Music's low note

Dentons' **Shona Harper** reviews the exhaustion of copyright protection of digital works and the contrasting approaches on either side of the Atlantic

The European principle of exhaustion of copyright stems from the fundamental principle of free movement of goods throughout the European Union. It means that while the owner of copyright-protected works may prevent third parties from selling his works that he has not put on the market, he may not prevent the re-sale of works, which he has already legitimately sold or distributed (for free or otherwise). Thus, legitimately obtained hard copies of CDs, books, DVDs and other copyright-protected works may be resold, for example, through second-hand shops, whether online or offline. However, this general principle of exhaustion applies only to the primary right of distribution, and not to the primary right of reproduction. If this were not the case, a work would lose its value on the very first distribution of the original work.

The principle of exhaustion is enshrined in various different pieces of legislation. This reflects the piecemeal nature of copyright protection for different works in European legislation. For example, in respect of software programs, the relevant article is Article 4(2) of the Software Directive 2009/24,

> "The first sale in the community of a copy of a program by the rightsholder or with his consent shall exhaust the distribution right within the community of that copy…"

However, the Copyright Directive[1] expressly prohibits exhaustion applying to certain rights (including the right to communicate the work to the public (article 3)) and to services and online services (recital 29). Thus, it was generally accepted (but not expressly considered by the European courts), that online sales would not exhaust copyright in digital works, in contrast to offline sales, which do exhaust copyright protection, thereby allowing re-sale.

The *UsedSoft* ruling

In *UsedSoft*,[2] for the first time the Court of Justice of the European Union (CJEU) applied the principle of exhaustion to intangible goods bought on the internet, namely computer programs, albeit under specific rules relating to software rather than the general overarching rules setting out copyright protection. Based on the ruling and the specific facts of the case, copyright in such digital works, ie, computer programs, is exhausted after the first legitimate sale and a lawful owner of a software licence may re-sell the whole of that licence provided that:

- he legitimately downloaded his copy of the software from the internet;
- he received a licence equivalent to ownership (rather than a short or medium-term licence);
- he effectively "bought" that licence by paying a fee designed to be the rightsholder's remuneration; and
- by re-selling the licence in question, he gives up all his ability to use the software under the licence in question, as he would if he were re-selling physical copies of the work.

The facts of *UsedSoft* were that Oracle generally distributed the computer programs in question via the internet and, in return for payment of a fee, granted rights "for an unlimited period" of time for a specific number of users. UsedSoft's business model was to acquire unwanted Oracle licences and re-sell them, such that the original owner could no longer access the computer program and the new owner received the benefit of the "unlimited period" of rights. Oracle sued UsedSoft for infringement.

The CJEU considered that Oracle's system of transfer by download by, and subsequent licence to, the user was a "first sale" by the rightsholder that exhausted its rights, even though it did not in fact charge a fee for the download, only for the licence itself. The court considered that these two acts were indivisible.[4] Further, and crucially for the future application of the judgment, the court also ruled that, as the licence was for an unlimited period of time, it was akin to ownership.[5]

The CJEU rejected Oracle's argument that the "making available" of the software programs on its website was a primary right of reproduction which could not be exhausted. Rather, due to the change of ownership, the act of making available was changed into an act of distribution which can and was exhausted.[6] Given the principle of exhaustion is to avoid partitioning of markets, the distribution right can only be exercised by rightsholders to the extent necessary to safeguard the specific intellectual property in question. Having

already received a fair remuneration for the first sale, the rightsholder's IP rights had been protected and exercised appropriately. To allow the rightsholder to control further sales through the "making available" right, it would have the same restrictive, anti-competitive effects that partitioning does, and therefore should not be permitted, regardless of which of the copyright "rights" are used to argue against exhaustion.

The first-sale doctrine in the US

The same principle of exhaustion of copyright is applied in the US, but it is known as the 'first-sale doctrine': after the first legitimate sale, the rightsholder's rights are exhausted and the work in question may be resold by the legitimate owner. This principle has recently been reinforced by the Supreme Court in respect of hard copy works in *Kirtsaeng,*[7] even where the works in question were first sold overseas and then imported and resold in the US. This will have a considerable impact on original works publishers who have charged different prices or selected different initial release dates in different markets internationally. The possible ultimate commercial impact may be simultaneous release worldwide, with all prices being the same. This would mean price rises in some markets and potentially reductions in others.

The *Redigi* ruling

However, and in contrast to the approach taken by the CJEU in *UsedSoft*, the first sale principle has recently been rejected by the US courts in respect of digital music works. In *Capital Records, LLC v Redigi Inc*,[8] the court considered the legitimacy of a digital re-sale marketplace offered by the defendant, Redigi. This marketplace allowed legitimate owners to offer unwanted digital content to third parties, to give up their own access to the works in question and to recoup some of their original investment. The owners of the copyright had still benefitted from the original first sale through the receipt of fair remuneration and so arguably ought to have had their rights exhausted by that first sale, in the same way that the original owners had in *Kirtsaeng*. However, the court did not take this view, considering that any such re-sale must involve an illegal infringement of the exclusive rights of both reproduction and distribution in the copyright-protected work. The court stated that any change in these principles, ie, to update US copyright law so that it reflects the ease and speed of data transfer in modern day, digital life, must be made by legislative law-makers, not judicial ones.[9] The director of the US Copyright Office, Maria Pallante, has similarly called on the US Congress to update the first sale doctrine.[10]

The *Redigi* decision comes as a blow not only to Redigi, who has already said it will appeal, but also to digital giants including Apple and Amazon. Both have applied for and received patents relating to the technology underpinning similar second-hand digital marketplaces for original purchasers to re-sell (and therefore lose access to) digital products, with the digital copy moving to the buyer. However, if US law remains as set out in the *Redigi* decision, then there will be no scope for such services.

It would therefore appear that second-hand digital marketplaces may be an option for European businesses, but not for US ones. This is because immediate parallels can be drawn between the software, which was the subject of the *UsedSoft* ruling and all other digital copyright-protected works, such as the music tracks being resold by Redigi in the US. Following the CJEU's principles from *UsedSoft,* it would arguably be valid to establish a business in Europe that allowed a user who had legitimately bought an online music track (and so received the equivalent of ownership through the licence to use the track for an unlimited period of time[11]) to re-sell that track, acknowledging that it would lose all access to the track. The copyright owner would have received fair and genuine remuneration on the first sale and thus would have no right to any benefit from further re-sales.

The key legal issue for Redigi and other music re-sellers considering opening a European business is that the *UsedSoft* decision considered software under a specific and specialist directive. While the court expressly stated that the concepts underlying the Copyright and Software Directives must in principle have the same meaning,[12] it will require a further ruling from the highest court in Europe for there to be certainty as to whether the first sale or exhaustion principle applies to copyright in music tracks on this side of the Atlantic. In the meantime, pending the outcome of the appeal of the decision in *Redigi,* the position on the US side is that such a business is not permitted.

The key commercial issue for international re-sellers considering such businesses will be the challenge of managing the business while the approach to the exhaustion of digital rights in the major markets on either side of the Atlantic remains inconsistent. Examples of such challenges include ensuring that users from each location can only access those works that they are permitted to purchase by using technologies such as geo-blocking user access. It may be that to the extent companies are prepared to start up digital re-selling marketplaces, they limit those marketplaces to the jurisdictions and the works that have been expressly cleared for such re-selling. In the meantime, the digital user loses out and, as has been shown by online piracy, such users often revert to illegitimate versions of works they cannot obtain legitimately. This would result in, yet again, all stakeholders in the creative industries losing out while uncertainty in the law of copyright continues.

Footnotes

1. 2001/29.
2. *UsedSoft GmbH v Oracle International Corporation*, C-128-11; 3 July 2012.
3. Paragraphs 46, 48.
4. Paragraph 44.
5. Paragraphs 44-46.
6. Paragraph 52
7. US Supreme Court Volume 568, docket number 11-697.
8. No. 12 Civ 95 US Southern District Court of New York.
9. Page 13.
10. Pallante, Maria: 'The Next Great Copyright Act," *Columbia Journal of Law & the Arts;* http://www.law.columbia.edu/null/download?&exclusive=filemgr.download&file_id=612486.
11. Although the ownership of digital music tracks is currently the subject of a separate debate, Apple's terms of use limit the use of the tracks to that user's devices only, thereby preventing the inheritance of the tracks for example, despite the purchase of an individual track using either service being the 21st Century equivalent of buying a physical single and the fundamental factor behind the success of iTunes. Amazon goes one step further: its terms expressly state that the user does *"not acquire any ownership rights in the software or music content"*. This ownership has yet to be resolved on either side of the Atlantic.
12. For example, at paragraph 60 .

Author

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