a provider.[73] Given the recent trend in streaming music, it may be only a matter of time before streaming electronic book services are available in

71. Specifically, a secondary market is not needed if consumers are not purchasing or licensing the music in the first place but are instead listening to it for free on services like YouTube.

72. Nicholas Carr, *Will Gutenberg Laugh Last*, ROUGH TYPE (Jan. 1, 2013, 4:50 PM), http://www.roughtype.com/?p=2296.

73. *See* Emma Hutchings, *24Symbols Aims to Become the "Spotify for E-books,"* PSFK (Apr. 11, 2011), http://www.psfk.com/2011/04/24symbols-aims-to-become-the-spotify-for-e-books.html ("24symbols is a Spanish startup currently in beta ahead of its launch in June [2011]. Adopting a 'freemium' model, the service will offer readers different alternatives, such as streaming books for free with ads, and paying a subscription for advanced options like offline reading and an extended catalogue to choose from."); Jeremy Greenfield, *Why Netflix or Spotify for Ebooks Will Work*, FORBES (Oct. 29, 2013, 4:49 PM), http://www.forbes.com/sites/jeremygreenfield/2013/10/29/why-netflix-or-spotify-for-ebooks-will-work/ (quoting James McQuivey, an analyst of the book publishing industry)_("All the evidence suggests that consumers love subscription content models – it's the original model of magazines and newspapers and cable, and now it's the power behind Netflix. I believe it would work with books, but like the ebook model in the early days, it won't work until the publishers are ready to embrace it."). These are subscription-based models, however, and services like YouTube or advertisement-based free access may never exist in the electronic book arena. Therefore, the secondary market for e-books is still in demand by users.

the United States. Providers of electronic books recognize the immediate viability of the secondary market, as Amazon has recently patented technology to create one.[74] The impact that streaming services will have on the electronic book market remains to be seen; the applicability of a digital first sale doctrine to electronic books, however, is immediately relevant.

With respect to the second question, the United States Court of Appeals for the Ninth Circuit, in *Vernor v. Autodesk, Inc.*, determined that the first sale doctrine only applies to legal owners of a copyrighted good and does not extend to licensees of a copy.[75] Autodesk, a software manufacturer, sold a software program to consumers pursuant to a software license agreement, to which consumers had to agree prior to installing the software.[76] Specifically, the license "recite[d] that Autodesk retains title to all copies . . . that the customer has a nonexclusive and nontransferable license to use . . . [and] impose[d] transfer restrictions, prohibiting customers from renting, leasing, or transferring the software without Autodesk's prior consent."[77] Vernor purchased copies of Autodesk's software and subsequently posted them for sale on eBay.[78] Pursuant to the Digital Millennium Copyright Act, Autodesk issued a takedown notice to eBay, claiming that Vernor's sales infringed its copyright, and eBay terminated Vernor's auction.[79] Vernor brought a declaratory action against Autodesk, stating that his sales of the software were protected by the first sale doctrine.[80] The court looked to three factors to determine if a software user is a licensee rather than an owner: (1) "whether the copyright owner specifie[d] that a user [wa]s granted a license," (2) "whether the copyright owner significantly restrict[ed] the user's ability to transfer the software," and (3) "whether the copyright owner impose[d] notable use restrictions."[81] In determining that Vernor was a licensee, the court stated that he was not entitled to invoke the first sale doctrine because he had not received title to the copies and "accordingly could not pass ownership on to others."[82]

To clarify the *Vernor* decision, the Ninth Circuit, in *MDY Industries, LLC v. Blizzard Entertainment, Inc.*, determined the circumstances in

74. *Amazon Poised to Sell Used E-books*, PUBLISHERS WKLY. (Feb. 7, 2013), http://www.publishersweekly.com/pw/by-topic/industry-news/bookselling/article/55849-amazon-poised-to-sell-used-e-books.html.

75. Vernor v. Autodesk, Inc., 621 F.3d 1102, 1107 (9th Cir. 2010).

76. *Id.* at 1104.

77. *Id.*

78. *Id.* at 1105.

79. *Id.*

80. *Id.* at 1106.

81. *Id.* at 1110–11.

82. *Id.* at 1112.

which a violation of a license agreement amounts to copyright infringement and when it is simply a breach of contract.[83] The difference between breach of contract and copyright infringement is substantial: a copyright infringer may be subject to statutory damages of up to $150,000 for each infringement.[84] The court noted that if the terms of the license amount to a condition, then a breach of that condition constitutes copyright infringement.[85] If the terms of the license amount to a covenant, then a breach of that covenant is actionable only under contract law.[86] The two are distinguishable because "[a] covenant is a contractual promise," while a "condition precedent is an act or event that must occur before a duty to perform a promise arises."[87] Therefore, a copyright owner who grants a nonexclusive, limited license generally may not sue their licensees for copyright infringement but may instead only recover under a breach of contract theory.[88] But, if the licensee acts outside the scope of the license agreement, then the copyright owner may sue the licensee for copyright infringement.[89] This is significant because individuals who sell or transfer digital goods that they obtained pursuant to a licensing agreement are generally acting outside of the scope of the agreement and will be liable for copyright infringement, not simply breach of contract.[90]

The Ninth Circuit, in *UMG Recordings, Inc. v. Augusto*, placed some restrictions on the ability of copyright owners to control transfers of their goods through the use of licenses.[91] Perhaps realizing the significant implications of the rights granted to an "owner" as opposed to a "licensee," the court ruled that compact discs distributed to music critics and DJs for promotional purposes only are owned by the recipient and may be resold or otherwise transferred without the copyright owner's consent pursuant to the first sale doctrine of the Copyright Act and the Unordered Merchandise Statute.[92] The court noted that simply calling a transaction "a license rather than a sale, although it [is] a factor to be considered, [is] not by itself

83. 629 F.3d 928 (9th Cir. 2010).

84. 17 U.S.C. § 504 (2012).

85. 629 F.3d at 939 (citing Sun Microsystems, Inc. v. Microsoft Corp. (*Sun I*), 188 F.3d 1115, 1120 (9th Cir. 1999)).

86. *Id.* (citing *Sun I*, 188 F.3d at 1120).

87. *Id.* (citing TravelCenters of Am. LLC v. Brog, No. 3751-CC, 2008 Del. Ch. LEXIS 183, at *9 (Del. Ch. Dec. 5, 2008); RESTATEMENT (SECOND) OF CONTRACTS § 2 (1981)).

88. *Id.* (quoting *Sun I*, 188 F.3d at 1121).

89. *Id.* (citing *Sun I*, 188 F.3d at 1121).

90. *See* Vernor v. Autodesk, Inc., 621 F.3d 1102, 1112 (9th Cir. 2010) (determining that because Vernor was a licensee and not an owner, his actions infringed upon Autodesk's copyright).

91. 628 F.3d 1175 (9th Cir. 2011).

92. *Id.* at 1178–79.

dispositive of the issue."[93] The court determined that these distributions were "sales," not "licenses," because they had been unsolicited, because there was no evidence that the recipients had agreed to a license, and because the distributor had made no effort to track the use or disposition of the CDs after they had been distributed.[94]

Additionally, the Copyright Office has stated that the first sale doctrine does not extend to cover digital transmission.[95] With the world quickly shifting towards digital access to copyrighted works, however, the underlying policies of the first sale doctrine still apply. It seems fairly obvious that a major reason companies such as Apple and Amazon are offering digital goods pursuant to licenses is to control the after-market for resales. In this respect, whether the good is tangible or intangible, these practices are hard to distinguish from the facts at issue in *Bobbs-Merrill*, as they all attempt to prevent individuals from profiting from downstream sales.

V. THE FIRST SALE DOCTRINE AND DIGITAL GOODS IN THE EUROPEAN UNION

The ECJ was recently faced with the question of whether the first sale doctrine applies to software in *UsedSoft GmbH v. Oracle International Corp.*, and, in stark contrast to United States courts, determined that content licenses may not prohibit the further transfer or resale of software under Article 4(2) of Directive 2009/24.[96] UsedSoft enables companies to resell software licenses that they have purchased but do not use or need.[97] Oracle develops computer software and distributes it to consumers by allowing users to download it from the Internet.[98] When UsedSoft sold customers used licenses, the purchasers were able to download a copy of Oracle's software to their computers.[99] Subsequently, Oracle brought suit against UsedSoft.[100]

The ECJ was faced with the task of interpreting the Computer Programs Directive to determine if UsedSoft had violated Oracle's reproduction right. Unlike the district court in *ReDigi*, however, the ECJ was able to avoid the reproduction issue by equating the sale of the used

93. *Id.* at 1180 (citing *Vernor*, 621 F.3d at 1109).
94. *Id.* at 1180.
95. U.S. COPYRIGHT OFFICE, *supra* note 39.
96. Case C-128/11 (July 3, 2012), *available at* http://curia.europa.eu/.
97. *Id.* ¶¶ 24–25.
98. *Id.* ¶ 21.
99. *Id.* ¶ 26.
100. *Id.* ¶ 27.

license to that of the original downloaded copy.[101] Pursuant to article 5(1) of the Computer Programs Directive, a "lawful acquirer" of a computer program does not need authorization from the copyright holder to use the program in accordance with its intended purpose.[102] Additionally, Article 4(2) states, "The first sale in the Community of a copy of a program by the rightholder or with his consent shall exhaust the distribution right within the Community of that copy, with the exception of the right to control further rental of the program or a copy thereof."[103] The ECJ noted that "a commonly accepted definition [of] a 'sale' is an agreement by which a person, in return for payment, transfers to another person his rights of ownership in an item of tangible or intangible property belonging to him."[104] The court then determined that a buyer of used software is a "lawful acquirer" under article 5(1) because the buyer retains the original license to the software.[105]

Therefore, the court interpreted the first sale doctrine broadly, applying it to "the grant of a right to use a copy of a computer program, for an unlimited period, in return for payment of a fee designed to enable the copyright holder to obtain a remuneration corresponding to the economic value of the copy of the work" regardless of whether it was purchased pursuant to a license agreement.[106] If the first sale doctrine were not interpreted broadly, "the effectiveness of [Article 4(2)] would be undermined, since suppliers would merely have to call the contract a 'licence' rather than a 'sale' in order to circumvent the rule of exhaustion and divest it of all scope."[107] The *UsedSoft* decision made clear that exhaustion applies to used software in the European Union.[108] It is less clear whether exhaustion applies to other digital goods, such as electronic books or music.

Recently, the German Regional Court of Bielefeld determined that the *UsedSoft* decision does not apply to electronic or audio books.[109] The court reasoned that the *UsedSoft* decision had relied upon the Computer Programs Directive and therefore applies solely to software—not to any

101. *Id.* ¶¶ 61–63.
102. Council Directive 2009/24, art. 5, ¶ 1, 2009 O.J. (L 111) 16, 18 (EC).
103. *Id.* art. 4, ¶ 2.
104. Case C-128/11, *UsedSoft GmbH*, ¶ 42.
105. *Id.* ¶ 89.
106. *Id.* ¶ 49.
107. *Id.*
108. *Id.* ¶ 88.
109. Linklater, *supra* note 15.

other digital goods.[110] The court looked to the Information Society Directive, which provides for the exhaustion of copyright, and found that it did not contain language comparable to Article 5(1) of the Computer Programs Directive, which allows for the resale of used software.[111] Without similar language, the court concluded that the resale of used electronic books is prohibited.[112] The parties have indicated their intent to appeal, but as it stands now, this decision upholds the status quo regarding the resale of electronic books in Europe.[113]

Currently, the United States and the European Union have different stances on the first sale doctrine as applied to software.[114] Article 4(2) of the Computer Programs Directive explicitly states that a sale of software within the EU only exhausts all rights within the EU;[115] therefore, United States law will govern software that was produced in the EU but licensed to a consumer in the United States. But under the Supreme Court's recent decision in *Kirtsaeng v. John Wiley & Sons, Inc.*, software that United States corporations license to consumers in the EU can be resold or transferred to a third party in the EU, who, in turn, can then resell it in the United States.[116] Although *Vernor* explicitly prohibits applying the first sale doctrine to licensees,[117] courts will be faced with determining whether the United States consumer who purchased the license from the EU is a licensee or an owner.

VI. CREATING A DIGITAL FIRST SALE DOCTRINE

Given the current state of the law and the pervasive licensing of digital goods, secondary markets for those goods will be unavailable for the foreseeable future. Although the demand for secondary markets for digital music may be waning, there may be serious implications for consumers' ability to participate in a secondary market for electronic books. For consumers to have access to secondary markets in both the United States and the EU, the judicial or legislative systems in those two governments must alter the state of the current law.

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110. *Id.*

111. *Id.*

112. *Id.*

113. *Id.*

114. *Compare* Capitol Records, LLC v. ReDigi Inc., 934 F. Supp. 2d 640 (S.D.N.Y. 2013), *with* Case C-128/11, UsedSoft GmbH v. Oracle Int'l Corp., (July 3, 2012), *available at* http://curia.europa.eu/.

115. Council Directive 2009/24, *supra* note 102.

116. *See* Kirtsaeng v. John Wiley & Sons, Inc., 133 S. Ct. 1351 (2013) (holding that the first sale doctrine applies to copies of copyrighted works lawfully made in foreign countries).

117. Vernor v. Autodesk, Inc., 621 F.3d 1102, 1115 (9th Cir. 2010).

A. Judicial Response in the United States

To access digital secondary markets in the United States, users must get around the copyright owner's reproduction right and, perhaps more importantly, the restrictive licensing schemes attached to all digital goods. Federal courts have exceptional latitude within the arena of copyright law. Absent congressional intervention, judicial decisions have advanced and defined copyright law, for better or worse. Therefore, the judicial system has the ability to expand consumer protection by limiting restrictive licensing agreements and by expanding the first sale doctrine to digital goods. Consumers may attempt to challenge licenses through the copyright misuse defense or by claiming that they are adhesion contracts. Additionally, courts in the United States and in the EU may determine, as the ECJ did in the case of software, that the restrictive licensing schemes attached to digital goods are simply a device used by corporations to escape the first sale doctrine in contravention of the basic purpose of copyright.

Copyright misuse "is a judicially crafted affirmative defense to copyright infringement, derived from the long-standing existence of such a defense in patent litigation."[118] The Supreme Court has not yet weighed in on the viability of the defense, which has caused confusion in the circuits: "several circuits allow a misuse defense to stand where a defendant can demonstrate a violation of 'public policy,' whereas other courts require copyright misuse defendants to make a showing that the plaintiff violated the antitrust laws by attempting to extend its copyright."[119] Courts that adhere to the public policy-based defense look "specifically at copyright licensing provisions and decide[] whether the scope of the private rights granted by the copyright is being improperly expanded."[120] Under this reading, circuit courts have affirmed findings of copyright misuse where "the licensor restricted the licensee's ability to develop similar software, effectively expanding the scope of the copyright beyond the protected expression to the unprotected idea"; where "license provisions restrict[ed] the licensee's ability to use competing products"; and where a "license provision[] . . . restricted a licensee's ability to develop products to compete with the licensor's uncopyrighted products."[121] Courts that adhere to the antitrust-based defense focus "on assessing the challenged conduct's

118. Apple Inc. v. Psystar Corp., 658 F.3d 1150, 1157 (9th Cir. 2011).

119. Scott A. Sher, In Re Napster, Inc. Copyright Litigation*: Defining the Contours of the Copyright Misuse Doctrine*, 18 SANTA CLARA COMPUTER & HIGH TECH. L.J. 325, 328 (2002).

120. Brett Frischmann & Daniel Moyland, *The Evolving Doctrine of Copyright Misuse*, *in* INTELLECTUAL PROPERTY AND INFORMATION WEALTH: ISSUES AND PRACTICES IN THE DIGITAL AGE 269, 292 (Peter K. Yu ed., 2007).

121. *Id.*

actual and potential effect on competition."[122] Courts will first "evaluate the scope of the rights and the breadth of protection granted to copyright holders; and, second, . . . evaluate the net competitive effects of any questionable conduct."[123]

Under either approach, it seems at least plausible that the Court could find that the licensing schemes used in connection with digital goods amount to copyright misuse. Unfortunately, the copyright misuse defense has not been successfully used to challenge the validity of licensing schemes that prevent resale in secondary markets in the United States.[124] In the EU, while the ECJ did not specifically state in *UsedSoft* that the software license amounted to copyright misuse, it found that allowing licenses that restricted resale would completely undermine the rule of exhaustion.[125]

Consumers may also challenge these licenses as unconscionable adhesion contracts. State law governs the contours of adhesion contracts; for example, California has defined such a contract as "a standardized contract, drafted by the party of superior bargaining strength, that relegates to the subscribing party only the opportunity to adhere to the contract or reject it."[126] Even though a contract is adhesive, it "must still be interpreted in the light of the reasonable expectations of the adhering parties"[127] and will not be struck down by the court "[a]bsent clear evidence of other factors, such as undue oppression or unconscionability."[128]

One example of unconscionable adhesion contracts are "shrinkwrap" licenses, which "refer[] to the fact that the license begins when the purchaser reads its terms and tears open the transparent plastic wrapping, or 'shrinkwrap,' that encloses the software product."[129] The debate

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122. *Id.* at 291.

123. *Id.*

124. *See* UMG Recordings, Inc., v. MP3.com, Inc., 92 F. Supp. 2d 349, 352 (S.D.N.Y. 2000) (citing Castle Rock Entm't, Inc. v. Carol Publ'g Grp., Inc., 150 F.3d 132, 145–46 (2d Cir. 1998); Salinger v. Random House, Inc., 811 F.2d 90, 99 (2d Cir. 1987) ("[A] copyrighterholder's [sic] 'exclusive' rights, derived from the Constitution and the Copyright Act, include the right, within broad limits, to curb the development of such a derivative market by refusing to license a copyrighted work or by doing so only on terms the copyright owner finds acceptable").

125. Case C-128/11, UsedSoft GmbH v. Oracle Int'l Corp., ¶ 49 (July 3, 2012), *available at* http://curia.europa.eu/.

126. Ting v. AT&T, 319 F.3d 1126, 1148 (9th Cir. 2003) (citing Armendariz v. Found. Health Psychcare Servs., Inc., 6 P.3d 669, 690 (Cal. 2000)). While the definition may differ slightly from state to state, this is a generally accepted definition for an adhesion contract.

127. Realnetworks, Inc. v. DVD Copy Control Ass'n, 641 F. Supp. 2d 913, 947 (N.D. Cal. 2009) (citing State Farm Fire & Cas. Co. v. Keenan, 216 Cal. Rptr. 318, 325 (Cal. Ct. App. 1985).

128. *Id.* at 947–48 (citing Graham v. Scissor-Tail, Inc., 623 P.2d 165, 172 (Cal. 1990).

129. SoftMan Products Co. v. Adobe Sys. Inc., 171 F. Supp. 2d 1075, 1085 n.12 (C.D. Cal. 2001).

surrounding the enforceability of licenses began with the use of these licenses by software companies.[130] A number of courts found shrinkwrap licenses invalid, "characterizing them as contracts of adhesion, unconscionable, and/or unacceptable pursuant to the Uniform Commercial Code."[131] These decisions, however, rested on the fact that the user had not had the opportunity to assent;[132] licensees of digital goods assent to a license agreement before they are able to download the item.

The licensing agreements to which users are subjected prior to obtaining digital goods are fairly obviously adhesion contracts: they are imposed and drafted by the party of superior bargaining strength, and the user only has the opportunity to adhere to the contract or reject it.[133] It seems unreasonable, however, that a corporation would separately negotiate every single license with potential licensees. Therefore, it seems unlikely that a court would find that the licensing schemes used in digital goods are unenforceable adhesion contracts.

The Supreme Court could also choose to opine on this issue. It would need to hold that the copyright owner's reproduction right was not violated and invalidate any licensing agreement attached to the purchase of the good. The Court could easily hold that the reproduction right was not violated through the reasoning in *Sony Corp. of America v. Universal City Studios, Inc.*[134] There, Sony had developed the Betamax videotape recording device, which allowed consumers to make copies of television shows for the purpose of "time shifting."[135] Universal City Studios argued that the technology violated their exclusive rights granted in the Copyright Act.[136] The Court held that Sony was not liable and thus reaffirmed its position that where "technological change has rendered its literal terms ambiguous, the Copyright Act must be construed in light of [its] basic purpose":[137] to incentivize creative works for the "ultimate[] . . . cause of

130. *See SoftMan Products Co.*, 171 F. Supp. 2d; *see also* ProCD, Inc. v. Zeidenberg, 86 F.3d 1447, 1450 (7th Cir. 1996).

131. *SoftMan Products Co.*, 171 F. Supp. 2d at 1088 (citing Step–Saver Data Sys., Inc. v. Wyse Tech., 939 F.2d 91 (3d Cir. 1991); Vault Corp. v. Quaid Software Ltd., 847 F.2d 255 (5th Cir. 1988)).

132. *Id.*

133. *See* Ting v. AT&T, 319 F.3d 1126, 1149 (9th Cir. 2003) ("In finding the CSA [agreement] procedurally unconscionable, the district court emphasized that, after drafting the agreement, AT&T imposed the CSA on its customers without opportunity for negotiation, modification, or waiver. We agree. AT&T mailed the CSA in an envelope that few customers realized contained a contract, and offered its terms on a take-it-or-leave-it basis.").

134. 464 U.S. 417 (1984).

135. *Id.* at 443 (citing Universal City Studios, Inc. v. Sony Corp. of Am., 480 F. Supp. 429, 468 (C.D. Cal. 1979), *rev'd* 659 F.2d 963 (9th Cir. 1981), *rev'd* 464 U.S. 417 (1984)).

136. *Id.* at 420.

137. *Id.* at 432 (quoting Twentieth Century Music Corp. v. Aiken, 422 U.S. 151, 156 (1975)).

promoting broad public availability of literature, music, and the other arts."[138] Since digital technology has "rendered its literal terms ambiguous," the Court could find that ReDigi's technology serves the Copyright Act's basic purpose by making "used" digital music available to consumers more cheaply than "new" music from iTunes or Amazon, for example.

The Court would then need to determine the effect of licensing agreements on the first sale doctrine. The Court should take a functional rather than a textual approach in construing the limits of a license. Before the dawn of the digital age, some courts noted that the first sale doctrine applied when the copyright proprietor was fairly compensated and had thus "received his reward" for the use of the copyrighted material.[139] Additionally, in *Krause v. Titleserv, Inc.*, the United States Court of Appeals for the Second Circuit held that "courts should inquire into whether the party exercises sufficient incidents of ownership over a copy of the program to be sensibly considered the owner of the copy."[140] The Court may also look to the international community's response to the application of exhaustion to digital goods: most notably, the *UsedSoft* decision.[141]

While there are many policy justifications for permitting licensing schemes, such as enabling price discrimination and decreasing piracy, copyright owners are not granted a right to make their goods available through tiered pricing models in the Copyright Act. In applying a functional approach, the Court might determine that the licensing agreements used by the music and electronic book industry are actually "sales" for the purpose of the first sale doctrine. Specifically, it might grant users the right to use the music or electronic book however they please, as they have paid a fee that fairly remunerates the copyright owner. By labeling the purchase of a digital good pursuant to a license a "sale," the Court would make secondary markets available for digital goods.

B. Judicial Response in the European Union

The ECJ has addressed the validity of exhaustion as applied to software, but it is unclear whether exhaustion applies to all digital goods. The *UsedSoft* decision relied on language in the Computer Programs

138. *Id.* at 431–32 (quoting Fox Film Corp. v. Doyal, 286 U.S. 123, 127 (1932)).
139. *See supra* note 36 and accompanying text.
140. 402 F.3d 119, 124 (2d Cir. 2005).
141. *See supra* notes 96–108 and accompanying text.

Directive to determine that exhaustion applies to software.[142] The Information Society Directive provides for the exhaustion of all other copyrighted works.[143] Given the recent German decision,[144] the ECJ may have the opportunity to clarify the application of the doctrine to all digital goods.

The Information Society Directive was enacted by the European Parliament and the Council of the European Union to harmonize the copyright laws of the Member States, which would provide "increased legal certainty . . . [and] a high level of protection of intellectual property . . . [and] foster substantial investment in creativity and innovation."[145] The Directive states that an act of communication does not give rise to exhaustion; "first sale or other transfer of ownership" does, however.[146] The ECJ mentioned the Information Society Directive in *UsedSoft*, stating:

> [T]he existence of a transfer of ownership changes an 'act of communication to the public' provided for in Article 3 of [the Information Society Directive] into an act of distribution referred to in Article 4 of the [Information Society Directive] which, if the conditions in Article 4(2) of the [Information Society Directive] are satisfied, can, like a 'first sale . . . of a copy of a program' referred to in Article 4(2) of [the Computer Programs] Directive . . . , give rise to exhaustion of the distribution right.[147]

Since the ECJ determined that a consumer downloading a product from the Internet, paying the corresponding fee, and acquiring the right to use it for an unlimited period is an "act of distribution," giving rise to exhaustion, it might also determine that downloading digital music and electronic books is an act of distribution, which would give rise to exhaustion under the Information Society Directive.

The ECJ does face obstacles to finding that exhaustion applies to all digital goods, however. First, the Information Society Directive states that "[t]he question of exhaustion does not arise in the case of services and on-line services in particular."[148] Additionally, unlike physical CD-ROMs or

142. *See supra* note 111 and accompanying text.

143. Council Directive 2001/29, *supra* note 2, arts. 10, 12.

144. *See supra* notes 109–13 and accompanying text.

145. Council Directive 2001/29, *supra* note 2, recital 4.

146. *Id.* art. 4, ¶ 2.

147. Case C-128/11, UsedSoft GmbH v. Oracle Int'l Corp., ¶ 52 (July 3, 2012), *available at* http://curia.europa.eu/.

148. Council Directive 2001/29, *supra* note 2, recital 29.

CD-Is, which are tangible media on which intellectual property is located, "every on-line service is in fact an act which should be subject to authorisation where the copyright or related right so provides."[149] As technology advanced, the EU distinguished intangible items such as downloaded digital goods from tangible items such as CD-ROMs, and it appears that the EU, similar to the United States, is having difficulty applying the rule of exhaustion to intangible items. Given the ECJ's concerns about the abuse of licenses to circumvent exhaustion,[150] the court may be open to an argument that downloading digital goods, as opposed to streaming digital music, is not an "on-line service" and that therefore exhaustion can arise.

Finally, the ECJ will have to determine whether the temporary reproduction of a digital file that is currently necessary to make the file available for resale is a lawful use. Article 2 of the Information Society Directive "prohibit[s] direct or indirect, temporary or permanent reproduction by any means and in any form, in whole or in part."[151] Article 5(1) does allow for temporary reproductions "which are transient or incidental [and] an integral and essential part of a technological process and whose sole purpose is to enable: (a) a transmission in a network between third parties by an intermediary, or (b) a lawful use."[152] As noted above, the United States has determined that temporary reproductions are not lawful.[153] Given the ECJ's broad interpretation of the rule of exhaustion based on policy concerns about the ability of suppliers to abuse licenses to circumvent the rule,[154] it may be amenable to expanding the scope of exhaustion to include all digital goods.

C. Legislative Response in the United States

Perhaps the most realistic opportunity for the creation and viability of secondary markets for digital goods is through new legislation. In 2013,

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149. *Id.*

150. *See supra* note 107 and accompanying text.

151. *Id.* art. 2.

152. *Id.* art. 5, ¶ 1.

153. Vernor v. Autodesk, Inc., 621 F.3d 1102, 1107, 1109 (9th Cir 2010) (quoting 17 U.S.C. § 117(a)(1) (2012)) ("The exclusive distribution right is limited by the **first sale doctrine,** an affirmative defense to copyright infringement that allows owners of copies of copyrighted works to resell those copies. The exclusive reproduction right is limited within the software context by the **essential step defense,** another affirmative defense to copyright infringement . . . . [whereby] a software user who is the 'owner of a copy' of a copyrighted software program does not infringe by making a copy of the computer program, if the new copy is 'created as an essential step in the utilization of the computer program in conjunction with a machine and . . . is used in no other manner.'").

154. *See supra* note 107 and accompanying text.

realizing the need to update the 1976 Copyright Act, Maria Pallante, the current Registrar of the United States Copyright Office, called for Congress to change the copyright statute, given "the age of the Internet, where technology can so quickly affect the creation and communication of creative materials."[155] Pallante reiterated that although the underlying policy for the first sale doctrine is "rooted in the common law rule against restraints on the alienation of tangible property," Congress could choose to review the rule's application to digital goods.[156] According to Pallante, Congress has two choices in such a review:

> On the one hand, Congress may believe that in a digital marketplace, the copyright owner should control all copies of his work, particularly because digital copies are perfect copies (not dog-eared copies of lesser value) or because in online commerce the migration from the sale of copies to the proffering of licenses has negated the issue. On the other hand, Congress may find that the general principle of first sale has ongoing merit in the digital age and can be adequately policed through technology—for example, through measures that would prevent or destroy duplicative copies. Or, more simply, Congress may not want a copyright law where everything is licensed and nothing is owned.[157]

Additionally, the United States Patent and Trademark Office, in collaboration with the Copyright Office, is attempting to find "a way to preserve the [first sale] doctrine's benefits, allowing the equivalent of sharing favorite books with friends, or enabling the availability of less-than-full-price versions to impecunious students" in the digital era, through possible amendments to the Copyright Act.[158] It acknowledged that licensing is quickly becoming the common means of distribution for music and electronic books, which will "render the first sale doctrine meaningless" as applied to digital goods.[159] In recognizing the implications of licensing on secondary markets, the Patent & Trademark Office stated that "courts or policy makers [may want] to reinterpret what constitutes a 'license' or to expand the scope of the first sale doctrine."[160]

The United States Congress has unsuccessfully attempted to pass

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155. Maria A. Pallante, *The Next Great Copyright Act*, 36 COLUM. J.L. & ARTS 315, 320 (2013).

156. *Id.* at 331.

157. *Id.* at 332.

158. DEP'T OF COMMERCE INTERNET POLICY TASK FORCE, COPYRIGHT POLICY, CREATIVITY, AND INNOVATION IN THE DIGITAL ECONOMY 37 (2013), *available at* http://www.uspto.gov/news/publications/copyrightgreenpaper.pdf.

159. *Id.* at 36.

160. *Id.*

legislation establishing a digital first sale doctrine. The Benefit Authors Without Limiting Advancement or Net Consumer Expectations (BALANCE) Act of 2003 sought to amend section 109 of the Copyright Act by allowing first sale to apply "if the owner does not retain the copy or phonorecord in a retrievable form and the work is so sold or otherwise disposed of in its original format."[161] Additionally, if digital works were obtained subject to nonnegotiable license terms, the terms of such license would be unenforceable.[162] This legislation failed to become law due to the loopholes that it left open regarding the reproduction right, its failure to specify how the digital good would be deleted from the original owner's devices, and the severe limitations that it placed on the use of restrictive licensing agreements.[163]

Given that "used" digital goods are indistinguishable from "new" digital goods, Congress may have to alter the traditional first sale doctrine to protect the original market for these goods. One suggestion has been to institute a resale royalty scheme.[164] By allowing copyright holders to collect resale royalties for their digital goods sold in the secondary markets, Congress would protect them from "the unique risks that nondegrading digital formats, connected to a vast and limitless distribution system, pose for copyright owners."[165]

D. Legislative Response in the European Union

The legislative response in the European Union has similarly failed to sufficiently address the growing inadequacies of current copyright law in the digital era. In December of 2012, in response to the *Hargreaves Review of Intellectual Property and Growth*, the United Kingdom's Intellectual Property Office released a report that set out a number of recommendations for the UK to "adapt its strong but rigid framework for copyright into one that is modern, robust and flexible."[166] The Office recognized that "[t]he digital era and digital technologies provide new opportunities across the creative sectors and beyond, but pose new

161. H.R. 1066, 108th Cong. § 4 (2003).

162. *Id.* § 123(b).

163. *Bill Summary & Status, 108th Congress (2003 - 2004), H.R. 1066*, LIBR. CONGRESS: THOMAS, http://thomas.loc.gov/cgi-bin/bdquery/z?d108:H.R.1066: (last visited Mar. 26, 2014); Grant Gross, *Bill Would 'Protect' Consumers from DMCA: Effort Seen as Uphill Fight in Congress*, INFOWORLD (Mar. 5, 2003), http://www.infoworld.com/t/applications/bill-would-protect-consumers-dmca-950?page=0,0.

164. *See* Serra, *supra* note 18, at 1798.

165. *Id.* at 1799.

166. HM GOVERNMENT, MODERNISING COPYRIGHT: A MODERN, ROBUST AND FLEXIBLE FRAMEWORK 2 (2012), *available at* http://www.ipo.gov.uk/response-2011-copyright-final.pdf.

questions of a copyright regime that is based on an analogue world."[167] Unfortunately, the proposed amendments do not squarely address digital exhaustion. Specifically, the Office has proposed a private copying exception, which would allow an individual to make a copy of a copyrighted work and to permanently transfer that copy to another person so long as the original copy is destroyed.[168] Additionally, if any term of a contract were to restrict or prevent an individual from copying or transferring the copy to another person, that term would be deemed unenforceable.[169]

Although this amendment is not explicitly limited to transfers of physical copies, it would be difficult to argue that it sanctions the copying of digital goods, as it fails to address the reproduction right that is currently implicated in a digital transfer. Additionally, this proposal does not address forward-and-delete technology, essentially leaving to the user the responsibility of deleting the original file after it has been copied and transferred to another user. Lastly, the private copying that is sanctioned by the proposed amendment only applies to copies made for the individual's private use, not to copies made for commercial purposes (i.e., sales).[170] On the bright side, the language of the amendment does limit the use of restrictive licenses, which is necessary for the existence of digital secondary markets.

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While the recognition of a digital first sale doctrine in both the United States and the European Union would make secondary digital markets available, if secondary markets are to become a reality, any legislation will ultimately have to address licensing schemes, the reproduction right, and forward-and-delete technology. Specifically, legislation will need to place limits on the acceptable terms of licensing agreements: that they cannot prohibit the transfer or resale of digital goods. Legislation must also address the reproduction right that is implicated during the transfer from one user to another—perhaps by creating an exception to the reproduction right when a digital file is copied for the sole purpose of completing a sale or purchase in the secondary market. Lastly, legislation must address the mechanisms for ensuring that the seller does not retain a copy of the digital good after it is transferred to the buyer. The private sector may create technology that circumvents the reproduction right when selling used

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167. *Id.*

168. INTELLECTUAL PROP. OFFICE, PRIVATE COPYING annex a, *available at* http://www.ipo.gov.uk/types/hargreaves/hargreaves-copyright/hargreaves-copyright-techreview.htm.

169. *Id.*

170. *Id.*

digital goods and sufficient forward-and-delete technology. Legislation would still be required, however, to limit the use of restrictive licensing schemes in connection with obtaining digital goods. Ultimately, legislators must accept the fact that the current copyright regimes do not sufficiently protect consumers in the digital era.

CONCLUSION

To "promote the Progress of Science and useful Arts"[171] in the United States and to "ensur[e] the maintenance and development of creativity in the interests of authors, performers, producers, consumers, culture, industry and the public at large"[172] in the European Union, consumers should be able to purchase and sell digital goods in the secondary market. While consumers in the United States do not have access to any secondary markets for digital goods, the European Union has recognized the valuable space that secondary markets occupy in today's digital age, at least with regards to software, but have not yet applied the rule of exhaustion to all digital goods.[173]

In the United States, the Southern District of New York is the most recent court to foreclose secondary markets with its ruling in *ReDigi*.[174] Although the ECJ determined that exhaustion applied to software in *UsedSoft*, the recent decision by the German Regional Court stated that the reasoning in *UsedSoft* does not apply to other digital goods and therefore held that exhaustion does not apply to electronic books.[175] Despite this decision, ReDigi is now preparing to launch in Europe, likely due to the application of exhaustion to software and perhaps to their optimistic outlook on the European Union applying exhaustion to all digital goods.[176]

This paper's suggested changes can be made through either the judicial or legislative systems. Although the courts in both the United States and the European Union have been averse to applying the first sale doctrine and exhaustion to digital goods, the ECJ has recognized the danger of allowing restrictive licensing agreements in connection with obtaining software: by attaching a license to a transaction, the first sale doctrine and the exhaustion doctrine are completely circumvented, giving manufacturers and distributors the power to control all downstream sales. This reasoning

171. U.S. CONST. art. I, § 8, cl. 8.

172. Council Directive 2001/29, *supra* note 2.

173. *See supra* Part V.

174. *See supra* Part I.

175. *See supra* Part V.

176. *ReDigi is Crossing the Pond! Sign up to Stay in the Loop!*, REDIGI, http://newsroom.redigi.com/europe/ (last visited May 4, 2014) ("ReDigi is preparing to open its doors in Europe.").

should be expanded to apply to all digital goods, both in the European Union and the United States, which in turn would limit the enforceability of restrictive licensing agreements and allow digital goods to be sold and purchased in secondary markets.

While the judicial systems in the United States and the European Union have the ability to transform copyright law, the most efficient way to make the necessary changes would be through new copyright legislation. Unfortunately, legislators in both the United States and the European Union have failed to adequately address the barriers that currently prevent the availability of secondary markets for digital goods. If secondary markets are going to be a viable marketplace for consumers to purchase and sell used digital goods, it is imperative that the United States and the European Union make changes to their arcane copyright laws. Simply creating a digital first sale doctrine, however, does not entirely solve the problem; they must allow for intermediate copying so that the actual purchase or sale of digital goods does not infringe a copyright owner's reproduction right. Additionally, limits must be placed on the acceptable terms of restrictive licensing agreements in connection with digital goods. These changes would not only modernize the current copyright regimes but also recognize the important role that consumers play in the dissemination and promotion of the arts and sciences in the digital era.