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**A Comparative Analysis of Online
Distribution of Software in the United
States and Europe: Piracy or Freedom of
"First Use"?**

Petra Heindl

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Stanford Law School
Crown Quadrangle
559 Nathan Abbott Way
Stanford, CA 94305-8610

University of Vienna School of Law
Department of Business Law
Schottenbastei 10-16
1010 Vienna, Austria

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About the Author

Petra Heindl received her Mag.iur. degree [JD] and Dr.iur. degree [JSD] from the University of Vienna School of Law in Austria. After graduating from the Vienna Law School, she completed an LL.M. in European Union law at the Danube University Krems in Austria. In addition, she earned an LL.M. in U.S. Law from Santa Clara University School of Law.

Petra Heindl is a Fellow of the Stanford-Vienna Transatlantic Technology Law Forum. Her research work is also connected with the Forum on Contemporary Europe at Stanford University's Freeman Spogli Institute for International Studies. She works as an associate with Binder Groesswang Attorneys at Law in Vienna, Austria. Her research focuses on European and international business and technology law.

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Abstract

This paper provides an understanding of the current copyright laws regarding software licensing in the United States and Europe. The concept of copyright under both the U.S. and EU legal regimes is to convey on the copyright owners the exclusive right to distribute their copyrighted software. In case of sales transactions, that right is expressly limited to statutory copyright law.

Sections 109 and 117 of the U.S. Copyright Act are the respective core provisions to apply to software transactions. It is not an infringement for the owner of a copy of a work obtained at an authorized sale to sell or otherwise dispose of the possession of that copy. In addition, the owner of a copy of a computer program may, *inter alia*, create another copy of that program provided that the copy is made either as an essential step in the utilization of the computer program in conjunction with a machine and that it is used in no other manner, or for archival or back-up purposes. Under U.S. case law the crucial question is whether a licensee of software can be deemed as an "owner" of a copy of the software and as such trigger the first sale immunities. The paper shows the different approaches taken by different courts on the so-called "sale versus license debate".

Article 4(c) of the Council Directive on the Legal Protection of Computer Programs ("EC Software Directive") contains the European version of the first sale doctrine, the Community exhaustion doctrine. The first sale of a copy of a computer program by the copyright owners or with their consent shall exhaust the distribution right of that copy within the European Communities (EC) or European Economic Area (EEA). Contrary to the sale versus license debate in U.S. case law, European courts—with no greater argument—deemed software licensees subject to exhaustion. The courts have been more concerned to apply the doctrine of exhaustion in a way as to further the implementation of the fundamental freedom of free movement of goods and services in the EC.

On the basis of a transatlantic copyright analysis the paper will discuss, in a second step, the existence of a digital first sale doctrine (as called in the United States) or digital Community exhaustion doctrine (as known under EC law). The paper debates whether the first sale/exhaustion privilege is to apply also in the event of online-transmissions of software, i.e., when no tangible data carrier embodying the target software changes hands. In today's world, copies of copyrighted works, including software, are bought with increasing frequency by electronically downloading them through networks, mostly the Internet, with no tangible copy of the target software provided. However, digital transmissions of copyrighted works over the Internet fit neither comfortably within the narrow concepts of first sale nor exhaustion. In discussing whether online distribution of software shall render sections 109 and 117 of the U.S. Copyright Act or Article 4(c) of the EC Software Directive applicable, the paper concludes that in the absence of persuasive case law in either jurisdiction on this matter, U.S. governmental authorities tend to protect software copyright owners,

whereas the existence of a digital Community exhaustion doctrine may be based on the ground of free movement of information.

"To promote the Progress of Science
and useful Arts ..."

Article 1, Section 8
U. S. CONSTITUTION

... in a world that is in
"the process of creating an ever closer union among the
peoples..."

Preamble
TREATY OF LISBON

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A. INTRODUCTION

This paper undertakes to provide an understanding of the current copyright law regarding software licensing in the United States and Europe. In addition, this paper reviews the existence of a digital first sale doctrine (as called in the United States) and a digital Community exhaustion doctrine (as called in the European Community). Using a transatlantic approach, this paper will examine whether the first sale/exhaustion privilege should apply in the event of online transmissions of the target software.

Copyright is the property right in an original work of authorship fixed in any tangible medium of expression. A software copyright owner holds ownership in both the copyrighted computer program and in the data medium embodying the target software. Yet the conveyance of rights in the software copyright (intangible property) does not necessarily require a transfer of the tangible copy embodying the copyrighted work itself and vice versa. In most cases involving computer software transactions, the parties intend to stipulate in their contract terms that the license is to use the target software, not to sell or buy the tangible copy embodying the target software.

Part A of this paper shows that the concept of copyright underlying both the U.S. and European Community ("EC") legal regimes conveys on the copyright owner the exclusive right to distribute its copyrighted work. However, in the case of sales transactions, the distribution right is expressly limited by statutory copyright law, known in U.S. legal parlance as the first sale doctrine and in European legal terminology as the Community exhaustion doctrine. This general concept also applies to computer programs.

Sections 109 and 117 of the U.S. Copyright Act are the core provisions that apply to software transactions. If the copyright owner sells a copy of software to a third person, that person has the right under the first sale doctrine to resell that copy to anyone else without permission of or payment to the copyright owner. In addition, the owner of a copy of a computer program may create another copy or adaptation of the purchased program, provided that the copy or adaptation is made either as an essential step in the utilization of the computer program in conjunction with a machine, and that it is used in no other manner, or for archival or back-up purposes. The wording of section 109 of the Copyright Act indicates that the first sale doctrine shall apply to authorized, unconditional sales of a copy or other transfer of ownership in the material object, like a CD-ROM, containing the target software. Section 117 is similarly limited. However, the

practice of selling software is rather out of touch with reality in the software industry. The real business model in today's software world is licensing of software, thereby defeating the first sale doctrine. The first sale doctrine is only triggered by the first actual transfer of certain rights in the tangible copy, whereas a copyright owner does not forfeit its exclusive rights by entering into a licensing agreement with respect to that target software. Under U.S. case law, the crucial question is whether or when a software licensee can be deemed an "owner" of a software copy for the purpose of the first sale exemptions. Following the introduction of the relevant legal framework applicable to software transactions, this paper investigates and analyzes the contradicting theories created by case law on how to construe distribution agreements involving sales or licenses (the so-called "sale versus license debate").

The economic right of distribution has been one major area of difference in the EC Member States.¹ Before the enactment of the Council Directive of 14 May 1991 on the Legal Protection of Computer Programs ("EC Software Directive"), neither the Berne Convention, to which all the Member States² are signatories, nor the Universal Copyright Convention³ have contained a general distribution right.⁴ The distribution right, where it existed, was defined in different ways in different Member States. Some Member States only codified a general distribution right. With respect to computer software in particular, some copyright laws, such as those in Spain, the United Kingdom, and Denmark provided for an explicit distribution right. Other Member States such as France, Belgium, and Luxembourg did not rule on the distribution right at all.⁵ Thus, it was one of the objectives of the EC Software Directive to harmonize a fairly sensitive area of

¹ Nonetheless the Commission Green Paper still reasoned that an introduction of a general distribution right in all Member States had not been a Community action requirement as most identified issues seemed to be capable of adequate solution at national level. *See Commission Green Paper on Copyright and the Challenge of Technology – Copyright Issues requiring Immediate Action*, para. 4.4.4., at 153, COM (1988) 172 final (June 7, 1988) [hereinafter Commission Green Paper].

² Currently 27 countries have become members of the European Union: Federal Republic of Germany, France, United Kingdom, Austria, Spain, Portugal, Sweden, Finland, Estonia, Poland, the Czech Republic, Slovakia, Greece, Italy, Malta, Belgium, the Netherlands, Ireland, Hungary, Cyprus, Romania, Slovenia, Lithuania, Latvia, Luxembourg, Denmark, and Bulgaria (hereinafter the "Member States").

³ Universal Copyright Convention adopted in Geneva in 1952 and as revised at Paris on 24 July 1971 [hereinafter the UCC]. Since almost all of the states in the world are either members or aspiring members of the World Trade Organization, and are thus conforming to the Agreement on Trade-Related Aspects of Intellectual Property Rights Agreement, the UCC has lost significance.

⁴ *But see* the Statement of the International Bureau of the WIPO regarding a protocol on the Berne Convention, Copyright 1993, 84, 86, demonstrating that the Berne Convention does not contain a general distribution right but a "right of first distribution" = "right of putting into circulation", "droit de mise en circulation."

⁵ For a summary *see* JOCHEN MARLY, URHEBERRECHTSSCHUTZ FÜR COMPUTERSOFTWARE IN DER EUROPÄISCHEN UNION [COPYRIGHT PROTECTION FOR COMPUTER SOFTWARE IN THE EUROPEAN UNION] 238-41 (1995).

different national copyright laws, namely the right to control commercial exploitation of computer software. Article 4(c) of the EC Software Directive contains the European version of the first sale doctrine, the exhaustion doctrine. The first sale of a copy of a computer program by the copyright owner or with his consent shall exhaust the distribution right of that copy within the EC or European Economic Area (EEA). European courts did not bother to lead a similar sale versus license debate as in the United States. According to the European understanding of the exhaustion doctrine, it is the license to use the target software rather than the software copy itself that is regarded as the subject of exhaustion. Courts have been more concerned to apply the doctrine of exhaustion in a way as to further the implementation of the fundamental freedom of free movement of goods and services and free competition throughout Europe.

Most recently, software licensing in the digital world has resulted in revisiting the doctrines at both sides of the Atlantic. The picture of the software industry where a computer program is delivered on a diskette to be loaded into a computer memory and then run by the user, which is still underlying the current wording of both the first sale doctrine, and the exhaustion doctrine, is outdated. Copies of software are bought with increasing frequency by electronically downloading them through information networks, mostly the Internet. In the event of online transmission no tangible copy is transferred, thus, a transfer of ownership in the copy containing the target computer program does not take place. Part B of the paper shows that digital transmissions of copyrighted works over the Internet do not comfortably fit within the narrow copyright concepts of first sale or exhaustion under sections 109 and 117 of the U.S. Copyright Act and Article 4(c) of the EC Software Directive. In particular, the question examined is whether making a local copy of the downloaded target software on one's computer system shall satisfy the tangible copy requirement for applying either doctrine. Ultimately, the paper attempts to draw a conclusion regarding whether the U.S. and the European copyright regimes are ready to apply the privileges of first sale/exhaustion to digital copies.

B. THE CONCEPT OF EXHAUSTION AFTER FIRST SALE OF A COMPUTER PROGRAM IN THE UNITED STATES AND EUROPE

I. First Sale Doctrine under U.S. Copyright Law

1. The Rule—Distribution Right

Section 106(3) of the Copyright Act⁶ vests in the copyright owner the exclusive right to distribute copies of its copyrighted work.⁷ The rationale underlying section 106(3) is that the copyright owner will control the initial distribution of an authorized copy of his copyrighted work. The copyright owner can choose to dispose of a copy by sale, gift, loan, or some other rental or lease arrangement,⁸ thereby ensuring that he is fully compensated for each copy so distributed (notion of full compensation).⁹ As it is the copyright owner who sets the amount of whatever return the market and its interest dictate for the chosen distribution, copyright law implies an incentive for the creation and dissemination of works.¹⁰

2. The Exemption—First Sale Doctrine

2.1 *Rationale*

The exclusive distribution right provides the copyright owner with a means of controlling the first distribution of a copy of its work. The concept of compensation in return for creation and dissemination of works is a fundamental notion of the copyright regime. If the copyright owner

⁶ "Subject to sections 107 through 122, the owner of copyright under this title has the exclusive rights to do and to authorize [...] to distribute copies [...] of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending". 17 U.S.C. § 106(3).

⁷ Also electronic transmissions of copies fall within the meaning of distribution under this section. *See, e.g., A&M Records, Inc. v. Napster, Inc.*, 239 F.3d 1004, 1014 (9th Cir. 2001) (uploading file names to the search index for others to copy was held to infringe plaintiffs' distribution rights); *see also* BRUCE P. KELLER, JEFFREY P. CUNARD, *COPYRIGHT LAW—A PRACTITIONER'S GUIDE* §14:2:3[C] (2007) (citing further instances that qualify as "distribution", such as the making available of files on a user's server to others in a peer-to-peer sharing arrangement or distribution as a result from an upload to a central server).

⁸ *See, e.g.*, 1 HOWARD B. ABRAMS, *THE LAW OF COPYRIGHT* § 5:177, at 5-206 (2006).

⁹ *See* Christian H. Nadan, *Software Licensing in the 21st Century: Are Software "Licenses" Really Sales, and How Will the Software Industry Respond?*, PLI ORDER NO. 14631, 327, 332-33 (2008).

¹⁰ *See* U.S. CONST. art. I, § 8, cl. 8 (granting Congress the power to "[t]o promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries").

chooses to distribute its software¹¹ by selling copies thereof, it will obtain whatever return the market and its interest dictate for that sale.¹² The copyright holder will also ensure that the return reflects subsequent use and distribution of its software. Cross market segments foster indirect competition with the effect, *inter alia*, that the prices will be dictated by the market and no longer by the software vendors themselves. Once the copyright owner is rewarded for its work on the market, the work shall be available to the public as incentive for further innovation.

Controlling any further use or disposition of copies of software already sold on the market enables price discrimination.¹³ A price discrimination scheme can be established if the software vendor can entirely preclude resale, condition resale on prior approval, or otherwise limit the class of purchasers to whom the target software is to be sold.¹⁴ The same copy can be significantly more valuable to a commercial user than to a private user.¹⁵ For example, control over any further redistribution of software would allow a software vendor to sell software copies at different prices to different end-users (e.g., educational users, commercial users, single user licensees, multi-user licensees). Software vendors can offer lower price versions for low-use or noncommercial users and more expensive versions to commercial users.¹⁶ The system of price discrimination fails if a low valuation user can purchase a software copy at a low price and then resell that copy to a high valuation user.¹⁷

Beyond price discrimination, the software vendor will likely want to prohibit all transferability of its software with respect to competitors.¹⁸ The exclusive distribution right enables the copyright

¹¹ This paper uses the terms "computer software," "software program," and "computer program" interchangeably.

¹² See 2 RAYMOND T. NIMMER, INFORMATION LAW §11:70 (2008).

¹³ Price discrimination occurs when consumers of an identical product are charged different prices by the same seller, or that consumers of similar products made by the same seller are charged a price differential unrelated to the actual cost of production. See *ProCD v. Zeidenberg*, 86 F.3d 1447, 1449-50 (7th Cir. 1996).

¹⁴ See MARK A. LEMLEY, PETER S. MENELL, ROBERT P. MERGES & PAMELA SAMUELSON, SOFTWARE AND INTERNET LAW 323 (3rd ed. 2006).

¹⁵ See Nadan, *supra* note 9, at 329-30, 332 (stating that the personal and commercial versions of software are often identical, except the only difference is the license that comes with the software).

¹⁶ See *id.* at 341-43.

¹⁷ See Michael J. Meurer, *Price Discrimination, Personal Use and Piracy: Copyright Protection of Digital Works*, 45 BUFF. L. REV. 845 (1997).

¹⁸ See LEMLEY, MENELL, MERGES & SAMUELSON, *supra* note 14, at 323 (pointing out that restrictions to sell only to a particular class of purchasers, such as by contract provisions prohibiting the buyer from competing against the seller, are potentially anti-competitive, especially when the software vendor has market power).

owner to restrain the free alienability of goods.¹⁹ Successive possessors of a copy of the copyrighted work might not want to negotiate with the copyright owner each time they contemplate a further transfer of that copy. Likewise, the copyright owner has usually no interest in undertaking the expense of such additional negotiations.²⁰

For all these reasons, the so-called first sale doctrine was incorporated in the Copyright Act in order to extinguish the copyright owner's control of copies of its work. The first sale frees the sold copy from the copyright owner's authority to consent to any further distribution of that copy. But as shown elsewhere in this paper, the copyright owner who otherwise wishes to encumber the subsequent transfer of that copy can do so by initially licensing it, rather than ultimately parting with ownership of that particular copy.

2.2 *Legal Framework*

Two sections of the Copyright Act give the software owner of a work certain privileges with respect to the copy of a piece of (copyrighted) software. Sections 109 and 117 of the Copyright Act work in concert to empower the owner of a copy of a computer program to sell that program to any transferee, and enable the copy owner to use the program.²¹ Unlike a novel, which can be read without copying it, a computer program can be used only by way of making a (temporary) copy in the memory storage of the user's computer. If the transferee could not use the program, he would have no desire to acquire it, and the first sale doctrine would be of little use.

¹⁹ See U.S. COPYRIGHT OFFICE, A REPORT OF THE REGISTER OF COPYRIGHTS PURSUANT TO SECTION 104 OF THE DIGITAL MILLENNIUM COPYRIGHT ACT—EXECUTIVE SUMMARY, Part III.B.1.a (2001), available at http://www.copyright.gov/reports/studies/dmca/dmca_study.html (last visited July 27, 2009) [hereinafter Copyright Office Report] (stating that the underlying policy of the first sale doctrine as adopted by the early court decisions is to give effect to the common law rule against restraints on the alienation of tangible property).

Also the patent exhaustion doctrine owes its origin to the common law doctrine against restraints on alienation of chattels (post-sale restraints), which dates back at least to the 15th century. Cf. *Dr Miles Medical Co. v. John D Parke & Sons Co.*, 220 U.S. 373 (1911) ("The right of alienation is one of the essential incidents of a right of general property in movables, and restraints upon alienation have been generally regarded as obnoxious to public policy, which is best subserved by great freedom of traffic in such things as pass from hand to hand. General restraints in the alienation of articles, things, chattels [...] have been generally held void. 'If a man,' says Lord Coke, in *Coke on Littleton*, section 360, 'be possessed [...] of a horse or of any other channel, real or personal, and give or sell his whole interest or property therein, upon condition that the donee or vendee shall not alien the same, the same is void, because the whole interest and property is out of him [...]").

²⁰ See PAUL GOLDSTEIN, GOLDSTEIN ON COPYRIGHT §7.6.1 (2008).

²¹ See Nadan, *supra* note 9, at 325, 336-37.

2.2.1 Section 109 of the Copyright Act

Section 109 of the Copyright Act, commonly known as the "first sale doctrine",²² limits the copyright owner's distribution right by providing that

[n]otwithstanding the provisions of section 106(3), the owner of a particular copy [...] 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 [...].²³

Under the first sale doctrine,²⁴ once the copyright owner has parted with the copy of its copyrighted work, the copyright owner's authority to interfere with almost all kinds of subsequent distribution of that particular copy²⁵ has terminated. In other words, it shall not be a copyright infringement by the person who owns the copy embodying the copyrighted work to redistribute that copy or publicly display that copy at its location.²⁶ The initial transfer of

²² The first sale doctrine originated in case law. The U.S. Supreme Court held in *Bobbs-Merrill Company v. Straus*, 210 U.S. 339 (1908), that "the sole right to vend" a copyright work under the then current copyright statutes did not extend the rights of a copyright owner to restrict future sales of copies of a work once the first sale was made. The holding established what came to be known as the "first sale doctrine," which was first incorporated into the Copyright Act of 1909 in 17 U.S.C. § 27 and now is codified in §109(a) of the Copyright Act of 1976. *See also Action Tapes, Inc. v. Mattson*, 462 F.3d 1010 (8th Cir. 2006) ("A century ago, the Supreme Court held that a copyright owner's exclusive right to distribute a copyrighted product does not include the power to control a purchaser's subsequent disposition of the purchased copy.").

²³ 17 U.S.C. § 109(a). Besides copies, the other type of physical embodiment of a copyrightable work is a phonorecord. For the purpose of this paper, the text is phrased in terms of "copies" of computer programs only.

²⁴ In the international context, what is known as the "first sale doctrine" under U.S. terminology is called "exhaustion" of the distribution right. The notion underlying either terminology is the same. The term "exhaustion" refers to the exhaustion of a copyright owner's right to control further distribution of a lawfully made copy once there has been an authorized distribution thereof. *See* for the "exhaustion doctrine" under European copyright law, Council Directive of 14 May 1991 on the Legal Protection of Computer Programs, art. 9(2), 1991 O.J. (L 122) 45 (as amended by Council Directive 93/98/EEC); *see also* II WILLIAM F. PATRY, COPYRIGHT LAW AND PRACTICE 842 n.37 (1994).

²⁵ *See* 2 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT §8.12[B][1] (2007) (with reference to the first sale doctrine as incorporated under section 27 of the Copyright Act of 1909, equaling the current section 109(a), stating that under the first sale doctrine the copyright owner cannot prevent or restrict the resale, or other subsequent transfer even if not through resale, of such copies once the copyright owner has exercised its distribution right); *see also* II GOLDSTEIN ON COPYRIGHT, *supra* note 20, §7.6.1 (clarifying that "everyone in the succeeding chain of title—owners and nonowners alike—will enjoy the [first sale] privilege").

However, the first sale doctrine is limited by statutes restricting rental of software. *See* 17 U.S.C. § 109(b)(1)(A) (1994) prohibiting a buyer from renting software for profit.

²⁶ In the case of computer application programs, on which type of software this paper is primarily focusing, the exemption as to public display of the program copy, for practical reasons, may be deemed of minor importance. For a demarcation of the scope of the distribution right and the publication right *see* 2 NIMMER ON COPYRIGHT, *supra* note 25, §8.12[B][1]. In *Red Baron-Franklin Park, Inc. v. Taito Corp.*,

ownership in that particular copy ceases the copyright owner's ability to control the distribution channel of that copy, as well as control the conditions imposed on the further distribution of that copy²⁷ in the stream of commerce (i.e., the secondary market).²⁸

Furthermore, the first sale doctrine balances the economic rights of the copyright owner and the transferees with respect to copyrighted works. If a copyright owner elects to transfer full ownership of a copy of its software to a transferee, it most likely will ensure that the distribution of that copy yields the full return for that copy on the market.²⁹ Once the copyright owner has parted with ownership of the copy he is unable to extract further profits from that particular copy of the work.

2.2.2 Section 117 of the Copyright Act

In addition to section 109 of the Copyright Act, section 117 provides for another limitation on the copyright owner's exclusive rights with respect to computer software.³⁰ While section 109(a), the primary statutory source of the first sale doctrine, applies to copies of any type of copyrighted work, including computer programs,³¹ section 117 of the Copyright Act is a related form of the

883 F.2d 275 (4th Cir. 1989), the court held a computer video game played in a public arcade to be a public performance rather than a mere display of the work because it resulted in the sequential exhibition of the images of the audiovisual work. The right to conduct a public performance is not exempted under the first sale doctrine and thus is exclusively vested in the copyright owner.

²⁷ Restrictions and conditions on future distribution of physical copies (like retail price-caps), imposed by contract between the copyright owner and the first transferee, cannot be enforced by a copyright infringement action. However, such restrictions and conditions could be enforced under state contract law. *See* II GOLDSTEIN ON COPYRIGHT, *supra* note 20, §7.6.1 (indicating that the imposition of a restriction on the first distribution of a particular copy cannot avoid the first sale doctrine, "at least under copyright law"); *see also Bobbs-Merrill Co. v. Straus*, 210 U.S. 339, 350 (1908) (holding that 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, a limitation at which the book shall be sold at retail by future purchasers, with whom there is no privity of contract).

²⁸ The first sale doctrine provides the legal basis for authorizing second-hand stores, flea markets, and countless other forms of disposing of lawfully owned copies of copyrighted works. *See* 136 CONG. REC. H8270 (daily ed. Sept. 27, 1990) (statement of Mr. Kastenmeier); *see also American Int'l Pictures, Inc. v. Foreman*, 576 F.2d 661, 664 (5th Cir. 1978).

²⁹ *See Nadan*, *supra* note 9, at 332-33.

³⁰ *See* RAYMOND T. NIMMER, LICENSING OF INTELLECTUAL PROPERTY AND OTHER INFORMATION ASSETS 267 (2nd ed. 2007).

³¹ For the definition of a computer program *see* 17 U.S.C. § 101 ("A 'computer program' is a set of statements or instructions to be used directly or indirectly in a computer in order to bring about a certain result.").

first sale doctrine solely applicable to owners of copies of computer programs.³² Section 117 allows the copy owner to make such copies for any purpose associated with the use of the copy by the authorized copy owner.³³ In a nutshell, section 117 "deals only with the exclusive rights of a copyright owner with respect to computer uses, that is, the bundle of rights specified for other types of uses in section 106 and qualified in sections 107 through [122 of the Copyright Act]."³⁴ Section 117(a)³⁵ frees the owner of a copy of a computer program from liability arising out of copyright infringement for the making of incidental copies of the computer program without permission of the copyright owner.³⁶ The owner shall not infringe the software author's copyright by copying and making adaptations of his computer program, provided that either (i) it is an essential step in the utilization of the program in conjunction with the computer and that it is used in no other manner, or (ii) a copy is made only for archival or back-up purposes.³⁷ Section 117(b)³⁸ provides that the owner of a copy of a computer program does not infringe the copyright owner's copyright in that copy when the copy owner transfers that copy of the program:

³² See 1 RAYMOND T. NIMMER, *THE LAW OF COMPUTER TECHNOLOGY* §1:111 (2006) (pointing out that section 117 is expressly restricted to "computer programs" and therefore does not apply to any and all digital works).

³³ Cf. 2 NIMMER ON COPYRIGHT, *supra* note 25, at § 8.12[A] (contrasting the distribution right from traditional copyrighted works in that "such other rights all involve copying in a broad sense").

³⁴ H.R. REP. 94-1476, at 116 (1976), *reprinted in* 1976 U.S.C.C.A.N 5659 at 5731.

³⁵ "MAKING OF ADDITIONAL COPY OR ADAPTATION BY OWNER OF COPY.—Notwithstanding the provisions of section 106, it is not an infringement for the owner of a copy of a computer program to make or authorize the making of another copy or adaptation of that computer program provided:

(1) that such a new copy or adaptation is created as an essential step in the utilization of the computer program in conjunction with a machine and that it is used in no other manner, or

(2) that such new copy or adaptation is for archival purposes only and that all archival copies are destroyed in the event that continued possession of the computer program should cease to be rightful." 17 U.S.C. § 117(a).

³⁶ See COPYRIGHT OFFICE REPORT, *supra* note 19, at vii (indicating that the need of incidental copies justifies the exemptions under section 117 of the Copyright Act).

³⁷ This provision reflects the Ninth Circuit holding in *Sony Computer Entertainment, Inc. v. Connectix Corp.*, 203 F.3d 596, 600 n.1 (9th Cir. 2000), *cert. denied*, 531 U.S. 871 (2000) ("Any purchaser of a copyrighted software program must copy the program into the memory of a computer in order to make any use at all of the program."). Besides the temporarily storing of copies of computer programs in the user computer's random access memory (RAM), the other exempted activities, such as making backup copies in the event the user's computer crashes or is subjected to a virus attack, are also commonplace and necessary in the computer environment. See KELLER & CUNARD, *supra* note 7, §9:11.

³⁸ "LEASE, SALE, OR OTHER TRANSFER OF ADDITIONAL COPY OR ADAPTATION.—Any exact copies prepared [as an essential step in the utilization of the computer program, for archival purposes or for the purpose of maintenance and repair] in accordance with the provisions of this section may be leased, sold, or otherwise transferred, along with the copy from which such copies were prepared, only as part of the

- (i) in original form, and
- (ii) as long as the copy owner does not retain any copies of that program after the transfer, and
- (iii) transfers all rights of the copy owner in that program.³⁹

Lastly, section 117(c)⁴⁰ permits the owner or lessee of a machine to make a temporary copy of a computer program if such copy is made solely by virtue of the activation of a machine that lawfully contains an authorized copy of the computer program, for purposes of maintenance or repair of that machine; i.e., provided that the copied software continues to reside on the computer that is being maintained or repaired.⁴¹ In recent years, courts have shown a tendency to dismiss section 117 defenses raised by accused infringers.⁴²

Under sections 109 and 117 of the Copyright Act, the concept and scope of the first sale doctrine with respect to computer programs vary from case to case. As is evident from the plain language of the said sections, the exemptions set forth under sections 117 and 109(a) are direct consequences of copy ownership. What the statute does not state are the circumstances under which a user shall be deemed the owner of the copy embodying the target software. In the particular context of online transmissions of computer programs, the tangible copy requirement inherent in both sections of the Copyright Act⁴³ has been challenged by modern digital commerce.

lease, sale, or other transfer of all rights in the program. Adaptations so prepared may be transferred only with the authorization of the copyright owner." 17 U.S.C. § 117(b).

³⁹ See 1 RAYMOND T. NIMMER, *supra* note 32, at §1:116.

⁴⁰ "MACHINE MAINTENANCE OR REPAIR.—Notwithstanding the provisions of section 106, it is not an infringement for the owner or lessee of a machine to make or authorize the making of a copy of a computer program if such copy is made solely by virtue of the activation of a machine that lawfully contains an authorized copy of the computer program, for purposes only of maintenance or repair of that machine, if—

(1) such new copy is used in no other manner and is destroyed immediately after the maintenance or repair is completed; and

(2) with respect to any computer program or part thereof that is not necessary for that machine to be activated, such program or part thereof is not accessed or used other than to make such new copy by virtue of the activation of the machine." 17 U.S.C. § 117(c).

⁴¹ See *PracticeWorks, Inc. v. Professional Software Solutions of Illinois, Inc.*, Not Reported in --- F.Supp.2d---, 2004 WL 1429955 (D.Md. 2004) (holding that the use of software provided technical support to other software users, rather than repairing the computer on which the given software resided, was beyond the scope of the section 117(c) exception).

⁴² See KATHERYN A. ANDRESEN, *LAW AND BUSINESS OF COMPUTER SOFTWARE* §22:35 (2007).

⁴³ See 1 RAYMOND T. NIMMER, *supra* note 32, at §1:114 (stating that the section 117 exceptions to the otherwise exclusive rights of the copyright owner parallel the concept under the first sale doctrine but add additional exemptions pertinent to the ordinary use of a computer program).

2.2.3 Exceptions to the First Sale Exemption

Exceptions to the limitations of the first sale doctrine relate to commercial lending of computer software. The foremost threat to which the software rental exception responds is the establishment of an organized rental industry. Businesses specializing in the rental of such popular programs as Microsoft Office were feared to facilitate unauthorized private copying, which would damage the economic health of the software industry.⁴⁴

Section 109(b)⁴⁵ grants to the software copyright owner the right to prevent owners of lawfully made copies of the computer program from renting, leasing, or lending their copies of the program, or any indirect methods in the nature thereof⁴⁶ to others for "purpose of direct or indirect commercial advantage."⁴⁷ Otherwise, the owner of a program copy would be free to transfer that copy as he desires. Unauthorized software rental constitutes copyright infringement, and no criminal liability is incurred.

However, the restrictions on software rental are not absolute. First, the copyright owner's overriding right to control lending of his computer program does not apply to the lending of a

⁴⁴ See 136 CONG. REC. S17,577 (daily ed. Oct. 27, 1990) (statements of Senator Hatch).

⁴⁵ Copyright Software Rental Amendments Act of 1990, Pub. L. No. 101-650, 104 Stat. 5089 (1990).

⁴⁶ In *Central Point Software, Inc. v. Global Software & Accessories, Inc.*, 880 F.Supp. 957 (E.D.N.Y. 1995), the court held a retail distribution plan in which a buyer was allowed to take software home for five days for a fee characterized as a nonrefundable deposit or restocking fee, whereby the purchase price would be only charged if the customer wished to keep the software, to fall within the scope of the Rental Amendment Act as incorporated under 109(b) of the Copyright Act; see also 1 RAYMOND T. NIMMER, *supra* note 32, at §1:113 (identifying the issue not to be whether the transaction is to be construed as lease under state law, but whether the deal creates the type of problem that the statute sought to cure, such as short-term rentals that are most likely to encourage unauthorized copying).

⁴⁷ 17 U.S.C. § 109(b)(1) reads in full:

"(A) Notwithstanding the provisions of subsection (a), unless authorized by the owners of copyright in the sound recording or the owner of copyright in a computer program (including any tape, disk, or other medium embodying such program), and in the case of a sound recording in the musical works embodied therein, neither the owner of a particular phonorecord nor any person in possession of a particular copy of a computer program (including any tape, disk, or other medium embodying such program), may, for the purposes of direct or indirect commercial advantage, dispose of, or authorize the disposal of, the possession of that phonorecord or computer program (including any tape, disk, or other medium embodying such program) by rental, lease, or lending, or by any other act or practice in the nature of rental, lease, or lending. Nothing in the preceding sentence shall apply to the rental, lease, or lending of a phonorecord for nonprofit purposes by a nonprofit library or nonprofit educational institution. The transfer of possession of a lawfully made copy of a computer program by a nonprofit educational institution to another nonprofit educational institution or to faculty, staff, and students does not constitute rental, lease, or lending for direct or indirect commercial purposes under this subsection.

(B) This subsection does not apply to—

(i) a computer program which is embodied in a machine or product and which cannot be copied during the ordinary operation or use of the machine or product; or

(ii) a computer program embodied in or used in conjunction with a limited purpose computer that is designed for playing video games and may be designed for other purposes."

copy by a nonprofit library for nonprofit purposes, provided that the library has affixed an appropriate copyright warning.⁴⁸ Second, the copyright owner shall be able to control programs embodied in a machine or product that cannot be copied in the ordinary operation of the machine.⁴⁹ Third, as a general rule, computer programs embodied in or used in conjunction with a limited purpose computer that is designed for playing videogames or other purposes is not covered by the rental exemption.⁵⁰

2.3 *Scope of the First Sale Doctrine*

The statutory copyright doctrine of first sale is described in terms of privileges or immunities from certain infringement claims that flow to a person who has become an owner of a copy through an authorized, unconditional transfer of a copy.⁵¹ Yet, copyright does not define the key term "owner". According to common sense, one who buys a copy of a work in a sale is regarded an owner of that copy.⁵² Ownership comprises in one person all rights to enjoy property without limitation, including the right to convey it to any third parties at the owner's discretion.⁵³ The first sale doctrine interpreted accordingly would mean that only an unconditional and unlimited transfer of title of the material object embodying the copyrighted work to another triggers the doctrine of first sale.⁵⁴ The following paragraphs will examine how legislators and case law have defined "owner" for the purpose of sections 109 and 117 of the Copyright Act.

⁴⁸ 17 U.S.C. § 109(b)(2)(A).

⁴⁹ 17 U.S.C. § 109(b)(1)(B)(i).

⁵⁰ The rental exception covers only cases in which the program is a standalone product. *See* 17 U.S.C. § 109(b)(1)(B)(ii); 17 U.S.C. § 109(e).

⁵¹ *See, e.g., Quality King Distributors, Inc. v. L'Anza Research Int'l., Inc.*, 523 U.S. 135, 146-7 (1998) ("[The first sale doctrine] is available only to the 'owner' of a [...] copy.").

⁵² Possessing a leased copy of a copyrighted work or any other lesser conveyance of title does not satisfy the ownership requirement of sections 109 and 117. *See* Nadan, *supra* note 9, at 337-40 (illustrating that someone who borrows a book from the library cannot sell it to someone else because it still belongs to the library and thus she/he is not the owner of that book).

⁵³ *See* BLACK'S LAW DICTIONARY 1138 (8th ed. 2004) (defining "ownership" as "[t]he bundle of rights allowing one to use, manage, and enjoy property, including the right to convey it to others").

⁵⁴ *See, e.g.,* 1 RAYMOND T. NIMMER, *supra* note 32, §7:67.

2.3.1 Legislative History

Congress based section 117 of the Copyright Act on the final report of the National Commission on New Technological Uses of Copyrighted Works (CONTU), a congressional commission created to accommodate the Copyright Act of 1976 in a way that would meet the needs of the users and developers of computer software. The version of section 117 proposed by CONTU has been adopted by Congress almost verbatim, with one pivotal exception. According to the CONTU draft, it should not be a copyright infringement for "the rightful possessor of a copy of a computer program" to make copies in the course of using it. A "person in rightful possession of copies" would include, for example, any authorized licensee or lessee.⁵⁵ Congress, without disclosing the underlying rationale,⁵⁶ replaced the words "rightful possessor" with "owner".⁵⁷ Proponents of a transfer of title interpretation argue that Congress' intent behind the change in the wording was to restrict the scope of the section 117 exception to "one who has complete title to the program".⁵⁸ Thus, mere authorized possession of a copy without passing of the title in the tangible copy shall not affect the copyright owner's exclusive right of distribution under section 106(3) of the Copyright Act.⁵⁹

At first sight, it may seem that for the purpose of the "first sale" doctrine,⁶⁰ only the incident of a "sale" would constitute ownership to the transferee.⁶¹ However, section 109(a) of the Copyright

⁵⁵ See FINAL REPORT OF THE NATIONAL COMMISSION ON NEW TECHNOLOGICAL USES OF COPYRIGHTED WORKS 30, U.S. Dept. of Commerce, PB-282141 (July 31, 1978).

⁵⁶ See H.R. REP. NO. 96-1307(I), at 23 (1980), *reprinted in* 1980 U.S.C.A.C.A.N. 6460 at 6492 (indicating that the 1980 amendments were intended to embody the CONTU recommendations).

⁵⁷ See Pub. L. No. 96-517, 94 Stat. 3015 (1980).

⁵⁸ See *Applied Information Management, Inc. v. Icart*, 976 F.Supp. 149, 153 (E.D.N.Y. 1997).

Furthermore, a literal reading of section 109(a) of the Copyright Act leads to the conclusion that only subsequent sales or other transfers of title will qualify under its privilege. See 17 U.S.C. § 109(a) (explaining that permission to "sell or otherwise dispose of the possession" does not encompass nontitle transfers such as leases and licenses). Also, the omission of section 106(3)'s reference to "rental, lease or lending" buttresses this view. See II GOLDSTEIN ON COPYRIGHT, *supra* note 20, §7.6.1(c).

⁵⁹ See *Platt & Munk Co. v. Republic Graphics, Inc.*, 315 F.2d 847 (2nd Cir. 1963) (questioning the conclusion that "[i]f lawful possession by another sufficed to deprive the copyright proprietor of his right to control the transfer of the copyrighted objects, any bailee of such objects could sell them without infringing the copyright").

⁶⁰ See 2 NIMMER ON COPYRIGHT, *supra* note 25, §8.12[B][1] (suggesting to rephrase the contractual wording from "first sale" to "first authorized transfer of ownership").

⁶¹ One trial court seemed to adopt the argument that a licensor who transfers a copy to a transferee *must* do so under terms consistent with a first sale. However, the opinion was withdrawn in light of a settl

ement prior to appeal. *Cf. SoftMan Prods. Co., LLC v. Adobe Sys., Inc.*, 171 F.Supp. 2d 1075 (C.D. Cal. 2001) (On request for preliminary injunction, the court held that the given software transaction was a sale of a copy creating ownership, rather than a license, where the price for that software was a fixed amount for a perpetual license.).

Act literally refers to the disposition of the *possession* of the copy. Delivery of possession must not inevitably involve transfer of title to the copy. Critics of the theory of transfer of title understand the formal title to be one clue among others to determine ownership of a copy.⁶² Other critics argue that Congress might have regarded the term "rightful possessor" recommended by CONTU as too broad of a meaning, as it would cover any person temporarily in lawful possession of a copy, such as a messenger delivering a computer program or a bailee. Furthermore, the question of whether formal title in a software copy is given may be subject to relevant state law,⁶³ thereby contradicting the Copyright Act's "express objective of creating national, uniform copyright law by broadly pre-empting state statutory and common-law copyright regulation."⁶⁴

In fact, the transfer of title argument based solely on legislative history is fairly weak. Legislative history can be cited in favor of the contrary line of argumentation in the ownership debate as well—either to nail down a narrow, formalistic approach of ownership dependent on title, or to clarify the scope of rightful possessor. However, neither reasoning by itself relies on legislative history as the ultimate persuasive authority for any of the above definitions.

2.3.2 Article 2 of the UCC

Another arguable source for the transfer of title approach is Article 2 of the Uniform Commercial Code (UCC).⁶⁵ The default rule of Article 2 provides that if the parties intend a sale, then title to the goods passes when the seller completes its obligations with respect to delivery of the goods. However, the presumption of a transfer of title arises only in cases involving a sale of goods. It does not govern all transactions of goods. Article 2's rule does not apply to licenses, which is the predominant case with regard to software. Therefore, the statute cannot substantially contribute

⁶² See, e.g., *Krause v. Titleserv, Inc.*, 402 F.3d 119, 122, 123 (2nd Cir. 2005) (considering the legislative history as sparse with providing only limited guidance on this point; however, "Congress's decision to reject 'rightful possessor' in favor of 'owner' does not indicate an intention to limit the protection of the statute to those possessing formal title").

⁶³ See 2 NIMMER ON COPYRIGHT, *supra* note 25, §8.08[B][1] (noting that copy ownership "arises presumably under state law").

⁶⁴ *Comm. for Creative Non-Violence v. Reid*, 490 U.S. 730, 740 (1989); see also 17 U.S.C. § 301(a) (preemption with respect to other laws).

⁶⁵ U.C.C. § 2-401(2) (as last revised or amended in 2003):

"Unless otherwise explicitly agreed title passes to the buyer at the time and place at which the seller completes hi performance with reference to the physical delivery of the goods, despite any reservation of a security interest and even though if a document of title is to be delivered at a different time or place[.]"

to the debate on how to define a section 109(a)/117 owner.⁶⁶ Most of the relevant cases simply do not mention Article 2 of the UCC,⁶⁷ or the facts do not contemplate a sale or other transfer of title to the software copy, and thus there are no grounds for the application of Article 2.⁶⁸ It is up to case law to interpret on a case-by-case basis who shall be an owner of a copy of a work for the purpose of the first sale doctrine.

2.3.3 Case Law

For the first time in 1993, the Ninth Circuit in *MAI Systems Corp. v. Peak Computer, Inc.* considered the sale versus license debate.⁶⁹ MAI Systems Corporation ("MAI"), the owner of a software copyright, transferred copies of its copyrighted software to Peak Computer, Inc. ("Peak") under a licensing agreement that imposed severe restrictions on Peak's rights with respect to those copies.⁷⁰ In the copyright infringement suit, the Ninth Circuit held that Peak was not an owner of the copies of the software for the purpose of section 117 of the Copyright Act because Peak was a mere licensee of the MAI software.⁷¹ The Ninth Circuit did not elaborate on why it deemed Peak was a licensee rather than an owner.⁷² Notably, the *MAI* court failed to distinguish between ownership of the copyright in the software, which is usually licensed, and ownership of physical copies embodying the copyrighted software, which are usually owned.⁷³ Therefore, the court did not rule out that a copyright owner could license rights in the software to

⁶⁶ See 2 RAYMOND T. NIMMER, *supra* note 12, at §11:70 (arguing that no statutory mandate requires that, in a license, delivery of possession transfers ownership).

⁶⁷ See 1 RAYMOND T. NIMMER, *supra* note 32, §7:68; *but see Softman*, 171 F.Supp. 2d at 1084 ("A number of courts have held that the sale of software is the sale of a good within the meaning of Uniform Commercial Code.").

⁶⁸ See, e.g., *Berthold Types Ltd. v. Adobe Sys., Inc.*, 101 F.Supp. 2d 697 (N.D. Ill. 2000) ("A pure license agreement [...] does not involve transfer of title, and so is not a sale for Article 2 purposes.").

⁶⁹ 911 F.2d 511 (9th Cir. 1993), *cert. dismissed*, 510 U.S. 1033 (1994) [hereinafter MAI].

⁷⁰ MAI, 991 F.2d at 517 n.3.

⁷¹ *Id.* at 518 n.5; see also *NCR Corp. v. ATM Exchange, Inc.*, 2006 WL 1401635 *2 (S.D. Ohio 2006) (holding that "[s]everal district courts have held that a software manufacturer's distribution of copies of its software to licensed distributors did not constitute the first sale of copies;" thus, the first sale doctrine defense is not to apply to software distributed subject to a licensing agreement because the doctrine only applies to true owners).

⁷² The Ninth Circuit has been widely criticized for failing to come up with a more in-depth analysis on its holding. See, e.g., Christopher B. Yeh, *Wall Data Inc. v. Los Angeles County Sheriff's Department: License versus Sale at the Crossroads of Contract and Copyright*, 22 BERKELEY TECH. L.J. 355, 357, 363 (2007) (defining a "license" as "the transfer of anything less than a totality of a work").

⁷³ See RAYMOND T. NIMMER, *supra* note 30, at 271.

a transferee, while the same transferee acquired ownership of the copy embodying the target software.⁷⁴

In *Quality King Distributors, Inc. v. L'Anza Research International, Inc.*, the U.S. Supreme Court undertook to reason why licensees are non-owners under the first sale doctrine.⁷⁵ The court found that the characters of bailees and consignees showed a limitation of their rights in the physical product, rather than in the intellectual property.⁷⁶ Presumably, equating licensees with bailees and consignees results from their similar legal natures. A limited grant in the physical copy, rather than in the copyright, shall be decisive to qualify the owner of a software copy as licensee.⁷⁷

The copyright owner of computer software may opt for either selling a copy of its software or distributing the software under a different contractual arrangement. With a limited purpose transaction in mind, the copyright owner usually chooses to distribute the particular copy under a licensing agreement. A pragmatic approach would result in software being routinely licensed rather than sold.⁷⁸ Licensing and conditional sales—as compared to outright sales agreements—are now very common in the computer mass market and are also widespread in modern distribution systems.⁷⁹ Thus, case law has been carving out various circumstances under which a distribution agreement shall constitute the transfer of ownership of the copy, or the transfer of only limited rights in the copy, under the meaning of a license. This distinction is of significant consequence under U.S. copyright law.

Under the Copyright Act, the copyright owner of computer software is not required to distribute his copyrighted software through the sale of copies. As for copyright infringement, the sale of a program copy by law gives the owner of a copy of a program certain privileges with respect to that particular copy. To "non-owners", like licensees of a particular program copy, however,

⁷⁴ See 2 NIMMER ON COPYRIGHT, *supra* note 25, at §8.08[B][1]; *cf.* *Wall Data Inc. v. L.A. County Sheriff's Department*, 447 F.3d 769, 786 n.9 (9th Cir. 2006) (apparently neglecting to draw the distinction between sale of ownership in the material object embodying the software and licensing the software itself).

⁷⁵ *Quality King Distributors, Inc. v. L'Anza Research Int'l, Inc.*, 523 U.S. 135, 146-47 (1998).

⁷⁶ See also BLACK'S LAW DICTIONARY 151-52 (8th ed. 2004) (defining a "bailee" as one "who holds the property for a certain purpose," while "[u]nlike a sale or gift of personal property, a bailment involves a change in possession but not in title").

⁷⁷ See 2 NIMMER ON COPYRIGHT, *supra* note 25, §8.12[B][6][c] n.111.60.

⁷⁸ Declarants in the *One Stop* trial identified that the principle that software is rather licensed than sold is not true for video games software and CD-ROMs which are included as an ancillary feature with books. See *One Stop*, 84 F.Supp. 2d at 1091 (Declaration Nimmer), 1092 (Declaration Grant).

⁷⁹ Consequently, the Copyright Act incorporates the right of a copyright owner to distribute copies subject to technological controls that limit or regulate access to that work. 17 U.S.C. § 1201 (provision on unlawful circumvention of copyright protection systems).

these statutory exemptions do not apply.⁸⁰ Thus, the copyright owner would be enabled by contract specifically either to bar the non-owner from conveying the copy to any third person at all, or to allow a conveyance only under certain restrictions.⁸¹ In practice, ownership of a copy is determined by the terms of the contractual arrangement by which the copy was transferred.⁸² When a transaction involves a license, rather than an unrestricted sale, it is most often appropriate to treat the transaction as not conveying ownership of the copy.⁸³ That will most often correspond to the general expectations in the trade for such transactions.

This practice has resulted in an increase in litigation relating to when or whether first sale rules have been triggered.⁸⁴ Fundamentally, the discussion has centered on the distinction between selling and licensing of a program copy. Given the cited courts' imprecision in terms of ownership, the courts' more or less plain statements that licensees as such are to be characterized as non-owners has not been affirmed by the legal community.⁸⁵ Also, since there is little guidance to be obtained from either legislative history of the statute or the relevant statutes themselves, case law has pursued different approaches as to who qualifies as an owner or a licensee of a program copy.

2.3.4 Sale versus License Debate

The following paragraphs will outline the four standards in the so-called "sale versus license debate" as currently discussed in U.S. case law. To date, the U.S. Supreme Court has not ruled to set a copyright precedent in the ongoing sale versus license debate. Hence, after discussing and in

⁸⁰ See 1 RAYMOND T. NIMMER, *supra* note 32, at §1:115 (first sale privileges do not apply to licensees).

⁸¹ See, e.g., *Adobe Systems Inc. v. One Stop Micro, Inc.*, 84 F.Supp. 2d 1086, 1090 n.2 (N.D.Cal. 2000) (citing the limitations imposed on the reseller, the licensee, by the owner with respect to, *inter alia*, the area of further resales, the licensing terms which must be imposed on any further transferee).

⁸² See 1 RAYMOND T. NIMMER, *supra* note 12, at §2:48.

⁸³ See 1 RAYMOND T. NIMMER, *supra* note 32, at §1:115 (arguing that "the ordinary expectation is that title to the copy does not pass" and is routinely so enforced).

⁸⁴ See *MAI*, 991 F.2d at 518 n.5 (holding a licensee of a computer program no an "owner"); cf. *DSC Communications Corp. v. Pulse Communications, Inc.*, 170 F.3d 1354, 1360 (Fed. Cir. 1999) (holding that a licensee with severely limited contractual rights that are inconsistent with the rights normally enjoyed by owners of software copies is not an "owner"); see also *Nadan*, *supra* note 9, at 332.

⁸⁵ See *Applied Information Management, Inc. v. Icart*, 976 F.Supp. 149, 150-51 (E.D.N.Y. 1997) ("[T]he developer may transfer copyright rights in the software program (intellectual property rights) and at the same time transfer rights in the copy of the program through the material object that embodies the copyrighted work (personal property rights). [T]he technological developments that are the subject of such licensing agreements are relatively recent [and] courts that have considered the question have not directly addressed the distinction between the two different forms of property rights involved.").

part refuting these theories on how to construe distribution agreements involving sales or licenses, this paper will attempt to analyze how the debate may be settled in the future.

2.3.4.1 Restrictive Terms Test

After *MAI*, the Federal Circuit in *DSC Communications Corp. v. Pulse Communications, Inc.* took a stance in the sale versus license debate.⁸⁶ The court disagreed with *MAI*'s view that the mere existence of a licensing agreement implied a lack of ownership by basing its ruling on sounder reasoning.⁸⁷

DSC Communications Corporation ("DSC"), the owner of copyrighted software, entered into a series of comprehensive agreements with Regional Bell Operating Companies ("RBOCs") for providing the use of its technology. The agreements all contain provisions that licensed DSC's software to RBOCs under a variety of restrictions. Pulse Communications, Inc. ("Pulsecom") competed for the business of RBOCs. Pulsecom developed interface cards enabling access to DSC's systems used by RBOCs, which required copying DSC's software into the resident memory of Pulsecom's interface card every time it accessed DSC's systems.⁸⁸ DSC claimed that Pulsecom violated its exclusive right of reproduction.⁸⁹ In its defense, Pulsecom argued that it was entitled to the section 117 essential step defense. On the grounds of the district court's judgment,⁹⁰ the Federal Circuit, on appeal, had to consider whether Pulsecom was an owner of the software within the meaning of the Copyright Act.⁹¹

In its reasoning, the Federal Circuit stated that the Copyright Act itself does not provide a definition of the term "ownership". Nor does the legislative history of section 117⁹² or pertinent

⁸⁶ *DSC Communications Corp. v. Pulse Communications, Inc.*, 976 F.Supp. 359 (E.D. Va. 1997), *rev'd in part*, 170 F.3d 1354 (Fed. Cir. 1999), *cert. denied*, 528 U.S. 923 (1999) [hereinafter DSC].

⁸⁷ *See* DSC, 170 F.3d at 1360.

⁸⁸ *See* 170 F.3d at 1358.

⁸⁹ DSC filed an action in the United States District Court for the Eastern District of Virginia alleging that Pulsecom had violated various federal and state law, including (1) contributory infringement of DSC's copyright in certain software used with one of DSC's products; (2) direct infringement of DSC's copyright in that software; (3) misappropriation of DSC's trade secrets; and (4) tortious interference with DSC's business expectancy. *See id.* at 1357.

⁹⁰ The parties went to trial on DSC's claims, and at the close of DSC's case-in-chief, Pulsecom moved for judgment as a matter of law. The district court granted the motion and dismissed all four of DSC's claims. *See id.*

⁹¹ *See id.* at 1359-62.

⁹² *See id.* at 1360 (concluding that "Congress must have meant to require more than 'rightful possession' to trigger the section 117 defense"); *but see* H.R. REP. NO. 96-1307(I), at 23 (1980), *reprinted in* 1980 U.S.C.C.A.N. 6460 at 6482 (stating that the legislative history does not explain the reason for the

case law provide constructive guidance on key premises for defining "ownership". As the literal approach provided no further guidance on the matter, the Federal Circuit, in a second step, drew on the core of the concept of ownership, resulting in the development of the "restrictive terms test".

The district court identified the exchange of a single payment and the transfer of a right to possession of the software for an unlimited term as key criteria for the transfer of ownership of a copy of software.⁹³ Yet, the Federal Circuit did not affirm the district court's ruling.⁹⁴ The court found the concept of ownership of a copy to comprise various rights and interests, among which single payment and perpetual possession certainly weigh towards ownership status. But these criteria should not necessarily be absolutely determinative.⁹⁵ Rather, the court reviewed the contractual wording of the individual agreements between DSC and RBOCs regarding other restrictions that were inconsistent with the idea that the licensee "owned" the copy of the software:⁹⁶

All rights, title and interest in the [DSC] Software are and shall remain with [DSC as the] seller, subject, however, to a license to [the RBOC as the] Buyer to use the [DSC] Software solely in conjunction with the Material [i.e., all equipment manufactured by DSC] during the useful life of the Material.⁹⁷

In its interpretation of the language and the context of the agreement, the Federal Circuit concluded that "the clauses refer to DSC's rights to the copies of the software in RBOCs' possession, not DSC's copyright interest in the software."⁹⁸ The Federal Circuit seemed to assume that according to the software industry's business model, software owners ordinarily do not convey ownership interests in their copyrights on (end-)users as part of their licensing agreements. The case is different with regard to the ownership of the copies of the target

change from CONTU's proposed wording of "rightful possessor" to "owner" in the final version of section 117 of the Copyright Act).

⁹³ *See id.* at 1360 (concluding that the RBOCs were owners of the copies of DSC's software, based on these terms of the purchase transactions between DSC and the RBOCs).

⁹⁴ *See id.* at 1362 (criticizing the district court's approach as "overly simplistic" and as such not being adopted by other courts).

⁹⁵ *See id.*

⁹⁶ *See also S.O.S., Inc. v. Payday, Inc.*, 886 F.2d 1081, 1087-88 (9th Cir. 1989) ("The literal language of the parties' contract provides that S.O.S. retains 'all rights of ownership.' This language plainly encompasses not only copyright ownership, but also ownership of any copies of the software. Payday has not demonstrated that it acquired any more than the right to possess a copy of the software for the purpose of producing 'product' for its customers.").

⁹⁷ *See DSC*, 170 F.3d at 1361 (citing the agreement between DSC and BellSouth while identifying all other agreements at issue as being similar in effect).

⁹⁸ *See id.*

software, which needs to be addressed in the contracts. Nonetheless, there is a nexus between the ownership in the copyright and the program copies under the restrictive terms test. If the restrictions on the (end-)user's rights with respect to the copyrighted software were so material as to go beyond those normally imposed on a program user who owned copies of software subject only to the rights of the copyright owner under the Copyright Act, that user is likely not to qualify as owner of the copies of the software.⁹⁹ The court again referred to the wording of an agreement entered into by DSC and RBOC:

[The RBOC shall] not provide, disclose or make the [DSC] Software or any portions or aspects thereof available to any person except its employees on a 'need to know' basis without the prior written consent of [DSC] [...].¹⁰⁰

The license limited the licensee's right to transfer copies, to disclose the details of the software to third parties, and also limited the location where the software could be used. The nature of these rights given and of those withheld by the license obviously affected the first sale privileges under sections 109(a) and 117 of the Copyright Act, according to which the copy owner under certain circumstances could dispose of the copy freely.¹⁰¹ If the RBOC were the owner of the software copies, the wording would have clearly contradicted these exemptions granted to the copy owner which would have allowed the RBOC to transfer the owned copies of the software to third parties, like Pulsecom, and to use the DSC software on any hardware, irrespective of origin.¹⁰² In weighing the restrictiveness of the licensing terms, the *DSC* court, to a significant extent, referred to statutory copyright law as an objective measure. Furthermore, the Federal Circuit found *in dictum* that the label of the agreement shall not have any impact on the ownership status.¹⁰³

⁹⁹ *See id.* (deeming the RBOCs to be non-owners with respect to the DSC's copyrights in the software because the licensing agreements severely limited the rights of the RBOCs in DSC's software beyond that normally enjoyed by owners of copies of software).

Retrospectively, the Federal Circuit applied this rationale to the *MAI* case: "[B]ecause the agreement between MAI and Peak, like the agreements at issue in this case, imposed more severe restrictions on Peak's rights with respect to the software than would be imposed on a party who owned copies of software subject only to the rights of the copyright holder under the Copyright Act [...] it was proper to hold that Peak was not an 'owner' of copies of the copyrighted software for purposes of section 117." *See id.* at 1360 (citation omitted).

¹⁰⁰ *See id.* (citing the agreement between DSC and Ameritech).

¹⁰¹ *See* 1 RAYMOND T. NIMMER, *supra* note 12, at §2:48.

¹⁰² *See* DSC, 170 F.3d at 1361-62.

¹⁰³ It shall be immaterial what the contract, which comes along with the copy, is called. *See id.* at 1362 (stating that "[i]t is true that the transfer of rights to the [DSC] software in each of the agreements did not take the form of a lease, and that the transfer in each case was in exchange for a single payment and was for a term that was either unlimited or nearly so"); *see also* 1 NIMMER ON COPYRIGHT, *supra* note 25, § 8.08[B][1] ("[E]ven if the copyright owner conveys 'all right, title and interest' in the subject work [...] it

Ultimately, the *DSC* court arrived at the conclusion that Pulsecom was a licensee without ownership of the copy of DSC's software.¹⁰⁴ This ruling is consistent with the Uniform Computer Information Transaction Act (UCITA), which provides that in a license "title to a copy is determined by the license."¹⁰⁵

The crux of the restrictive terms test under the *DSC* reasoning is that the more objectively restrictive the terms of a licensing agreement are, the less likely the transferee of a copy of software will be deemed the owner of that copy.¹⁰⁶

Based on the holdings in *MAI* and *DSC*, the United States District Court for the Northern District of California, in *Adobe Systems, Inc. v. One Stop Micro, Inc.*,¹⁰⁷ again invoked the restrictive terms standard.¹⁰⁸ Adobe Systems, Inc. ("Adobe") entered into a distribution agreement with an intermediate Adobe-authorized educational distributor, the so-called "On Campus Reseller Agreement" ("OCRA"), for making Adobe's software available to certain educational end-users in compliance with certain conditions as laid down in the OCRA.¹⁰⁹ One restriction set forth in the terms of the OCRA reads as follows:

Reseller shall have the right to purchase [Adobe] Educational Software Products from Adobe [...] and to distribute the [Adobe] Educational

can still argue that it only intended to grant a license in the copyright, whereas parting absolutely only with physical ownership.").

¹⁰⁴ See *id.* at 1362 (reversing the district court's ruling).

¹⁰⁵ UCITA §502(a) reads in full text:

"In a license:

(1) title to a copy is determined by the license;

(2) a licensee's right under the license to possession or control of a copy is governed by the license and does not depend solely on title to the copy; and

(3) if a licensor reserves title to a copy, the licensor retains title to that copy and any copies made of it, unless the license grants the licensee a right to make and sell copies to others, in which case the reservation of title applies only to copies delivered to the licensee by the licensor."

¹⁰⁶ See RAYMOND T. NIMMER, *supra* note 30, at 273.

¹⁰⁷ 84 F.Supp. 2d 1086 (N.D.Cal. 2000) [hereinafter *One Stop*].

¹⁰⁸ *One Stop* was the first case in the "Adobe Trilogy." The Adobe Trilogy refers to three district court actions brought by Adobe against intermediate resellers of its software in which district courts were tasked with determining whether Adobe's distribution agreements with the resellers constituted a license or sale:

- *Adobe Systems Inc. v. One Stop Micro, Inc.*, 84 F.Supp. 2d 1086 (N.D. Cal. 2000);
- *SoftMan Products Company v. Adobe Systems, Inc.*, 171 F.Supp. 2d 1075 (C.D. Cal. 2001);
- *Adobe Systems, Inc. v. Stargate Software Inc.*, 216 F.Supp. 2d 1051 (N.D. Cal. 2002).

The first and the last of these Adobe cases confirmed that typical restrictions in a software distribution are sufficient to make the transaction a license. Sandwiched between these two cases, however, the *Softman* court broke new ground.

¹⁰⁹ See *One Stop*, 84 F.Supp. 2d at 1088.

Software Products so long as [...] Reseller distributes pursuant to the terms and conditions of the then current applicable Software Product End-User License Agreement ("End User Agreement").¹¹⁰

One Stop Micro, Inc. ("One Stop"), a distributor of computer software on the open market, purchased educational versions of Adobe's software from the Adobe-authorized distributor, then adulterated them and sold them as full retail versions to non-educational end-users.¹¹¹ Adobe filed suit against One Stop alleging, *inter alia*, infringement of Adobe's copyrights in its educational software. One Stop moved for summary judgment of the copyright infringement claim asserting that the first sale doctrine would apply because (i) the OCRA would constitute in fact a sales agreement rather than a licensing agreement, and (ii) as a result of the purchase of the software, One Stop's distribution of those program copies would be protected by the first sale doctrine. Thus, the district court had to examine the question of whether the OCRA constituted a sale or license.¹¹²

Key to the court's reasoning was the mutual intention of the parties inferred from the clear and explicit language of the agreements in question. The qualification of these agreements as either sale or licensing agreements was ambiguous. On the one hand, sales terminology such as "purchase" and "own" was used in the OCRA,¹¹³ and thereby indicating the intention of a sales agreement. On the other hand, under the End User Agreement ("EULA") imposed on the end-user through the intermediate distributor, the end-user was only granted a license to use the software. Given this ambiguity, the court admitted extrinsic evidence to clarify the intention underlying the wording of the OCRA. Declarants, including an Adobe representative and Adobe-authorized resellers, testified to their understanding of the OCRA as licensing agreement. The court also looked to trade usage, noting that even though the agreement used words like "sale" and "buy", the dominant practice in the software industry was to license software. Additionally, the court considered the unique nature of distributing computer software.¹¹⁴ The court further

¹¹⁰ See *id.* at 1090 n.2 (citing subpart (a) of ¶3 of the OCRA which stipulates the reseller's rights).

¹¹¹ See *id.* at 1088.

¹¹² See *id.* at 1089-90.

¹¹³ For example, One Stop submitted ¶11(c)(iv)(A) of the OCRA as example in support of its argument:

"Reseller shall submit to Adobe within ten (10) days after the effective date of termination a summary of the number of the respective Educational Software Products *owned* by Reseller as of the effective date of the termination. Adobe may, at its option, *repurchase* any or all of such Educational Software Products from Reseller [...]." See *id.* at 1090 (emphasis added).

¹¹⁴ See *id.* at 1091-92 (relying on the expert witness testimonies of Raymond T. Nimmer and Amy Grant testifying that licensing is the preferred distribution channel for computer software products).

found that it would make the distribution chain incongruous if the intermediate distributors were owners of Adobe's software while the end-users were granted a mere license to use the same software.¹¹⁵

The court concluded that the intentionally restrictive language used by Adobe in the context of Adobe's distribution practice of software suggests "a license rather than a sale because they undeniably interfere with the reseller's ability to further distribute the software".¹¹⁶ Applying the restrictive terms test ultimately made the court hold that the OCRA did not represent a first sale, and hence, the first sale defense could be raised by One Stop.¹¹⁷

Unlike the *DSC* court, however, the court in *One Stop* did not qualify the restrictiveness of the contractual language as to the extent of its deviance from statutory copyright law, but instead interpreted the restrictive wording in relation to the parties' intentions in entering into the agreement, trade usage, and the unique nature of software distribution.

In conclusion, the restrictive terms test generally suggests that the wording of the contract¹¹⁸ and the underlying intent of the parties¹¹⁹ shall control the interpretation of whether a distribution agreement constitutes a sale or license. It might be the case that the terms of a given distribution agreement directly stipulate that ownership in the particular copy and the copyright shall remain in the copyright owner. In this case, transfer of title to the copy would be explicitly precluded.¹²⁰

¹¹⁵ See *id.* at 1091, 1093 (holding that by obtaining Adobe's software from an intermediate Adobe-authorized distributor that is a party to the Adobe licensing agreement (OCRA) One Stop as later transferee was bound by the restrictive upstream terms of that agreement likewise).

¹¹⁶ *Id.* at 1091.

¹¹⁷ The district court held One Stop liable for copyright infringement as a matter of law under section 501(a) of the Copyright Act because One Stop distributed educational versions of Adobe software to non-educational end-users beyond the scope of Adobe's license and in violation of its right to distribute under section 106(3) of the Copyright Act. See *id.* at 1093.

¹¹⁸ Cf. also UCITA §502 (spelling out that the agreement controls on whether or not title passes).

¹¹⁹ See *RAYMOND T. NIMMER, supra* note 32, at §1:115 n.4 (finding that an intent to transfer ownership of a copy may be decisive to some extent when, for example, the "transaction in which the parties actually contemplated a transfer of copyright ownership but failed to achieve that result because of non-compliance with copyright law formalities"); see also *Logicom Inclusive, Inc. v. W.P. Stewart & Co.*, Not Reported in ---F.Supp.2d---, 2004 WL 1781009 (S.D.N.Y. 2004) (finding that "[w]hether the defendants at bar rightfully own a copy of [plaintiffs'] software presents a question of substance [...]. It is at least conceivable that parties intended a business relationship where once defendants were no longer in need of plaintiffs' services, plaintiffs were to take with them any and all copies of proprietary software, even those currently existing on [defendants'] computers. In such a scenario, defendants do not have ownership rights even to a copy of the computer program.").

¹²⁰ See *S.O.S., Inc. v. Payday, Inc.*, 886 F.2d 1081, 1088 (9th Cir. 1989) (interpreting the literal language of the distribution agreement, according to which plaintiff retains "all rights of ownership" (emphasis added), as encompassing not only copyright ownership, but also ownership of any copies of the

If this is not the case, courts applying the restrictive terms standard will look at the terms of the distribution agreement in order to assess whether the transferee's rights to use the software distributed are restricted to an extent sufficient to deny an unconditioned sale, thereby transferring ownership of that copy of the target software.¹²¹

2.3.4.2 Economic Realities Test

One year after *One Stop*, the United States District Court for the Central District of California, in *SoftMan Products Co. v. Adobe Systems, Inc.*,¹²² applied an alternative test for determining whether an agreement qualifies either as sale or license by looking at the "economic realities" of the given software transaction. In the sale versus license debate, the *SoftMan* court's holding, based on the so-called "economic realities test," was a blatantly contrary approach to the restrictive terms reasoning. Despite the facts that were similar to *One Stop*, the United States District Court for the Central District of California reached an opposite conclusion.¹²³ In contrast to the restrictive terms reasoning, which originated in copyright law, the economic realities test originated in bankruptcy law in *In re DAK Industries, Inc.*,¹²⁴ a case decided by the Ninth Circuit in 1995.

DAK Industries, Inc. ("DAK"), a bankrupt hardware vendor, owed money to Microsoft Corporation ("Microsoft") for software it had procured and distributed under an agreement entered into by DAK and Microsoft. DAK continued to distribute the software after it had filed for bankruptcy, which in turn prompted Microsoft to petition for administrative expenses as a result of these sales. Under bankruptcy law, the issue of whether or not DAK owed a debt to Microsoft for the software turned on whether the sales agreement could be categorized as a sale or license. To determine this key question, the Ninth Circuit looked at the economic realities of the particular arrangement.

Although the agreement at issue labels itself a "License Agreement" and calls payments "royalties",¹²⁵ which would arguably imply periodic payment for the use rather than a sale of

software, while defendant did not demonstrate that it acquired any more than the right to possess a copy of the particular software).

¹²¹ See, e.g., 1 RAYMOND T. NIMMER, *supra* note 32, at §1:115.

¹²² 171 F.Supp. 2d 1075 (C.D.Cal. 2001) [hereinafter *SoftMan*].

¹²³ See *Softman*, 171 F.Supp. 2d 1075 at 1086-87.

¹²⁴ 66 F.3d 1091 (9th Cir. 1995) [hereinafter *DAK*].

¹²⁵ See 66 F.3d at 1092 (finding that the express language of the agreement granted DAK certain nonexclusive, worldwide "license rights" to Microsoft's Word software ("Word") and obliged DAK to pay a "royalty rate" per distributed copy of Word).

Microsoft's software,¹²⁶ the court looked at the economic realities of the agreement. In its analysis, the Ninth Circuit found that (i) even though some of the installments were due after signing, DAK was absolutely obliged to pay the full amount at the signing of the agreement, regardless of how many, if any, copies of Microsoft's software DAK as reseller had already sold at this time, (ii) the pricing structure of the agreement was calculated based upon the quantity of software units DAK obtained from Microsoft rather than upon the duration of the use of Microsoft's property, (iii) upon signing DAK received all of the rights under the agreement (i.e., DAK could sell all of the software units at the outset of the contract term, even though the installments were due later into the term), and (iv) the agreement granted DAK a right to sell the software, not the permission to use an intellectual property. All these facts were persuasive enough for the court to hold that the agreement constituted a lump sum sale of Microsoft's software units to DAK, not a license to use Microsoft's intellectual property.¹²⁷

In *SoftMan*,¹²⁸ a copyright case, rather than a bankruptcy case, dealt with the economic realities test. A reseller of software products, SoftMan Products Co. ("SoftMan"), purchased Adobe software from an intermediate Adobe-authorized reseller¹²⁹ and subsequently distributed Adobe software by unbundling sets of individual Adobe programs ("Adobe Collections") with each program imprinted on a single CD and sold at a higher price to third parties.¹³⁰ Each piece of Adobe software was accompanied by an End User Licensing agreement ("EULA"), which set forth the terms of the license between Adobe and the end-user for that specific Adobe product. In particular, unbundling Adobe Collections were prohibited by the terms of the EULA.¹³¹ Adobe brought an action against SoftMan, alleging that the redistribution was infringement of Adobe's

¹²⁶ *See id.* at 1095 n.2.

¹²⁷ *See id.* at 1095-96.

¹²⁸ 171 F.Supp. 2d 1075 (C.D. Cal. 2001) [hereinafter *SoftMan*].

¹²⁹ *See id.* at 1082 (stressing that SoftMan has not entered a licensing agreement with Adobe).

¹³⁰ The price margin results from the fact that the Adobe Collections are offered by Adobe at a discount from the individual retail software copies comprising the Adobe Collection. For example, the "Adobe Publishing Collection" comprises of "Adobe Page-Maker," "Acrobat," "Photoshop," and "Illustrator," available for USD 999. Separately, these products retail as follows: Page-Maker for USD 499, Acrobat for USD 249, Photoshop for USD 609 and Illustrator for USD 399. *See id.* at 1080.

¹³¹ The EULA at issue provides that the end-user may "transfer all [his] rights to the Use of the Software to another person or legal entity provided that (a) [he] also transfer this Agreement, the Software and all other software or hardware bundled or preinstalled with the Software." In other words, any third party licensees are barred from transferring any individual Adobe software product that was originally distributed as part of an Adobe Collection unless it is transferred with all the software in the original Collection. *See id.* at 1082, 1083.

copyright in these software copies because it violated the terms of the upstream licenses used by Adobe. The question of whether the first sale privilege applies to bar Adobe's claim caused the district court to analyze the economic realities of the exchange¹³² and the effect of upstream terms to non-parties of agreements.

Under the economic realities standard, ownership of a copy shall be determined based on the substance of the particular transaction, irrespective of the form of the licensing agreement.¹³³ In principle, the district court reiterated the criteria adopted in the economic realities test by the *DAK* court to determine the sales character of a transaction, those being:

temporally unlimited possession, absence of time limits on copy possession, pricing and payment schemes that are unitary not serial, licenses under which subsequent transfer is neither prohibited nor conditioned on obtaining the licensor's prior approval [...], and licenses under which the use restrictions principal purpose is to protect intangible copyrightable subject matter, and not to preserve property interests in individual program copies.¹³⁴

In reviewing the above indications, the court concluded that the particular circumstances surrounding the given transaction strongly suggest in reality a sale rather than a license. Adobe's transferee obtained a single copy of the software, including documentation, for a single price, which the transferee paid at the time of the transaction in consideration for the right to perpetual possession of that software copy.¹³⁵ The agreement covered an indefinite period of time without need for renewal. The court, however, never addressed the transfer restrictions in Adobe's agreements that made the given transaction appear unlike a typical sale.¹³⁶ Exactly those kinds of restrictions were found to render transferees non-owners of software copies by earlier courts applying the restrictive terms standard.¹³⁷

Furthermore, the court found that the reality of Adobe's ordinary business environment also tended towards a sale of Adobe's software to its authorized distributors. The distributors and the secondary market and end-users pay full value for Adobe software and accept the risk that the

¹³² *See id.* at 1084 (citing the *DAK* court).

¹³³ *See id.* at 1086 (stating that mere labeling of an agreement as "lease" or "license" does not, by itself, determine the character of the transaction underlying that agreement).

¹³⁴ *See id.* at 1086.

¹³⁵ *See id.* at 1085.

¹³⁶ *See id.* at 1083-87. As a side note the court mentioned that the Adobe agreements prohibited the individual redistribution of software that was originally distributed as part of a bundle. *See id.* at 1082. It may thus be possible that the court implicitly found this relatively mild restriction not significant enough to indicate that the transferee had obtained less than an ownership interest. *See* Nadan, *supra* note 9, at 402 n.203.

¹³⁷ *See, e.g.,* One Stop, 84 F.Supp. 2d at 1090-91.

software may be damaged or lost, including the risk that they will be unable to resell the product.¹³⁸ Ultimately, the court held that the transfer of risk of loss generally suggests a transfer of title in the good (i.e., a sale).¹³⁹ This conclusion is flawed with respect to licensing the use of conventional items. For example, a library retains title to the book it loans out, but the library patron bears the risk of loss or damage to the book taken out. Therefore, the transfer of a product together with transfer of the risk of loss may not be a helpful indicator of whether a transaction is a sale or license.¹⁴⁰

The terms of the EULA underlying the relationship between Adobe and any third party expressly result in a license. According to Adobe's line of argument, each transaction throughout the entire stream of commerce, from Adobe-authorized distributors through the end-users, is characterized as a license. The court found that the EULA would require assent to be valid vis-à-vis SoftMan. In the case of Adobe's software, users are asked to agree to its terms as part of the installation process. As a consequence of the fact that SoftMan never loaded Adobe's software and therefore never agreed to the EULA, SoftMan was held not to be subject to the EULA.¹⁴¹ In its holding, the *SoftMan* court also rejected that part of the analysis adopted in *One Stop*¹⁴² where One Stop was found to be a party to the OCRA without being a signatory to that licensing agreement because One Stop obtained Adobe's software from an Adobe-authorized distributor that was party to the OCRA.

¹³⁸ See 171 F.Supp. 2d at 1085. The transfer of risk for reselling the "purchased" software has already been identified as a crucial factor for indicating a sale rather than a license by the *DAK* court.

¹³⁹ See 171 F.Supp. 2d at 1085. See also *Novell, Inc. v. Unicom Sales, Inc.*, 2004 WL 1839117 (N.D. Cal. 2004), where the court held that the software copies at issue had not been the subject of a first sale, although the licensing agreement granted the right to use the software for an unlimited period, use was limited to the user's organization, and the agreement expressly stated that all rights not expressly granted were reserved to the copyright owner. The court distinguished *SoftMan* on the ground that, unlike *SoftMan*, the agreement at issue provided that the licensing agreement would automatically terminate on breach, requiring the user to destroy the software copy or return it to the copyright owner. See *id.* at n.10.

¹⁴⁰ See *Nadan*, *supra* note 9, at 402-4.

¹⁴¹ See 171 F.Supp. 2d at 1087-88 (holding further that the notice placed outside on the Adobe Collections boxes stating "NOTICE TO USERS: This product is offered subject to the licensing agreement included with the media." is not equivalent to the degree of assent that occurs when Adobe's software is loaded onto the computer and the user is asked to agree to the terms of the license).

¹⁴² See *id.* at 1087-8 (declining to follow the analysis adopted in *Microsoft Corp. v. Harmony Computers & Electronics, Inc.*, 846 F.Supp. 208, 213 (E.D.N.Y. 1994), where the court found that "to the extent that defendants bought their Microsoft Products from authorized Microsoft licensees, they were subject to the same licensing restrictions under which those licensees operated" (citation omitted)).

In the end, the court concluded that the given circumstances would strongly suggest that the transaction constitutes a sale rather than a license, and thereby set a precedent in the U.S. District Court in California's Central District.¹⁴³

2.3.4.3 Functionality Theory

Beyond the particular language of distribution agreements, courts refer to the rationale underlying the distribution right pursuant to section 106(3) of the Copyright Act, which is to ensure that the copyright owner receives the full economic value of each copy upon its first disposition.¹⁴⁴ On the basis of the full compensation rationale, the doctrine of first sale assumes that a copyright owner, by selling a copy of this software, obtains whatever return the market and its interest dictate for that particular sold copy.¹⁴⁵ Thus, in consideration for full economic value of the software copy, the copyright owner transfers unconditioned and unlimited ownership of that copy to the transferee,¹⁴⁶ and thereby sacrifices its right to control the further disposition of that copy. The assumption does not work in transactions involving a limited sale, such as a license, because the copyright owner does not seek or obtain a return as defined by an outright sale, and the licensee-transferee seeks and obtains the rights given pursuant to the license terms.¹⁴⁷ A licensee who is significantly restricted on its right to use the copy will unlikely pay the full value for the software.¹⁴⁸ Courts adopting the full compensation theory most likely will deny licensing fees in consideration for using a copy of the copyright owner's software to be just rewards in the meaning of the full compensation conception.¹⁴⁹

However, in addition to licensing patterns, there are other circumstances where the transfer of title does not correspond with the economic value of a particular copy received by the copyright

¹⁴³ See 171 F.Supp. 2d at 1085.

¹⁴⁴ See II GOLDSTEIN ON COPYRIGHT, *supra* note 20, §7.6.1.1.b.

¹⁴⁵ See 1 RAYMOND T. NIMMER, *supra* note 32, §1:112.

¹⁴⁶ Cf. LEMLEY, MENELL, MERGES & SAMUELSON, *supra* note 14, at 312 (arguing that a product licensed to a user with a "no resale" restriction would be expected to sell at a lower price than one sold without such a restriction and thus could not completely be justified by the assumption adopted by section 109(a)).

¹⁴⁷ See 1 RAYMOND T. NIMMER, *supra* note 32, §7:68.

¹⁴⁸ See *id.* at §1:112 (not applying the just rewards concept underlying the first sale doctrine to license fact patterns).

¹⁴⁹ Cf. *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339, 343 (1908) ("a sale of a book at wholesale by the owners of the copyright, at a satisfactory price"); cf. also *SoftMan Products Co. v. Adobe Systems, Inc.*, 171 F.Supp. 2d 1075, 1085 (2001) (holding that the transfer of a product, *inter alia*, in consideration for payment of the full value of the merchandise constitutes a sale).

owner on the market.¹⁵⁰ A software copy may be a gift to someone else with the effect of transfer of title of that copy to the donee.¹⁵¹ By analogy inferred from patent law, one court concluded that the "first sale", which terminates the exclusive right to distribute a copy of a copyrighted work, may not necessarily be a truly voluntary one, but can consist of some reasonable and recognized form of compulsory transfer, such as judicial sale or court-compelled assignment.¹⁵² The court reasoned that the copyright owner received his reward for the use of the copy since his creditor gave him some value for which the copyrighted work has then been demanded.¹⁵³ In other words, courts tend to focus on the economic exchange between the parties rather than on a legal analysis in determining the transfer of ownership of a copy. Only recently, the United States District Court for the Northern District in *Stargate* appears to adopt a functional approach in the sale versus license debate by stating that the "[p]arties should be free to negotiate and/or set a price for the product being exchanged."¹⁵⁴ Also, statutory law does not require an exchange in consideration of full value.¹⁵⁵

In reconsidering the rationale of full compensation underlying the first sale doctrine, courts seem to take the "full" out of the compensation. In so doing, one may doubt whether the rationale can justify exempting software licensing from the privileges and immunities under the first sale doctrine.

¹⁵⁰ See II GOLDSTEIN ON COPYRIGHT, *supra* note 20, §7.6.1(b) (arguing that the principle of the full market value return should not be the mandatory element in determining whether a sale has occurred).

¹⁵¹ See II PATRY, *supra* note 24, 843 n.38 (declining to extend a "straightforward legal inquiry" for "subjective, pseudo-economic theories"); see also 2 NIMMER ON COPYRIGHT, *supra* note 25, § 8.12[B][1][a] (pointing out that "the initial disposition of that copy may be a sale, [but] the identical legal conclusion [shall] appl[y] to a gift or any other transfer of title in the copy").

¹⁵² In *Platt & Munk Co. v. Republic Graphics, Inc.*, a manufacturer of copyrighted goods was not paid by the copyright owner, because the copyright owner alleged the manufactured goods to be defective. The Second Circuit had to deal with the question of whether the manufacturer may sell the goods in satisfaction of his claim for the contract price without infringing the copyright owner's exclusive distribution right. See *Platt & Munk Co. v. Republic Graphics, Inc.*, 315 F.2d 847, 854 (2d Cir. 1963).

¹⁵³ See *id.* at 854. The court ruled that, on remand, the trial court should consider whether the defendant had made a valid tender of goods to the plaintiff and was consequently entitled to payment for them.

¹⁵⁴ See *Adobe Systems, Inc. v. Stargate Software Inc.*, 216 F.Supp. 2d 1051, 1054-55, 1059 (N.D.Cal. 2002) [hereinafter *Stargate*].

¹⁵⁵ See 1 RAYMOND T. NIMMER, *supra* note 32, at §1:114 and §7:68 (arguing that copyright law does not require a sale to justify certain use exemptions for the owner of a particular copy).

2.3.4.4 Business Model of Software Licensing

Licensing software copies is the prevailing trade practice in the software industry, so courts tend to interpret distribution agreements as licenses rather than sales.¹⁵⁶ If the distribution agreement in question does not allow for an unambiguous interpretation of its terms, pro-license oriented courts have relied on the software industry practice to construe the agreement at issue as a license rather than as a sale agreement.¹⁵⁷

With respect to traditional media, such as novels, the first sale doctrine means that one who buys a copy of a novel is entitled to resell it, rent it out, give it away, rebind it, or destroy it provided that the novel has been bought or otherwise transferred lawfully. Conversely, the book publisher by first sale sacrifices its further distribution right as to that particular novel. Yet, the situation with computer software is different.

The software industry's business model conceals the inherent thread of software licensing. As the case may be, licensing may enable competition. Because licensing of a software copy usually entails restrictions on use of that software, the full return of the market value would hardly be justified. The copyright owner-licensor will have to make sure that the license covers a broad scope of user activities. Reverse engineers, in particular, are likely to spend less time and money to understand the original target software program than the initial software programmer spent in developing its program.¹⁵⁸ Otherwise, a reverse engineering licensee may enjoy a competitive advantage in terms of cost structure, sales, or distribution. Furthermore, if the reverse engineering practice itself falls within the fair use exception of section 107—an issue on which case law has not yet unanimously sided—the copies made in the process of reverse engineering may be regarded as "lawfully made" in the meaning of section 109. The reverse engineer-licensee would be the owner of the lawfully made copy of the licensor's software program. As such, section 109 would subsequently permit the licensee to sell or otherwise dispose of the possession of that copy. As an indirect consequence, the licensee could market new software that it developed on

¹⁵⁶ See *id.* at §1:112 (stating that many courts have held that a distribution qualifies as license, even in the absence of clear documentation on the nature of the relevant transaction turned on the industry practice argument).

¹⁵⁷ See, e.g., *Wall Data*, 447 F.3d at 785 n.9 (commenting that "virtually all end users do not buy—but rather receive a license for—software [...] and [that] the industry is aware that all software [...] is distributed under license"); see also *One Stop*, 84 F.Supp. 2d at 1092 (N.D. Cal. 2000) (holding "the intent of 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" to indicate that the distribution contract is a license).

¹⁵⁸ See Pamela Samuelson & Suzanne Scotchmer, *The Law and Economics of Reverse Engineering*, 111 Yale L.J. 1575, 1587 (2002).

the basis of its lawful reverse engineering analysis. Thus, in a worst case scenario, enabling a competitor may actually backfire and result in decreasing sales for the copyright owner-licensor. Whether express license terms could prohibit reverse engineering by the licensee on an enforceable ground vis-à-vis statutory copyright law is discussed later.¹⁵⁹

2.3.4.5 A Prospective View

The Ninth Circuit recently had the opportunity to provide some clarification on the interpreting standards in the sale versus license debate in *Wall Data Inc. v. Los Angeles County Sheriff's Department*.¹⁶⁰

Wall Data, Inc. ("Wall Data"), a computer software developer, held the copyright in its RUMBA software. The Los Angeles County Sheriff's Department and the county of Los Angeles (collectively, "Sheriff's Department"), purchased 3,663 licenses to the RUMBA software from an authorized vendor. However, by using an image-based installation, the Sheriff's Department installed the RUMBA software on 6,007 computers¹⁶¹ and configured those computers by virtue of a password-based security system in a way that the total number of workstations able to access the installed RUMBA software did not exceed the total number of licenses the Sheriff's Department purchased.¹⁶² In that way, the total number of users who could access the RUMBA software was limited at one time to 3,663 purchased licenses. Wall Data brought a copyright infringement action against the Sheriffs' Department purporting that the Sheriff's Department's "over-installation" constituted a violation of the terms of its licenses.¹⁶³ The Sheriff's Department claimed, *inter alia*,¹⁶⁴ the affirmative defense under section 117(a)(1) of the Copyright Act on the

¹⁵⁹ See CHRISTOPHER M. ARENA & EDUARDO M. CARRERAS, *THE BUSINESS OF INTELLECTUAL PROPERTY* 288 (2008).

¹⁶⁰ 447 F.3d 769 (9th Cir. 2006) [hereinafter *Wall Data*].

¹⁶¹ See *id.* at 774 (describing the technical process of installation, the "hard drive imaging," as follows: The imaging process involved installing the RUMBA software only onto a central server connected to all workstations, which would then copy this "image" or collection of software programs onto every computer. This resulted in every workstation in the facility having an identical installation of the RUMBA software.).

¹⁶² Because the RUMBA software would only function on a workstation when the workstation had access to the main server, Wall Data's IT administrators planned to assign a unique identification number called a logical unit ("LU") to each workstation accessing the central server. The RUMBA Software installed on computers without an assigned LU became "ghost copies" and was unusable. Thus, by controlling which workstations were assigned an LU, the Sheriff's Department could control how many computers accessed the software. See *id.* at 775.

¹⁶³ See *id.* at 775 (arguing that the Sheriff's Department was licensed, at most, to install RUMBA software onto only 3,663 computers).

¹⁶⁴ The Sheriff's Department also claimed the affirmative defense of fair use under section 107 of the Copyright Act since the number of "useable" installations at any given time did not exceed the number of

ground that the copying as part of the hard disk imaging was an "essential step" because the hard disk imaging was a necessary step of installation.¹⁶⁵ The Ninth Circuit ruled that the Sheriff's Department could not claim a section 117 essential step defense because (i) it was not an "owner" of the RUMBA software and (ii) that the copying was a "matter of convenience" rather than an "essential step."¹⁶⁶ The Ninth Circuit did not engage with the first sale doctrine as such.¹⁶⁷ Instead the court denied the "owner" requirement in its analysis of the essential step defense.

The *Wall Data* court referred to the decision adopted in *MAI* as being criticized in the sale versus license debate.¹⁶⁸ Without expressly referring to the restrictive terms test, it seems that the court applied the restrictive terms test by basically relying on the *MAI* and *DSC* line of cases.¹⁶⁹ Wall Data's click-through license¹⁷⁰ included, *inter alia*, the following restrictions on the use of the RUMBA software:

Wall Data [...] grants you ("You"), the end user, a non-exclusive license to use the enclosed software program [...] on a single Designated Computer for which the software has been activated. [...] You may not use the Software in any other multiple computer or multiple user arrangement. You may not use the Software other than on a Designated Computer, except that You may transfer the Software to another Designated Computer and reactivate it for use with such other

software licenses the Sheriff's Department purchased. *See id.* at 776. The court rejected that there was a fair use because (i) the commercial purpose of the infringing use was commercial, non-transformative and did not provide an advancement of the arts, (ii) the RUMBA software was protected by copyright law, (iii) of the verbatim copies of the RUMBA software and (iv) of the effects on the legitimate market for the RUMBA software. *See id.* at 777-82.

¹⁶⁵ *See id.* at 776.

¹⁶⁶ *See id.* at 785-86 (copying the RUMBA software onto the hard drives of nearly all Sheriff's Department's workstations was "an effort to save time and preserve flexibility [...] [rather than] a necessity").

¹⁶⁷ *See id.* at 785 n.9 ("We decline to revisit [the *MAI* holding] in this case, because the Sheriff's Department's "essential step" defense fails for a more fundamental reason—that hard drive imaging was not an essential step of installation [...]").

¹⁶⁸ *See, e.g.*, 2 NIMMER ON COPYRIGHT, *supra* note 25, § 8.08[G][1][c] (criticizing the *MAI* court's ruling to imply inadequate logic by not addressing the distinction between intangible and physical ownership, leaving unanswered whether the relevant copies were owned, and hence whether the section 117 exemption should have applied); 1 RAYMOND T. NIMMER, *supra* note 32, §1:115 (criticizing that the *MAI* court simply assumed that a transaction based on a license, by and of itself, does not transfer title to the licensed copy to the transferee).

¹⁶⁹ *See Wall Data*, 447 F.3d at 784-85 ("Generally, if the copyright owner makes it clear that she or he is granting only a license to the copy of software and imposes significant restrictions on the purchaser's ability to redistribute or transfer that copy, the purchaser is considered a licensee, not an owner, of the software.").

¹⁷⁰ A "click-through license" is a form embedded in computer software which requires the person initially installing the software onto a computer to affirmatively click a box or an "accept" button indicating that the user accepts the terms of the license in order to complete the software installation and to use the software after it is installed. *See id.* at 775 n.5.

Designated Computer not more than once every 30 days, provided that the Software is removed from the Designated Computer from which it is transferred.¹⁷¹

The court found that the severe restrictions on the Sheriff's Department's ability to use the software pursuant to the terms of the click-through license which came along with a copy of the RUMBA software would normally not be imposed on a user who owned a copy of the software.¹⁷² The use restrictions inherently entailed the factual limitation on the Sheriff's Department's ability to redistribute and transfer the copy. Moreover, throughout its fair use and essential step analysis, the Ninth Circuit consistently cited precedent which supports the industry's business model of software licensing.¹⁷³ For these reasons, the Sheriff's Department was not an "owner" for the purpose of section 117. As a result, the licensee could neither invoke the protections of section 117, nor the safe harbor of section 109.

In conclusion, the Ninth Circuit indicated its willingness to side with a pro-license approach in the sale versus license debate.¹⁷⁴ However, the reasoning of the *Wall Data* decision is apparently based on pragmatic policy necessity in order to avoid dismantling the industry's software model, rather than on a sound analysis of the current copyright regime.¹⁷⁵

An even more recent Supreme Court decision in a patent case, *Quanta Computer, Inc. v. LG Electronics, Inc.*,¹⁷⁶ may also impact the copyright law doctrine of first sale. From the perspective of copyright law, the *Quanta* decision does not break significant new ground or suggest the need to re-evaluate the copyright first sale concept.¹⁷⁷ However, the decision implies that the Supreme Court, with respect to the patent exhaustion doctrine,¹⁷⁸ applies a kind of a restrictive terms test.

¹⁷¹ See *id.* at 775 n.5.

¹⁷² See *id.* at 785.

¹⁷³ See *id.* at 785 n.9.

¹⁷⁴ See Yeh, *supra* note 72, at 378-79 (concluding that the software industry and its supporters may invoke the *Wall Data* decision as further ground to buttress the continued existence of software licensing).

¹⁷⁵ See *id.* at 379.

¹⁷⁶ 553 U.S. ___ (2008), 128 S. Ct. 2109 (2008) (opinion by Associate Justice Clarence Thomas) [hereinafter *Quanta*].

¹⁷⁷ See Richard H. Stern, *Quanta Computer Inc v LGE Electronics Inc—Comments on the Reaffirmance of the Exhaustion Doctrine in the United States*, E.I.P.R. 2008, 527-35.

¹⁷⁸ Patent law has an "exhaustion" doctrine, which is the equivalent of the first sale doctrine. Like the copyright first sale doctrine, the doctrine of exhaustion in patent law establishes that, as a matter of property rights law, an authorized and unconditional sale of a product by a rightholder relinquishes some of its right with respect to the use of that product.

LG Electronics, Inc. ("LGE") owned patents on methods and systems for processing information. LGE entered into two contracts with Intel. In the licensing agreement, LGE authorized Intel to make and sell microprocessor products using the patented inventions ("Licensing Agreement"). In the separate master agreement, LGE required Intel to give its own customers notice that the sale did not create an implied license to use the product with non-licensed other products ("Master Agreement"). Quanta Computer Inc. ("Quanta"), a computer manufacturer, purchased microprocessors from Intel and manufactured computers using Intel parts in combination with non-Intel parts. LGE sued, asserting that this combination infringed the LGE patents.¹⁷⁹ A primary patent issue was whether the sales by Intel pursuant to its license triggered the exhaustion doctrine. The Supreme Court held that exhaustion occurred.¹⁸⁰

As in the first sale doctrine in copyright law, the lynchpin of the patent exhaustion doctrine lies in there being an authorized, unconditional sale of a product or other transfer of ownership. Thus, the agreements concluded between LGE and Intel were reviewed to see whether they provided for authorized, unconditional sales. The court concluded that (i) the Licensing Agreement was meant to authorize sales of the product, while (ii) the Master Agreement merely required that Intel give notice to its customers relating to the absence of any implied license. The Master Agreement was not found to be a limiting part or condition on Intel's right to make an authorized sale. Therefore, the Supreme Court held that the ultimate sale to Quanta was an authorized sale by the licensee Intel.¹⁸¹

In the context of the current sale versus license debate in copyright law, it is noteworthy that the Supreme Court focused on the wording of the contractual agreements to decide whether a transfer of ownership of the product had taken place, thereby reviewing whether material restrictions in the contracts indicate a transfer of product ownership. To conclude, the reasoning adopted by the Supreme Court in patent case *Quanta* resembles the restrictive terms test applied in copyright cases like *DSC*.¹⁸² The *Quanta* ruling may be regarded as the long-awaited precedent determining what elements are to be analyzed in detail in order to qualify a software transaction as sale or license. Yet, the bottom line is that it remains opaque to what extent, if at all, the

¹⁷⁹ See *Quanta*, 128 S. Ct. 2109 *1-2, 7-13.

¹⁸⁰ See 128 S. Ct. 2109 *2-7.

¹⁸¹ See *id.* at *5-6.

¹⁸² The *DSC* ruling means that a copyright owner can cause any distribution agreement to be a license, as long as he distributes the software copy under restrictions that are inconsistent with a sale of that copy. See also *PracticeWorks, Inc. v. Professional Software Solutions of Illinois, Inc.*, Not Reported in --- F.Supp.2d---, 2004 WL 1429955 (D.Md. 2004) (holding dealers non-owners of the copies because of being subject to restrictions).

Supreme Court will consider the ruling of *Quanta* as a patent case in the sale versus license debate under copyright law.

II. Exhaustion Doctrine under EU Copyright Law

1. Legal Framework

1.1. *The Rule—Distribution Right*

Pursuant to Article 4(c) of the EC Software Directive,¹⁸³ the author of a computer program has the exclusive right to do or to authorize any form of distribution to the public.¹⁸⁴ Under the first proposal for a Directive on the Legal Protection of Computer Programs drafted by the Commission,¹⁸⁵ the distribution right covered the sale, licensing, lease, rental, and importation for these purposes.¹⁸⁶ Yet, the first sentence in the final version of Article 4(c) of the EC Software Directive, grants the rightholder the right of making the original of a computer program or copies thereof available to the public, including rental. Compared to the final wording of the EC Software Directive, the first proposal has been amended in a way that includes any form of

¹⁸³ Council Directive of 14 May 1991 on the Legal Protection of Computer Programs, 1991 O.J. (L 122) 42 (as amended by Council Directive 93/98/EEC) [hereinafter EC Software Directive].

¹⁸⁴ Article 4(c) of the EC Software Directive, *supra* note 186, at 44, reads as follows:

"Subject to the provisions of Articles 5 and 6, the exclusive rights of the rightholder within the meaning of Article 2, shall include the right to do or to authorize: [...]

(c) any form of distribution to the public, including the rental, of the original computer program or of copies thereof. 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."

¹⁸⁵ The wording of the first proposal had been adopted unchanged in the Amended proposal; *see Amended Proposal for a Council Directive on the Legal Protection of Computer Programs*, 1991 O.J. (C 320) 27 [hereinafter Amended Proposal].

The Commission submitted its original proposal to the Council on January 5, 1989, 1989 O.J. (C 91) 4. The Economic and Social Committee delivered its opinion on the proposal on October 18, 1989. On July 11, 1990 the European Parliament proposed an amended version of the proposal. The Council submitted the amended proposal to the Council on October 18, 1990 and thereupon adopted a common position on the legislation. Following the second reading by the Parliament the Council formally adopted the EC Software Directive on May 14, 1991.

¹⁸⁶ The wording of the First proposal by the Commission is part of the *Commission Preparatory Memorandum of a Proposal for a Council Directive on the legal protection of computer programs*, Art. 4(c), 1989 O.J. (C 91) 14 [hereinafter Commission Preparatory Memorandum]. It reads in full:

"Subject to the provisions of Article 5, the exclusive rights referred to in Article 1 shall include the right to do or to authorize:

(c) the distribution of a computer program by means of sale, licensing, lease, rental and the importation for these purposes. The right to control the distribution of a program shall be exhausted in respect of its sale and its importation following the first marketing of the program by the right holder or with his consent."

distribution to the public,¹⁸⁷ including not only resale, licensing, lease, rental, and importation, but also barter, donation, *et cetera* of a computer program.¹⁸⁸ However, like section 109 of the U.S. Copyright Act, the EC Software Directive neither contains a definition of the term "distribution",¹⁸⁹ nor of the term "public".¹⁹⁰ As in the United States, it lies with case law to carve out the scope of the distribution right.

By referring to the World Intellectual Property Organisation ("WIPO") Copyright Treaty (and the WIPO Performances and Phonograms Treaty),¹⁹¹ the European Court of Justice ("ECJ"), in the *Peek & Cloppenburg* case,¹⁹² ruled that the concept of making available to the public, other than through sale, applies only where there is a transfer of ownership.¹⁹³ Article 6(1) of the WCT states that¹⁹⁴

¹⁸⁷ See HARALD D.J. JONGEN & ALFRED P. MEIJBOOM (EDS.), COPYRIGHT SOFTWARE PROTECTION IN THE EC 11 (1993) (stating that the copyright owner has the exclusive right to offer the computer program or a copy thereof to the public by circulation on the market).

¹⁸⁸ See MICHEL M. WALTER, EUROPÄISCHES URHEBERRECHT [EUROPEAN COPYRIGHT LAW] 167 (2001); see also WALTER BLOCHER in 2 HANS-GEORG KOPPENSTEINER (ed.), ÖSTERREICHISCHES UND EUROPÄISCHES WIRTSCHAFTSPRIVATRECHT [AUSTRIAN AND EUROPEAN ECONOMIC CIVIL LAW] 555 (1996).

¹⁸⁹ See the wording of different languages, e.g., "any form of distribution to the public," "jede Form der öffentlichen Verbreitung," "toute forme de distribution au public," "elke vorm van distributie onder het publiek."

See MARLY, *supra* note 5, at 250 (discussing the need to include a definition of "distribution" in the EC Software Directive).

¹⁹⁰ See BLOCHER in KOPPENSTEINER, *supra* note 191, at 557 (stating that it remains with the national legislators and courts to define "public;" however, in any case the distribution of program copies within the users' private sphere obviously shall not be subject to authorization).

¹⁹¹ The Diplomatic Conference held under the auspices of the World Intellectual Property Organisation (WIPO) in December 1996 led to the adoption of two new international treaties, the WIPO Copyright Treaty ("WCT") and the WIPO Performances and Phonograms Treaty ("WPPT"). The WCT and the WPPT as adopted in Geneva on December 20, 1996, S. TREATY DOC. NO. 105-17, 36 I.L.M. 65 (1997), were approved on behalf of the European Community by Council Decision 2000/278/EC on March 16, 2000 (2000 O.J. (L 89) 6).

¹⁹² Case C-456/06, *Peek & Cloppenburg KG/Cassina SpA*, [2008] E.C.R. I-(April 17, 2008) [hereinafter *Peek & Cloppenburg*]. A reference for a preliminary ruling under Article 234 EC Treaty was made from the Bundesgerichtshof (German Federal Court of Justice) concerning the interpretation of Article 4(1) of the Infosoc Directive.

¹⁹³ The reference was made in the course of proceedings between *Peek & Cloppenburg KG* ("*Peek & Cloppenburg*") and *Cassina SpA* ("*Cassina*") concerning the making available to the public and display of furniture which, according to *Cassina*, infringed its exclusive right of distribution. *Cassina* manufactures chairs. Its collection includes furniture manufactured according to the designs of Charles- Édouard Jeanneret ("*Le Corbusier Chairs*"). *Peek & Cloppenburg*, a chain operating menswear and womenswear throughout Germany, set up a rest area for customers in one of its shops. The rest area was fitted with *Le Corbusier Chairs*, and in an outlet display window, the chain placed a *Le Corbusier Chair*. However, those *Le Corbusier Chairs* did not come from *Cassina* but were manufactured without *Cassina's* consent in Bologna, Italy. *Cassina* brought an action against *Peek & Cloppenburg* seeking to order to (i) desist from exhibiting reproductions of *Le Corbusier Chairs* and (ii) pay damages for infringement. The

[a]uthors of literary and artistic works [including computer programs] shall enjoy the exclusive right of authorizing the making available to the public of the original and copies of their works through sale or *other transfer of ownership*.¹⁹⁵

The ECJ found that the referenced international treaties link the concept of distribution exclusively to that of transfer of ownership.¹⁹⁶ The Infosoc Directive is intended to implement that international obligation at the Community level.¹⁹⁷ In other words, Article 4(1) of the Infosoc Directive, which provides for "distribution by sale or otherwise" shall be interpreted in accordance with these treaties; i.e., as any form of distribution which entails a transfer of ownership.¹⁹⁸

In the absence of a definition, "any form of distribution" covers not only tangible works, like data media embodying computer programs, program listings, flow charts and other preparatory material, but also transmissions by wire or wireless.¹⁹⁹ Any form of distribution is controllable transmission of the original or copies thereof via any medium, including broadcasting in the meaning of Article 11^{bis} of the Berne Convention,²⁰⁰ networking, and any other form of making the works available to the public.²⁰¹

The provisions of the international treaties, including but not limited to those regarding copyright protection of computer programs, shall also be implemented at the Community level. On the basis of the *Peek & Cloppenburg* judgment, international treaties shall bind the Member States on how to interpret the EC Software Directive.

Bundesgerichtshof [German Federal Court of Justice] raised the question whether merely exhibiting reproductions of a copyrighted work without a transfer of ownership or possession, and thus without a transfer of the *de facto* power of disposal, can be classified as a distribution to the public otherwise than by sale for the purpose of Article 4(1) of the Infosoc Directive.

¹⁹⁴ Cf. also WPPT, *supra* note 194, art. 8, 12.

¹⁹⁵ WCT, *supra* note 194, art. 6(1) at 3 (emphasis added).

¹⁹⁶ See *Peek & Cloppenburg*, *supra* note 195, para. 32 (containing the same definition of the right of distribution as that enjoyed by performers and producers of phonograms).

¹⁹⁷ See Directive 2001/29/EC of the European Parliament and of the Council of 22 May 2001 on the harmonization of certain aspects of copyright and related rights in the information society, 2001 O.J. (L 167) recital 15, at 11 [hereinafter Infosoc Directive]; see also *Peek & Cloppenburg*, *supra* note 195, para. 31.

¹⁹⁸ See *Peek & Cloppenburg*, *supra* note 195, para. 33.

¹⁹⁹ See BLOCHER in KOPPENSTEINER, *supra* note 191, at 556.

²⁰⁰ Berne Convention for the Protection of Literary and Artistic Works, signed in Paris, Sept. 9, 1886, as revised in Paris, July 24, 1971, S. TREATY DOC. NO. 27, 99th Cong., 2d Sess. (1986) [hereinafter Berne Convention].

²⁰¹ See BRIDGET CZARNOTA & ROBERT J. HART, LEGAL PROTECTION OF COMPUTER PROGRAMS IN EUROPE: A GUIDE TO THE EC DIRECTIVE 59 (1993).

1.2. The Exemption—Community Exhaustion Doctrine

1.2.1 Rationale

The distribution of computer programs by sale²⁰² or licensing will usually be controlled by the author of the computer program himself, either directly, if he is also the developer of that program, or indirectly, if he confers his exclusive right upon a publisher or producer of computer programs.²⁰³ In both cases, copyright law conveys upon the software author a monopoly in the form of an exclusive distribution right. If the author decides to part with further control of his program or a copy thereof,²⁰⁴ he no longer shall hold the distribution monopoly in his program.²⁰⁵ In calculating the purchase price for his software, the software author is assumed to take into account the further disposition of that program copy.²⁰⁶ It is in the public interest that further redistribution of program copies cannot be subject to restrictions. After first sale of the program copy, the software author can neither claim reimbursement for subsequent resales, nor make any resales dependent on his consent.²⁰⁷ The problem of redistribution of software after the initial sale of an original program or a copy thereof by the rightholder had been debated long before enactment of the EC Software Directive. Redistribution is a contested issue in the context of adequate copyright protection of rightholders.²⁰⁸ The software manufacturers argue that software,

²⁰² See Walter Blocher, *Softwareschutz nach der EG-Richtlinie und nach österreichischem Recht* [Copyright Protection according to the EC-Directive and Austrian law], III EDV & RECHT 40 (1992) (Austria) (stating that usually distribution takes place by transferring a copy of a computer program recorded on a data medium or by renting or lending).

²⁰³ See Commission Preparatory Memorandum, *supra* note 190, art. 4, at 11.

²⁰⁴ See Amended Proposal, *supra* note 189, art. 4(c) at 27, where the Commission refers to "right to control the distribution":

"The right to control the distribution of a program shall be exhausted in respect of its sale and its importation following the first marketing of the program by the right holder or with his consent."

However, in the Common Position adopted by the Council on December 13, 1990, Document 10652/1/90 (Dec. 14, 1990), the wording was changed for the sake of clarifying the legal terminology.

²⁰⁵ See MELCHIOR CADUFF, DIE URHEBERRECHTLICHEN KONSEQUENZEN DER VERÄÜBERUNG VON COMPUTERPROGRAMMEN [COPYRIGHT LAW CONSEQUENCES OF SELLING COMPUTER PROGRAMS] 35 et seq. (1997).

²⁰⁶ See HAIMO SCHACK, URHEBER- UND URHEBERVERTRAGSRECHT [COPYRIGHT AND COPYRIGHT CONTRACT LAW] para. 390 at 381 (2nd ed. 2001); see also Thomas Hoeren, *Gutachten zur Frage der Geltung des urheberrechtlichen Erschöpfungsgrundsatzes bei der Online-Übertragung von Computerprogrammen* [Legal Opinion regarding the Question of Enforceability of the Copyright Exhaustion Doctrine in the Case of Online Transmission of Computer Programs], February 17, 2006, n.p., at 16 (justifying exhaustion by the reimbursement received by the software author).

²⁰⁷ See Hoeren, *supra* note 209, at 6.

²⁰⁸ See MARLY, *supra* note 5, at 233.

to a great extent, is exposed to acts of piracy.²⁰⁹ The pirate either makes copies of the original program for the purpose of subsequently selling them, or he sells the original program and keeps those copies which he, for example, made as back-up copies in accordance with Article 5 of the EC Software Directive. In any case technological advance will render it almost impossible for the rightholder to control further distribution of his program copies once they were sold. Furthermore, the rightholder will face difficulties in proving that a secondary user possesses an unauthorized copy of his program copy acquired on the black market.²¹⁰

The following three arguments can be raised as to whether an absolute ban on redistribution or a concept of exhaustion should be implemented. First, difficulties in controlling further redistribution and in proving the channels of redistribution of copies would suffice to justify a possible information obligation, but not a prohibition on any redistribution at all.²¹¹ Second, the author's control over the distribution of his program ensures that he might be financially rewarded for his creative achievement every time he sells or licenses a copy of his program.²¹² It lies with the author to consent to the distribution of his program copy, and to charge a purchase price or license fee in consideration for use of such copy.²¹³ However, once the author has parted with ownership of his program or a copy thereof²¹⁴ the monopoly is exhausted and the public interest in free movement of goods and transparent legal conditions prevails.²¹⁵ Third, the control over redistribution of program copies exercised by the rightholder seems to conflict with the notion of free movements of goods and free competition in the EC.²¹⁶ In order to ensure fair competition in the European market, the doctrine of exhaustion has been deemed an adequate and necessary correlative to the exclusive distribution right during the term of copyright protection.

²⁰⁹ Also broadcasting of software has been shown means of distribution of pirated software. Professional pirates from Eastern Europe smuggled pirated copies via mailboxes into Germany. See MARLY, *supra* note 5, at 251 n.88.

²¹⁰ Cf. CADUFF, *supra* note 208, at 52 (stating that only an authorized copy is free to be resold to any third parties without the consent of the rightholder).

²¹¹ See MARLY, *supra* note 5, at 234-35.

²¹² See BLOCHER in KOPPENSTEINER, *supra* note 191, at 560 (arguing that by the first sale of a copyrighted work the copyright owner has the chance to get rewarded for his creative achievement, thereby the purpose of the exclusive distribution right is accomplished).

²¹³ See CADUFF, *supra* note 208, at 35 et seq.

²¹⁴ Software rental does not result in transfer of ownership and thus is excluded.

²¹⁵ See MARLY, *supra* note 5, at 246 n.68.

²¹⁶ See *id.* at 233.

After weighing all the aforementioned arguments, the Community exhaustion doctrine was finally laid down in Article 4(c) of the EC Software Directive.²¹⁷

1.2.2 Scope of Community Exhaustion

The exclusive distribution right is subject to the exhaustion doctrine set forth in the second sentence of Article 4(c) of the EC Software Directive.²¹⁸ The first sale of a copy of a computer program on the market in the EC or the EEA²¹⁹ by the rightholder or with his consent exhausts the exclusive right of that copy within the EC.²²⁰ The mere transit through a Member State does

²¹⁷ Before codification of the exhaustion doctrine in the Software Copyright Directive the doctrine had long been established by the ECJ. *See, e.g.,* C-78/70 *Deutsche Grammophon Gesellschaft mbH v. Metro-SB-Großmärkte GmbH & Co. KG*. [1971] E.C.R. 487, para 13 [hereinafter *Grammophon*]:

"Consequently, it would be in conflict with the provisions prescribing the free movement of products within the common market for a manufacturer of sound recordings to exercise the exclusive right to distribute the protected articles, conferred upon him by the legislation of a member state, in such a way as to prohibit the sale in that state of products placed on the market by him or with his consent in another member state solely because such distribution did not occur within the territory of the first member state."

See also Joined Cases C-55 & 57/80, *Musik-Vertrieb membran GmbH et K-tel International v. GEMA-Gesellschaft für musikalische Aufführungs- und mechanische Vervielfältigungsrechte* (a German copyright management society), [1981] E.C.R. 147.

²¹⁸ Portugal was the only jurisdiction at the time of the EC Software Directive's enactment that had not provided for exhaustion of the author's distribution right after first sale of the copyrighted work. Although in Italy the doctrine of exhaustion had not been implemented *expressis verbis* in the Italian copyright law, the doctrine was already well recognized in the literature before enactment of the EC Software Directive. *See* MARLY, *supra* note 5, at 253.

²¹⁹ By conclusion of the Agreement on the European Economic Area, signed in Oporto on May 2, 1992 (1994 O.J. (L 1) 3) adjusted by the Protocol adjusting the Agreement on the European Economic Area of March 17, 1993 (1994 O.J. (L 1) 572) between the EFTA member states and the EC Member States the contracting member states (not including Switzerland) have undertaken to recognize the European Union law and therefore will participate in the concept of the internal market.

Pursuant to article 2 of the Agreement on the European Economic Area - Protocol 28 on intellectual property, 1994 O.J. (L 1) 194, the scope of exhaustion is described as follows:

"1. To the extent that exhaustion is dealt with in Community measures or jurisprudence, the Contracting Parties shall provide for such exhaustion of intellectual property rights as laid down in Community law. Without prejudice to future developments of case-law, this provision shall be interpreted in accordance with the meaning established in the relevant rulings of the Court of Justice of the European Communities given prior to the signature of the Agreement.

2. As regards patent rights, this provision shall take effect at the latest one year after the entry into force of the Agreement."

²²⁰ The concept of Community exhaustion was proclaimed by the ECJ, for example, in 1982, in Case C-270/80, *Polydor Limited and RSO Records Inc. v. Harlequin Records Shops Limited and Simons Records Limited*, [1982] E.C.R. 1-329, where the ECJ held that owners of national intellectual property rights may not prohibit further commercialization of goods which have been put on the market in the EC by the rightholder or with his consent:

"The enforcement by the proprietor or by persons entitled under him of copyrights protected by the law of a member state against the importation and marketing of gramophone records lawfully manufactured and placed on the market in the Portuguese Republic by licensees of the proprietor is

not suffice to trigger exhaustion within the EC or EEA,²²¹ nor does the transfer of any other copy of the program rendered by someone other than the rightholder-transferor.²²² Likewise, rental or mere cession of the right to use the target software will not exhaust the distribution right of the rightholder.

At the international level, exhaustion is dealt with in Article 6(2) of the WCT. Exhaustion under the WCT occurs upon "first sale or other transfer of title of the original or a copy of the work."²²³ Following the underlying rationale of the *Peek & Cloppenburg* judgment, according to which the concept of distribution and exhaustion under the international treaties²²⁴ is fully implemented at Community level, exhaustion under Article 4(c) of the EC Software Directive—within the meaning of Article 6 of the WCT—is triggered by transfer of ownership of the software copy. Software licensing does not inevitably entail the transfer of ownership of the copy embodying program to be licensed. Therefore, licensing can be excluded from being a trigger event for exhaustion.

By concluding "licensing agreements" rightholders aim at circumventing the legal consequences of exhaustion. Irrespective of the restrictive language of the treaties, at the European national level courts disregard the strict distinction between transfer of a tangible copy embodying the target software and a mere license to use the target software.²²⁵ In determining when a "first

justified on the ground of the protection of industrial and commercial property within the meaning of Article 23 of the agreement between the EEC and the Portuguese Republic and therefore does not constitute a restriction on trade [...]. Such enforcement does not constitute a means of arbitrary discrimination or a disguised restriction on trade between the Community and Portugal."

²²¹ See HELMUT HABERSTUMPF in 1.2 ERNST-JOACHIM MESTMÄCKER & ERICH SCHULZE (EDS.), KOMMENTAR ZUM DEUTSCHEN URHEBERRECHT [COMMENTARY ON GERMAN COPYRIGHT] §69c UrhG, para. 15 at 9 (2008).

²²² See SCHACK, *supra* note 209, para. 390 at 184 (pointing out that copies made on the occasion of online transmissions are especially not subject to exhaustion).

²²³ WCT, *supra* note 194, art. 6(2) at 3, reads as follows:

"(1) Authors of literary and artistic works shall enjoy the exclusive right of authorizing the making available to the public of the original and copies of their works through sale or other transfer of ownership.

(2) Nothing in this Treaty shall affect the freedom of Contracting Parties to determine the conditions, if any, under which the exhaustion of the right in paragraph (1) applies after the first sale or other transfer of ownership of the original or a copy of the work with the authorization of the author."

²²⁴ See *Peek & Cloppenburg*, *supra* note 195, para. 34 ("Those two provisions refer expressly to acts entailing a transfer of ownership.").

²²⁵ Cf. CADUFF, *supra* note 208, 38 n.210 (opining that under Swiss copyright law the type of contract is irrelevant as long as the *de facto* position is that a program or copy thereof is transferred on a long-term basis; i.e., not only purchases (*Sachkauf*) but also licenses to use a program or copy thereof might trigger exhaustion if the foregoing requirement is met); cf. also HABERSTUMPF in MESTMÄCKER & SCHULZE (EDS.), *supra* note 224, at §69c UrhG, para. 14 at 8 (arguing that under German copyright law the legal status of a licensing agreement does not depend on the explicit title of the agreement but on the contents of

sale"²²⁶ has occurred under the European exhaustion doctrine, national courts review whether the purchaser-user of the target software received the temporally indefinite right to dispose of that software under the distribution agreement in question.²²⁷ Contrary to U.S. case law,²²⁸ jurisdictions have not been addressing a similar sale versus license debate. Basically, it is the license to use a particular computer program rather than the tangible copy containing the program itself that is regarded to be subject to exhaustion.²²⁹ Not only sales agreements but also licensing agreements can result in exhaustion of the distribution right within the EC and EEA with regard to that software copy as long as the software vendor conveys in substance the perpetual right to dispose of the target software on the purchaser.²³⁰

1.2.3. International Exhaustion

Exhaustion occurs only within the territory of the EC²³¹ and the EEA.²³² In an ideal world of free movement of goods, the doctrine of international exhaustion has not been implemented.²³³ Both

the document—namely whether the agreement provides that the licensee is obliged to return or destroy the material data carrier embodying the target program after termination of the licensing agreement or the licensee otherwise shows that he is not interested in having that material object at his disposal on a permanent basis).

²²⁶ Cf. other authentic languages of the EC Software Directive: "Erstverkauf," "la première vente," "de eerste verkoop."

²²⁷ In ordinary legal use, a "sale" is the transfer of *de facto* power regarding the work, while the seller shows his intention to refrain from any further control over ownership of that work. *See, e.g.,* HABERSTUMPF in MESTMÄCKER & SCHULZE (EDS.), *supra* note 224, at §69c UrhG, para. 14 at 8.

²²⁸ *See* LEMLEY, MENELL, MERGES & SAMUELSON, *supra* note 14, at 300, 314 (concluding that courts and commentators in the United States have concluded that a software license transaction involving software is a sale of goods rather than a license).

²²⁹ Cf. Friedrich Rüffler, *Ist der Handel mit gebrauchter Software urheberrechtlich zulässig? [Is trading with Used Software Permitted by Copyright Law?]*, ÖBl 2008/11, 53 (2008) (stating that it is quite common to avoid terms like "purchase" or "transfer of title" and instead prefer terms like "right to use" or "license," but that the legal tests analyze the true legal and economic contents underlying an agreement regardless of its designation).

²³⁰ *See, e.g.,* ANDERL in KUCSKO (ED.), URHEBER.RECHT §16 [4.4.] (2008) (citing the Austrian Supreme Court in the *Handwerkerpaket WIN 2.3* case).

²³¹ *See* EC Software Directive, *supra* note 186, art. 4(c) at 44.

²³² *See* Hoeren, *supra* note 209, at 5.

²³³ Section 23 in connection with section 8(2) of the Danish Copyright Act arguably provides for an international concept of exhaustion by rendering exhaustion applicable on every occasion that the copyrighted work becomes available to the public with the author's consent; *see also* the respective case law in Switzerland, *e.g.,* *Imprafot AG v. Nintendo Co. Ltd.*, Bundesgericht [BGer] [Federal Court] July 20, 1998, 124 Entscheidungen des Schweizerischen Bundesgerichts [BGE] III 321, 333 (Switz.); *but contra* *Case C-173/98, Sebago Inc. and Ancienne Maison Dubois & Fils SA v. G-B Unic SA*, [1999] E.C.R. I-4103 (exhaustion of a trademark proprietor's rights).

European legislation and international treaties, such as the WCT,²³⁴ the WPPT,²³⁵ and the TRIPS Agreement,²³⁶ do not provide for a worldwide exhaustion.²³⁷ As pointed out by Commissioner Monti, the Commission has consistently taken the view that the EC Software Directive shall prevent Member States from applying a concept of international exhaustion in relation to the distribution of computer programs.²³⁸ Since no provision is made in the EC Software Directive for the exclusive right of distribution to be exhausted within the Community by a first sale outside the Community, Member States are not free to provide for exhaustion in regard to computer programs.²³⁹ Practically, if a European rightholder sells his software on condition that it shall be distributed exclusively in the U.S. market, the distribution right in all other territories, especially in the EC and EEA, is not exhausted.²⁴⁰ Thus, on the basis of his exclusive distribution right, the European rightholder can inhibit the re-import of his software that had been sold in the U.S. market to the EC and EEA market.²⁴¹

The implicit restriction of parallel imports of computer programs into the EC has not been expressly implemented by Denmark, Finland, the Netherlands, or Portugal.²⁴² It should be noted that the aforementioned Member States are known as the leading net importers of intellectual property. As such, they foster parallel imports of protected goods from countries outside the EC

²³⁴ Cf. WCT, *supra* note 194, art. 6(2).

²³⁵ Cf. WPPT, *supra* note 194, art. 8(2).

²³⁶ Agreement on Trade-Related Aspects of Intellectual Property Rights [hereinafter TRIPS Agreement]; cf. Article 6 of the TRIPS Agreement (providing that "[f]or the purposes of dispute settlement under this Agreement, subject to the provisions of Articles 3 and 4 [national treatment and most-favored nation clause] nothing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights").

²³⁷ See Christian Handig, *Urheberrechtliche Erschöpfung von Downloads im World Wide Web* [*Copyright Exhaustion of Downloads from the World Wide Web*], 1 Recht der Wirtschaft (RdW) [Economic Law] 2 (2003) (Austria).

²³⁸ See Commissioner Monti's response of July 11, 1995 to Oral Question H-0436/95 by Arthur Newens, MEP, Debates of the European Parliament (EN ed.) No. 466, p. 174.

²³⁹ See BLOCHER in KOPPENSTEINER, *supra* note 191, at 562.

²⁴⁰ See HABERSTUMPF in MESTMÄCKER & SCHULZE (EDS.), *supra* note 224, at §69c UrhG, para. 15 at 9 (stating that making program copies available on non-European markets does not trigger exhaustion and thus the rightholder may prevent imports to the EU or EEA).

²⁴¹ See, e.g., Oberster Gerichtshof [OGH] [Supreme Court] May 23, 2000, 4 Ob 30/00s, Handwerkerpaket WIN 2.3 (Austria) (pan-European exhaustion); see also SCHACK, *supra* note 209, at para. 390, at 183.

²⁴² *Commission Report to the Council, the European Parliament and the Economic and Social Committee on the implementation and effects of Directive 91/250/EEC on the legal protection of computer programs*, at 11, COM (2000) 199 final (Apr. 10, 2000) (hereinafter Commission Report).

into the EC.²⁴³ However, according to the President of the district court of The Hague in the *Novell* case, the Dutch copyright statute, which does not provide any rules on exhaustion, must be construed as much as possible in accordance with the provisions of the EC Software Directive.²⁴⁴ As a consequence of every Member State's obligation to construe and interpret national laws in accordance with the EC Software Directive, the President of the district court of The Hague arrived at the conclusion that as of September 1, 1994, a copyright regime that provides for Community exhaustion has to be applied to computer programs in the Netherlands.²⁴⁵ For this reason, the Commission *de lege ferenda* reiterated the debate on exhaustion in the context of trademark law, that with respect to computer programs, an international exhaustion of the distribution right *de lege lata* is not intended.²⁴⁶

1.2.4. Exclusive Software Rental Right

Exhaustion of the distribution right does not apply to the right to control further rental²⁴⁷ of the program or a copy thereof²⁴⁸ after the copy has been sold with the copyright owner's consent.²⁴⁹ This means that, as a rule,²⁵⁰ re-rental of a computer program is still subject to the authorization

²⁴³ See Jens-L. Gaster, *Der Erfahrungsbericht zur EG-Computerprogramm-Richtlinie* [*The After-Action Report on the EC Software Directive*], 1 COMPUTER & RECHT [COMPUTER & LAW] 11, 14 (2000) (F.R.G.).

²⁴⁴ See *Novell, Inc. v. America Direct B.V.*, District Court of The Hague, July 7, 1995, KG 95/591 (Neth.).

²⁴⁵ See Commission Report, *supra* note 245, at 12.

²⁴⁶ See Gaster, *supra* note 246, at 14.

²⁴⁷ The exclusive distribution right of the rightholder is exhausted in the event of neither rental nor leasing of the program or a copy thereof. See BLOCHER in KOPPENSTEINER, *supra* note 191, at 564.

²⁴⁸ In the preamble of the EC Software Directive the term "rental" is defined as "the making available for use, for a limited period of time and for profit-making purposes, of a computer program or a copy thereof; whereas this term does not encompass public lending, e.g. by a public library. The latter acts of distribution, accordingly, remain outside the scope of this Directive." EC Software Directive, *supra* note 186, recital 16, at 43.

See also definitions laid down in the Council Directive of 19 November 1992 on Rental Right and Lending Right and on Certain Rights Related to Copyright in the Field of Intellectual Property, 1992 O.J. (L 346) art. 1, at 62 (as amended by Directive 93/98/EEC) [hereinafter Rental Rights Directive], which also underlie the EC Software Directive:

"2. [...] 'rental' means making available for use, for a limited period of time and for direct or indirect economic or commercial advantage.

3. [...] 'lending' means making available for use, for a limited period of time and not for direct or indirect economic or commercial advantage, when it is made through establishments which are accessible to the public."

²⁴⁹ EC Software Directive, *supra* note 186, art. 4(c) second sentence, at 44.

²⁵⁰ "The exclusive right to control rental given in Article 4(c) is subject to a derogation in favor of one group of users for whom special arrangements can and should be made. This is non-profit making public

of the rightholder. Renting computer software is still the *de facto* exclusive right granted to the rightholder.²⁵¹ The rightholder will probably rent his software only in consideration for additional compensation.²⁵² Before the EC Software Directive was put in place, it was legal in most of the Member States to rent an original or copy of a computer program at a nominal charge, copy it at home by using relatively inexpensive material, and return it the following day.²⁵³ Unlike the transfer of music or video material to another medium, the digital transfer of computer programs does not entail a degradation of quality compared with the original. Cheap, short-term rental allowed the home copier to save on the expenditures of purchasing the original computer program, so an uncontrollable black market for software rental could be legally established.²⁵⁴ Furthermore, the reproduction of computer programs hardly entails any legal risk, as the figure of resolved software copyright infringement is still low.²⁵⁵ The Commission introduced the exclusive right to control rentals as a prophylactic against the tempting incentive for the users to engage in unauthorized copying and subsequent redistribution. The question was how to regulate the software rental market, which at that time constituted a gap in copyright protection.²⁵⁶ In the end, the Commission suggested that in all Member States²⁵⁷ software rental, with the limited exceptions pursuant to Article 5 of the EC Software Directive, should be prohibited.²⁵⁸ At the same time, the EC Software Directive has been drafted consistent with the international approach adopted in Article 11 of the TRIPS Agreement.²⁵⁹ However, the EC Software Directive

libraries where members of the public may go to use and to study computer programs. Libraries are able to control the use made of such programs and means of safeguards to prevent their duplication or their removal from the premises. It is important, given the need to encourage computer literacy in all sections of the Community, that libraries are able to offer computer programs for study by the public in the same way as they offer other literary works.” Commission Preparatory Memorandum, *supra* note 190, art. 5, at 12.

²⁵¹ See MARLY, *supra* note 5, at 246; see also Christopher Voss, *The Legal Protection of Computer Programs in the European Economic Community*, 11 *Computer/L.J.* 441, 451 (1992) (stating that the exception permits the rightholder to exercise exclusive, continuing control over the rental of a program which the rightholder—or one with the rightholder’s authorization—has previously distributed to the public).

²⁵² See HABERSTUMPF in MESTMÄCKER & SCHULZE (EDS.), *supra* note 224, at §69c UrhG, para. 11, at 7.

²⁵³ See Commission Preparatory Memorandum, *supra* note 190, art. 4, at 11.

²⁵⁴ WALTER, *supra* note 191, at 175 et seq.

²⁵⁵ See Voss, *supra* note 254, at 452.

²⁵⁶ See *id.* at 451-52.

²⁵⁷ Prior to enactment of the EC Software Directive an exclusive renting right of the rightholder had only been in force in the United Kingdom and Denmark. See MARLY, *supra* note 5, at 246.

²⁵⁸ See Commission Preparatory Memorandum, *supra* note 190, art. 4, at 11.

²⁵⁹ Article 11 of the TRIPS Agreement reads in full text:

did not follow the restriction inherent in the third sentence of Article 11 of the TRIPS Agreement, saying that the right to further control software rentals once the original or a copy thereof has been sold "does not apply to rentals where the program itself is not the essential object of the rental." Thus, under the TRIPS Agreement, it could be possible that the right to control further software rentals would cease with operating software installed on computer hardware that is to be rented or leased. The operating software as the non-essential part of the hardware rental or lease would probably not be subject to authorization with respect to its further disposition by the renting user or lessee-user.²⁶⁰ These kinds of cases involving the distribution of OEM software have been discussed in the context of the enforceability of contractual restrictions on purchasers of computer software who wish to redistribute their software.

"In respect of at least computer programs and cinematographic works, a Member shall provide authors and their successors in title the right to authorize or to prohibit the commercial rental to the public of originals or copies of their copyright works. [...] In respect of computer programs, this obligation does not apply to rentals where the program itself is not the essential object of the rental."

²⁶⁰ See THOMAS HOEREN in KÄTE NICOLINI & HARTWIG AHLBERG (EDS.), URHEBERRECHTSGESETZ KOMMENTAR [COPYRIGHT LAW COMMENTARY] para. 20, at 695 (2nd ed. 2000).

C. ONLINE TRANSMISSION OF SOFTWARE IN THE UNITED STATES AND EUROPE

I. A "Digital First Sale Doctrine" under U.S. Copyright Law?

1. Discussion

In essence, the first sale doctrine creates a limited exception to one of the exclusive rights of a copyright holder, that of distributing a copy of its copyrighted work.²⁶¹ The doctrine is restricted to the transfer of a *tangible copy* embodying the copyrighted work. There is no doubt that section 109 of the Copyright Act applies to copies in digital form, whether to physical copies of works in a digital format, such as CD-ROMs or DVDs, or to physical copies in analog form.²⁶² However, the picture of the software industry where a computer program is delivered on a diskette to be loaded into a computer memory and then run by the user, which was the basis for the current wording of the first sale doctrine, is outdated.

The fast paced development of digital communications technology enables authors and publishers to develop new business models with a more flexible array of products that can be tailored and priced to meet the needs of different consumers. In today's world, copies of copyrighted works, including computer software, are bought with increasing frequency by electronically downloading them through the Internet, with no tangible copy provided.²⁶³ Yet digital transmissions of copyrighted works over the Internet do not comfortably fit within the narrow concept of the first sale doctrine.²⁶⁴ Thus, the question is whether a tangible copy of a digitally downloaded work, such as a work downloaded to a floppy disk, Zip™ disk, or CD-ROM, is lawfully made, and as such, subject to the first sale doctrine. Plenty of literature has been produced on possible and final answers to this question.

²⁶¹ See *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339, 350-51 (1908) (carving out that "[t]he purchaser of a book, once sold by authority of the owner of the copyright, may sell it again, although he could not publish a new edition of it"); see also *United States v. Wise*, 550 F.2d 1180, 1187 (9th Cir.1977) (stating that under the first sale doctrine the copyright proprietor's exclusive rights other than the distribution right, such as reprinting, copying, etc., remain unimpaired).

²⁶² See Copyright Office Report, *supra* note 19, at xviii.

²⁶³ See NIMMER, *supra* note 32, §7:66, at 7-148.

²⁶⁴ See *KELLER & CUNARD*, *supra* note 7, §9:21:1 (stating that the effect and application of the first sale doctrine in the context of online distribution of copyrighted works in general are still unsettled).

1.1 *Contra-Arguments*

1.1.1 White Paper

In 1995, a task force was set up under the Clinton administration and released a report known as a "White Paper".²⁶⁵ The White Paper proposes a series of interpretations or modifications of copyright law to increase protection for digital works.

The authors of the White Paper argue that in the case of transmissions the owner of a particular copy of a work does not "dispose of the possession of that copy." A copy of the work remains with the first owner and the recipient of the transmission obtains just a reproduction of the original copy (i.e., a new copy), rather than the copy owned by the transmitter. However, the first sale doctrine should apply if the particular copy involved is in fact the copy that is further distributed, even if the copy was first obtained by transmission. Further, if the technology utilized allows the transmission of a copy without making an unlawful reproduction, i.e., no copy remains with the original owner, the first sale doctrine would apply. Otherwise, under the first sale doctrine the recipient who would need to render a copy of the transmitter's copyrighted work would be subject to copyright infringement.²⁶⁶

Applied to online transmission of software, the tenor of the White Paper reads that transmission would always involve reproduction of the target software on the recipient's computer system. In doing so, the first sale doctrine would not shield the recipient from liability for infringement of the copyright owner's exclusive reproduction right. In conclusion, the White Paper stands as a means of defense for copyright owners insofar as the first sale doctrine is denied to apply to digital works.

1.1.2 Copyright Office Report

In line with the efforts of the White Paper, the Copyright Office, in 2001, submitted to the Congress a report on, *inter alia*, the operation of sections 109 and 117 of the Copyright Act in relation to the existing and emergent technology. With the backdrop of a distribution model as it was developed within the confines of pre-digital technology, and with respect to the increasing online sales of software, the Copyright Office conducted a study on the possible need for

²⁶⁵ United States, Information Infrastructure Task Force, *Intellectual Property and the National Information Infrastructure: The Report of the Working Group on Intellectual Property Rights*, Bruce A. Lehman, Chair (Sept. 1995) [hereinafter the White Paper].

²⁶⁶ See White Paper, *supra* note 268, Part I.7.c.

implementing a "digital first sale doctrine" in the current statutory copyright law regime.²⁶⁷ For the time being, the Copyright Office has recommended no change to section 109 of the Copyright Act to include a digital first sale right,²⁶⁸ basing its conclusion on the following inherent differences regarding the nature of physical copies and information in digital format.²⁶⁹ First, digital files are much easier to copy without degradation with time and use.²⁷⁰ Second, reproduction of works in digital format is done flawlessly and such copies can be disseminated instantly and globally, at negligible cost and with low visibility. Third, digital transmissions can adversely affect the market for the original copy on a much greater degree than transfers of physical copies. Fourth, the underlying policy of the first sale doctrine does not apply to digital transmissions. The tangible nature of a copy is a defining element of the first sale doctrine and is critical to its rationale. The digital transmission of a work does not implicate the alienability of a material object. When a work is transmitted, the sender is exercising control over the intangible work only by way of making a reproduction, rather than common law dominion over an item of tangible personal property. Unlike the physical distribution of digital works on a tangible medium, such as a CD-ROM, the transmission of works interferes with the copyright owner's control over the intangible work and the exclusive right of reproduction.²⁷¹ Fifth, unless a forward-and-delete technology is employed to automatically delete the sender's copy, the deletion of a work requires an additional affirmative act on the part of the sender subsequent to the

²⁶⁷ The Copyright Office evaluated in its Report, *inter alia*, the relationship between existing and emergent technology and the operation of sections 109 and 117 of the Copyright Act. Specifically, the Report focuses on three proposals put forward during consultations with the public: creation of a "digital first sale doctrine;" creation of an exemption for the making of certain temporary incidental copies; and the expansion of the archival copying exemption for computer programs in section 117 of the Act. See Copyright Office Report, *supra* note 19, at v.

²⁶⁸ Likewise, the U.S. Department of Commerce National Telecommunication & Information Administration concluded that it is "premature to draw any conclusions or make any legislative recommendations at this time with respect to [...] Section 109 [...]." U.S. DEPARTMENT OF COMMERCE NATIONAL TELECOMMUNICATION & INFORMATION ADMINISTRATION, REPORT TO CONGRESS: STUDY EXAMINATION 17 U.S.C. SECTIONS 109 AND 117 PURSUANT TO SECTION 104 OF THE DIGITAL MILLENNIUM COPYRIGHT ACT, at 22 (March 2001), available at <http://www.ntia.doc.gov/ntiahome/occ/dmca2001/104gdmca.htm> (last visited July 28, 2009) [hereinafter the NTIA Report].

²⁶⁹ *But cf.* Nandan, *supra* note 9, at 330 (qualifying these arguments in view of the advent of photocopying machines and electronic storage (including digitally recorded movies, music and e-books) to make copying of traditional copyrighted works just as problematic).

²⁷⁰ See Stargate, 216 F.Supp. 2d 1059 (characterizing software as unique from other forms of copyrighted information in that software is "more readily and easily copied on a mass scale in an extraordinarily short amount of time and relatively inexpensively;" and since digital information can be recorded, concentrated, and conveyed with unprecedented ease and speed, software is extraordinarily vulnerable to illegal copying and piracy).

²⁷¹ See Copyright Office Report, *supra* note 19, at xviii-xx.

transmission.²⁷² This act might be difficult to prove or disprove, as is a person's claim to have transmitted only a single copy, thereby raising complex evidentiary concerns. There are conflicting views on whether effective forward and delete technologies exist today. Even if they do, it is not clear that the market will bear the cost of an expensive technological measure. In line with the Copyright Office's reasoning, other critics²⁷³ vehemently refuse to admit that technology is sufficiently advanced to ensure that digitally downloaded copies are either deleted or disabled after being transferred.

To conclude, the Copyright Office found that digital transfers cannot replicate real-world exchanges of physical copies.²⁷⁴ The new digital communications technologies would facilitate primarily unauthorized copying of copyrighted works, an activity which may result in a market substitute for sales of authorized physical copies of those works. Seemingly, the Copyright Office regards an expansion of the first sale doctrine covering online transmissions of works in digital form to be an inappropriate legal venue for dealing with those new technologies.²⁷⁵

1.2 *Pro-Arguments*

Contrary to the conclusions of the White Paper, the Copyright Office Report, and U.S. diplomats who have pushed for broader intellectual property protection for digital works,²⁷⁶ in academic literature it is demanded that the first sale doctrine be applicable to the online environment.²⁷⁷ It is contended that online transmissions that result in the creation of an at least temporary copy on the memory of the receiving computer would constitute a *de facto* distribution. Upon online distribution, the digital file stored on the receiving computer is then in the possession (i.e.,

²⁷² In the absence of an automatic "forward-and-delete" technology or equivalent human intervention (probably by the sender himself), the sender retains the licensed source copy. By sending a copy to the recipient, the sender infringes on both the reproduction and distribution rights of the copyright owner.

²⁷³ Among the opposing representatives one may find, *inter alia*, the Copyright Industry Organizations (the American Film Marketing Association, Association of Music Publishers, Business Software Alliance, Interactive Digital Software Association, Motion Picture Association of America, National Music Publishers' Association, and the Recording Industry of America, collectively and individually); Time Warner, Inc.; Software & Information Industry Association; and Broadcast Music, Inc. See NTIA Report, *supra* note 271, at n.26.

²⁷⁴ See NTIA Report, *supra* note 271, at 9, 10-11.

²⁷⁵ See Copyright Office Report, *supra* note 19, at xxi (concluding that market forces rather than "legislative fiat" should determine the proper distribution model for online exploitation of works).

²⁷⁶ See Meurer, *supra* note 17, at 845 n.19.

²⁷⁷ Both the National Association of Recording Merchandisers and the Video Software Dealers Association contend that the first sale doctrine already applies to digital media. See NTIA Report, *supra* note 271, at n.26.

owned) by the user. The online transmission, therefore, inevitably implicates the distribution of that digital file.²⁷⁸ Proponents²⁷⁹ of extending the current scope of the doctrine to apply, either by judicial interpretation or amendment,²⁸⁰ to content lawfully acquired by digital transmissions claim that today's digital network environment requires the same balancing of encouraging the public dissemination and proliferation of copyrighted works and creative incentives to promote the public interest as does the non-digital copyright regime. Instead of referring to the different nature of software compared to conventional copyright works, the arguments are based on the fundamental principles of copyright law as they apply to. The immediate effect of copyright law is to secure a fair return for an author's creative labor, that is, exclusive rights granted to the author and an adequate compensation. But the ultimate aim of this incentive is to stimulate artistic creativity for the general public good.²⁸¹ In addition, the proponents argue that copyright law should respond to technological progress, not hinder it. In conclusion, the proponents call for legal certainty in applying the traditional first sale doctrine to new digital technologies thus benefiting copyright owners and computer users alike. Further, legal certainty would open the market to more exciting and compelling technologies and business models.²⁸²

²⁷⁸ See KELLER & CUNARD, *supra* note 7, §14:2:3 (citing two court decisions that concluded that the public distribution right was at least implicated or violated by transmission of digital files, albeit without in-depth analysis of the definition of "distribution" or the technology underlying electronic transmission).

²⁷⁹ Lobbyists for extending sections 109 and 117 to digital media included, *inter alia*, the Digital Media Association (a coalition of more than 50 technology developers, webcasters, and retailers) ("DiMA"); the Digital Futures Coalition; the Home Recording Rights Coalition; the National Association of Recording Merchandisers ("NARM"); the Computer & Communications Industry Association; the Video Software Dealers Associations ("VSDA"); and the Library Associations. See NTIA Report, *supra* note 271, at n.26.

²⁸⁰ First introduced in November 1997 by Representatives Rick Boucher and Tom Campbell, H.R. 3048, the Digital Era Copyright Enhancement Act, would have added to Title 17 a new section 109(f) that would have permitted the operation of the first sale doctrine by transmission of copyrighted work to a single recipient, if the person effectuating the transfer erases or destroys his or her copy or phonorecord at substantially the same time. As Mr. Boucher explained in his statement accompanying introduction of the bill, "[T]his legislation best advances the interest of both creators and users of copyrighted works in the digital era by modernizing the Copyright Act in a way that will preserve the fundamental balance built into the act by our predecessors throughout the analog era." CONG. REC. at E2352 (daily ed. Nov. 13, 1997).

²⁸¹ See, e.g., *Sony Corporation of America v. Universal City Studios, Inc.*, 464 U.S. 417, 432 (1984).

²⁸² "CDs and books are resold freely; yet, the consumer/reseller may have copied these physical media using cassette or CD recorders, scanners, and photocopy equipment. Denying the first sale doctrine for digitally-delivered media ironically would deprive consumers of traditional privileges in a far more secure environment." See NTIA Report, *supra* note 271, at n.30 (comment by DiMA).

1.3 Innovative UCITA Approach

The Uniform Computer Information Transactions Act ("UCITA"), a model uniform law²⁸³ proposed by the National Commissioners on Uniform State Laws²⁸⁴ to address emerging issues in the sale and licensing of computer information, suggests an innovative approach on how the concept of the first sale doctrine may be molded to apply to today's digital software world. The UCITA spells out the licensor's general obligation to enable use of the information or access that it provides to the licensee. The term "enable use" by definition means

to grant a contractual right or permission with respect to information or informational rights and to complete the acts, if any, required under the agreement to make the information available to the licensee.²⁸⁵

The licensor is obliged to (i) give authority or permission to use the information, and (ii) make the information available if it is necessary to do so. The UCITA does not refer to a physical transfer of a copy embodying the target information. Rather, the crucial element is that the licensee is enabled to make use of the target information pursuant to the terms of the licensing agreement.²⁸⁶

The UCITA principle applied to the copyright doctrine of first sale would mean that the copyright owner would divest its right to distribute the copy in any format and by any means once it has enabled the licensee to use its work. A licensee who purchases a computer program online will only be enabled to use the program purchased if the licensor authorizes or permits him to copy the program. The authorized copy would be subject to the first sale doctrine with all its legal consequences. Accordingly, the transfer of tangible media embodying the target software would be replaced with the premise to enable use of the target software. In this way, the scope of the first sale doctrine would be extended to online distributions.

²⁸³ UCITA has been adopted in modified form in only two states, Virginia and Maryland. MD Code, Commercial Law, §§22-101 et seq.; Va. Code Ann. §§59.1-501.1 et seq. No other state has done so in the last five years, and several states have adopted so-called "bomb shelter" statutes that preclude a court from applying UCITA to their residents. *See* LEMLEY, MENELL, MERGES & SAMUELSON, *supra* note 14, at 316.

²⁸⁴ The scope of the UCITA is defined in section 102 as relating to an agreement of the performance of computer information or acts to create, modify, transfer, or license computer information or informational rights in computer information. *See* UCITA §102(a)(11). "Computer Information" is defined as information in electronic form which is obtained from or through the use of a computer. *See* UCITA §102(a)(10) (as amended in 2002).

²⁸⁵ UCITA §602(a) (as amended in 2002).

²⁸⁶ *See* UCITA §602(b) (as amended in 2002) (referring to the tender or delivery of a copy of the target information or of access thereto, without any reference to a transfer of tangible media in connection with enabling use of the target information).

If the copyright owner would not authorize or permit the licensee to copy the target program for using it, the licensee's copying of that software in order to run it on his computer is nonetheless sheltered from infringing on the copyright owner's exclusive copyrights by section 117(a)(1) of the Copyright Act. Making a copy of the online program would constitute an essential step to be able to use the program in conjunction with the computer. But the act of authorizing the copying *de lege* is limited in its purpose in such a way that the copy must not be used in any other manner than to run the program by the licensee.

It appears that the UCITA creates two different kinds of acts of authorization, one by the copyright owner himself, and another by order of law, each of them having a different impact on the copyright owner's exclusive distribution right. According to the UCITA, only the authorization by the copyright owner suffices to trigger the first sale doctrine.

2. First Sale Doctrine and Reproduction Right

The first sale doctrine provides a defense to an infringement of a copyright owner's distribution right, not to infringements of its reproduction right. Although the transferee is empowered by law to redistribute that particular copy, the first sale doctrine does not, however, permit the transferee to make and distribute multiple additional copies of the work without a respective license from the copyright owner.²⁸⁷ For example, selling a computer program downloaded to a CD-ROM divests the copyright owner, by virtue of the first sale doctrine, of the right to complain about further distribution of that CD-ROM, notwithstanding that the program downloaded on the CD-ROM is copyrighted. Nonetheless, the activity of copying or adapting the program beyond section 117 of the Copyright Act violates the copyright owner's reproduction and adaptation right,²⁸⁸ meaning that the first sale defense provides no shield to the copy owner with respect to those exclusive rights of the copyright owner.²⁸⁹ Section 109 should not be misused to limit the

²⁸⁷ See *A&M Records, Inc. v. Napster, Inc.*, 239 F.3d 1004 (9th Cir. 2001); *S.O.S., Inc. v. Payday, Inc.*, 886 F.2d 1081, 1088 (9th Cir. 1989) (denying right to make and retain copies of software).

²⁸⁸ See 1 RAYMOND T. NIMMER, *supra* note 32, at §1:117 (expressing that the exemption for adaptations under section 117 of the Copyright Act does not include the right to distribute the adapted work on the market without the permission of the copyright owner "even in connection with the sale of the copy owner's rights in the original copy").

²⁸⁹ However, the courts sometimes face the challenge of rendering delicate distinctions between a copyright owner's reproduction and adaptation rights and his distribution right when the first sale doctrine is at stake. For example, in *C. M. Paula Co. v. Logan*, 355 F.Supp. 189 (N.D. Tex. 1973), a case involving traditional copyrighted work, the defendant bought the plaintiff's greeting cards, transferred the designs on the cards to ceramic plaques, and subsequently sold these plaques commercially. The court held that

copyright owner's exclusive reproduction right other than the distribution right.²⁹⁰ The mere transfer of possession, even if accompanied by ownership, does not convey blanket rights in the work.²⁹¹ If a transferee wishes to obtain a right other than the right to distribute that particular copy, it must contract for it.

Unlike a transaction where a tangible copy changes hands, online distributions naturally result in a reproduction of the target software on the recipient's computer memory²⁹²—even if the sender subsequently deletes the original software copy that it transferred to the recipient. In the absence of an automatic forward-and-delete technology or equivalent human intervention (probably by the sender itself), the sender retains the licensed source copy. By sending a copy to the recipient, the sender could possibly infringe upon both the reproduction and distribution right of the software copyright owner. Although in the event of an online transmission of software the copying of the target software could be seen as the modern counterpart to the physical transfer of a medium embodying the target software, such electronic transfer, to date, seems not to be covered by the section 109 doctrine. In other words, for the time being, section 109 does not provide for a first sale privilege to transmissions of digital copies.

The freedom of disposition of physical copies of the work applies only where the copy is produced lawfully under Title 17 of the Copyright Act.²⁹³ The scope of Title 17 embraces, for example, copies made with the copyright owner's authorization, as well as, copies made under

neither the plaintiff's reproduction nor adaptation right was infringed because the defendant was not reproducing the work but merely disposing of it physically. *See id.* at 191. *See also Fawcett Publications, Inc. v. Eliot Pub. Co.*, 46 F.Supp. 717 (S.D.N.Y. 1942) (finding no infringement of the copyright owner's distribution right where individuals have lawfully purchased copies of paper-bound books and rebound them in hard covers, even when combined with other works); *but cf. National Geographic Society v. Classified Geographic*, 27 F.Supp. 655, 659-60 (D.C.Mass. 1939) (finding infringement of the copyright owner's adaptation right by taking individual articles from the "National Geographic Magazine" and reassembling them with defendant's own index).

²⁹⁰ *See* NTIA Report, *supra* note 271, at 7.

²⁹¹ *See* 1 RAYMOND T. NIMMER, *supra* note 32, §7:67.

²⁹² *See* KELLER & CUNARD, *supra* note 7, §9:21:1.

²⁹³ *See* H.R. REP. NO. 94-1476, at 79 (1976), *reprinted in* 1976 U.S.C.C.A.N 5659 at 5693; *see also* II GOLDSTEIN ON COPYRIGHT, *supra* note 20, §7.6.1; *see also Microsoft Corp. v. Software Wholesale Club, Inc.*, 129 F.Supp. 2d 995 (S.D. Tex. 2000) (observing that the first sale doctrine does not apply to counterfeit units). In a later case, another court nailed down the meaning of counterfeit as a copy not lawfully manufactured with authorization of the copyright owner. *See Microsoft Corp. v. Action Software*, 136 F.Supp. 2d 735, 737 n.2 (N.D. Ohio 2001).

the fair use privilege of section 107 of the Copyright Act.²⁹⁴ However, the interplay between section 109 and sections 107 and 117 may incur unwanted consequences for copyright owners. The fair use privilege is a broad concept applied by case law on a case-to-case basis. Presumably, most common archival activities by computer users qualify as fair use under section 107. To the extent that section 107 permits a user to make a backup copy of a work stored on a hard drive, that copy is lawfully made and the user owns it. Likewise, pursuant to section 117, the copyright owner is permitted to reproduce copies as an "essential step in the utilization of the computer program" that are lawfully made, and therefore owned by the user.²⁹⁵ Section 109, on its face, appears to permit the user subsequently to sell or otherwise dispose of the possession of those lawfully made copies. With respect to copies prepared under section 117's exemption, section 117 further provides that "[a]ny exact copies prepared in accordance with the provisions of this section may be leased, sold, or otherwise transferred, along with the copy from which such copies were prepared, only as part of the lease, sale, or other transfer of all rights in the program."²⁹⁶ Adaptations so made "may be transferred only with the authorization of the copyright owner."²⁹⁷ However, a similar provision is not available to copies made pursuant to the section 107 exception. Legislative history is silent on this point. The literal interpretation of the Copyright Act could lead a court to conclude that copies lawfully made under the fair use doctrine may be freely distributed under section 109. A possible reason why no court has had to rule on this issue may be the fact that the need to make archival copies of software has diminished because ordinarily software and its upgrades sold in the United States is distributed on CD-ROM, which itself serves as an archival copy in the event of technical hard drive

²⁹⁴ 17 U.S.C. §107 reads in full text as follows:

"Notwithstanding the provisions of sections 106 and 106A, the fair use of a copyrighted work, including such use by reproduction in copies or phonorecords or by any other means specified by that section, for purposes such as criticism, comment, news reporting, teaching (including multiple copies for classroom use), scholarship, or research, is not an infringement of copyright. In determining whether the use made of a work in any particular case is a fair use the factors to be considered shall include—

- (1) the purpose and character of the use, including whether such use is of a commercial nature or is for nonprofit educational purposes;
- (2) the nature of the copyrighted work;
- (3) the amount and substantiality of the portion used in relation to the copy-righted work as a whole; and
- (4) the effect of the use upon the potential market for or value of the copy-righted work.

The fact that a work is unpublished shall not itself bar a finding of fair use if such finding is made upon consideration of all the above factors."

²⁹⁵ See II GOLDSTEIN ON COPYRIGHT, *supra* note 20, §7.6.1(2).

²⁹⁶ 17 U.S.C. § 117(b).

²⁹⁷ See *id.*

problems.²⁹⁸ However, today the transfer of software via networks, in particular the Internet, is also known as state-of-the-art in the software industry.

In sum, the effect and application of the first sale doctrine in the context of online distribution of copyrighted works in general, and software in particular, are still unsettled. For the time being, in the absence of any express modification of the first sale provision, the online exchange of copyrighted works is more likely to be protected by the notion of fair use rather than by first sale principles.²⁹⁹

II. A "Digital Exhaustion Doctrine" under European Copyright Law?

1. Legal Framework

1.1 *European Primary Legislation*

Second-hand software may also be distributed by companies having their seats somewhere else in the EC. European primary law, in particular the fundamental freedom of free movement of goods and services, will apply to cross-border transactions within the EC,³⁰⁰ and as such will prevail over conflicting European secondary legislation. It is to be reviewed whether the doctrine of exhaustion under the EC Software Directive complies with the fundamental freedoms of the EC. In the first cases involving licensing agreements containing provisions that aimed at preventing reimports, the ECJ found them noncompliant with European competition law, particularly Article 81(1) of the EC Treaty.³⁰¹ In the absence of an agreement as required under Article 81,

²⁹⁸ *But see* Copyright Office Report, *supra* note 19, Part III.B.3.b (recommending that Congress amend the current section 109(a) to ensure that fair use copies are not subject to the fair sale privilege).

²⁹⁹ *See* KELLER & CUNARD, *supra* note 7, §14:2:3.

³⁰⁰ *See* Handig, *supra* note 240, at 3 (arguing that the Infosoc Directive is driven by the intention to implement the fundamental freedoms of the EC Treaty, particularly free movement of goods and services).

³⁰¹ This paper does not review software licensing under European competition rules as this would be beyond the scope of the paper. For a discussion on licensing agreements and competition rules *see* Guido Westkamp, *Intellectual Property, Competition Rules, and the Emerging Internal Market: Some Thoughts on the European Exhaustion Doctrine*, 11 MARQ. INTELL. PROP. L. REV. 291 (2007).

The Treaty on European Union and the Treaty on the Functioning of the European Union, 2008 O.J. (C 115) 1 [hereinafter the Treaty of Lisbon], are an consolidated international agreement signed in Lisbon on December 13, 2007 that would amend, *inter alia*, the EC Treaty. The provisions relevant to the subject

the ECJ turned to the principle of free movement of goods.³⁰² Articles 28 and 29 of the EC Treaty incorporate the fundamental right of free movement of goods by prohibiting quantitative restrictions on imports and exports between Member States and all other measures of equivalent effect.³⁰³ Under Article 30 of the EC Treaty,³⁰⁴ however, national law may restrict the principle of free movement of goods if the measure in question is justified and proportionate to the *prima facie* infringement of Articles 28 and 29 of the EC Treaty. Article 30 must not be understood as a blanket justification for each and every exercise of a national intellectual property right. Rather, the ECJ generally draws a distinction between the existence and the exercise of intellectual property rights. Whereas the existence of copyright is determined according to national copyright law, the ECJ shall be competent with respect to issues concerning the exercise of the copyright. For this purpose, the ECJ refers to the specific object underlying the copyright.³⁰⁵ With respect to computer software, the specific object underlying the copyright is to enable the software author to economically exploit his software; i.e., to get a fee in return for selling his software.³⁰⁶ Different provisions apply to different ways of exploitation of the software. While the ECJ applies Article 30 of the EC Treaty only to exploitation of tangible software copies, Article 49 of the EC Treaty³⁰⁷ applies to exploitation of software in an intangible form. Yet, case law regarding

matter of this paper have been adopted verbatim in the Treaty of Lisbon. Since the Treaty of Lisbon has not been ratified by all Member States primary references in the paper will still be made to the relevant sections of the EC Treaty. For Article 81 of the EC Treaty *see* now Article 101 of the Treaty of Lisbon, 2008 O.J. (C 115) 88.

³⁰² *See id.* at 295.

³⁰³ *See* Articles 28 and 29 of the Treaty Establishing the European Community, 2002 O.J. (L 325) 33, at 47 [hereinafter EC Treaty], reads in full text:

"Article 28. Quantitative restrictions on imports and all measures having equivalent effect shall be prohibited between Member States.

Article 29. Quantitative restrictions on exports, and all measures having equivalent effect, shall be prohibited between Member States."

Cf. Articles 34 and 35 of the Treaty of Lisbon, 2008 O.J. (C 115) 61.

³⁰⁴ *See* EC Treaty, *supra* note 206, art. 30, at 47, reads in full text:

"The provisions of Articles 28 and 29 shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of public morality, public policy or public security; the protection of health and life of humans, animals or plants; the protection of national treasures possessing artistic, historic or archaeological value; or the protection of industrial and commercial property. Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States."

Cf. Treaty of Lisbon, *supra* note 305, at 61.

³⁰⁵ *See* Westkamp, *supra* note 304, at 295-96.

³⁰⁶ *See* MARLY, *supra* note 5, 256-57.

³⁰⁷ *See* EC Treaty, *supra* note 306, art. 49, at 54, reads in full text:

Article 30 *mutatis mutandis* rules on cases involving the free movement of services.³⁰⁸ Regarding both forms of exploitation, the line must be drawn where copyright law is intended to be misused by the software author as a means for controlling the distribution channels.³⁰⁹ In the *OEM-version* case, the German Federal Court of Justice stated that it is not the objective of copyright to ensure the supply of the same software at different prices for different market segments.³¹⁰ A derogation from the fundamental freedom of free movement of goods and services can only be justified if the measure at the national level is necessary to accomplish the specific objective of the national rule—that is, if the exercise of the intellectual property right was within the "essence" of the right.³¹¹ Here the doctrine of exhaustion as codified in European secondary legislation comes into play.

In conclusion, Article 4(c) of the EC Software Directive is consistent with Articles 30 and 49 of the EC Treaty. Thus, the copyright of the software author shall be exhausted at the time when the software is first sold by him, or with his consent, because in return for the first sale the author will get financially reimbursed.³¹²

"Within the framework of the provisions set out below, restrictions on freedom to provide services within the Community shall be prohibited in respect of nationals of Member States who are established in a State of the Community other than that of the person for whom the services are intended.

The Council may, acting by a qualified majority on a proposal from the Commission, extend the provisions of the Chapter to nationals of a third country who provide services and who are established within the Community."

Cf. Treaty of Lisbon, *supra* note 305, art. 56, at 70.

³⁰⁸ The author must get reimbursed for sale of its property with respect to services. *See, e.g.*, Case C-262/81, Coditel SA, Compagnie générale pour la diffusion de la télévision, and others v Ciné-Vog Films SA and others, [1982] E.C.R. 3381 ("The distinction, implicit in Article 36 of the [EC] Treaty, between the existence of a right conferred by the legislation of a member state in regard to the protection of artistic and intellectual property, which cannot be affected by the provisions of the [EC] Treaty, and the exercise of such right, which might constitute a disguised restriction on trade between member states, also applies where that right is exercised in the context of the movement of services.").

³⁰⁹ *See* Rüffler, *supra* note 232, at 55.

³¹⁰ Bundesgerichtshof [BGH] [Federal Court of Justice] July 6, 2000, I ZR 244/97 (F.R.G.), CR 2000, 651, also available at <http://www.jurpc.de/rechtspr/20000220.htm> (last visited December 17, 2008) [hereinafter *OEM Version*].

³¹¹ *See* Grammophon, *supra* note 219, summary para. 5 ("It is clear from article 36 that, although the treaty does not affect the existence of rights recognized by the legislation of a member state with regard to industrial and commercial property, the exercise of such rights may nevertheless fall within the prohibitions laid down by the treaty. Article 36 only admits derogations from the free movement of products in order to protect industrial and commercial property to the extent to which such derogations are justified for the purpose of safeguarding rights which constitute the specific matter of such property.").

³¹² *See* MARLY, *supra* note 5, at 258.

1.2. European Secondary Legislation

1.2.1 EC Software Directive

The Community exhaustion doctrine under the EC Software Directive covers *any form* of distribution to the public.³¹³ Because of different copyright regimes adopted in different Member States, the lack of a definition might lead to diverse understandings of the term "any form of distribution". For example, in accordance with German copyright law, distribution means only the transfer of tangible copies,³¹⁴ whereas UK copyright law makes the term "distribution" subject to a broad interpretation.³¹⁵ Neither the EC Software Directive itself nor the legislative history provides any guidance on the scope of term "distribution". Thus, the Member States have been left with the question of whether the Commission has intended to broaden the scope of the distribution right under Article 4(c) in a way that does not limit the distribution of copies of a computer program on tangible data media like floppy disks,³¹⁶ program listings, requirement specifications, or miscellaneous preparatory design works.³¹⁷ Answering this question requires interpreting the provision in the context of European and international copyright law.

How is the term "distribution" used in international copyright law? According to the usage of the WIPO, there is a difference between the meanings of distribution of a tangible work and distribution of all other works. Basically, the term "distribution of a work", or "*mise en circulation d'une oeuvre*" and "*distribución de una obra*," refers to making originals or copies available to the public by commercial means. On the other hand, terms like "dissemination", "*diffusion*", and "*difusión*" mean not only distribution of the originals or copies in physical form, but any form of distribution, including but not limited to broadcasting, transmission by wire,

³¹³ See Commission Report, *supra* note 245, at 17.

³¹⁴ See section 15(1)(2) of the German Copyright Act.

"(1) The author shall have the exclusive right to dispose of its work in physical form; the right covers in particular [...]

(2) the distribution right (sec. 17)." (author trans.)

See section 17(1) of the German Copyright Act:

"(1) The distribution right means the right to offer to the public or put into circulation the original work or a copy thereof." (author trans.)

³¹⁵ Distribution under UK copyright law covers any acts of transmission, like broadcasting in the meaning of Art. 11^{bis}(1) of the Berne Convention and public performance (what might be of less relevance with respect to computer programs).

³¹⁶ At the time of enacting the EC Software Directive it was still widespread custom to distribute computer programs in the form of floppy disks. It was not until the adoption of the Infosoc Directive that online transmissions were dealt with at Community level.

³¹⁷ See Blocher, *supra* note 205, at 39.

public performance, and any other communication to the public.³¹⁸ When applying the WIPO definitions to the EC Software Directive, a literal interpretation leads to the conclusion that only the distribution of computer programs in physical form shall be covered by the scope of the Directive.

Furthermore, the EC Software Directive—unlike the WIPO Copyright Treaty—does not explicitly refer to online transmissions. In Article 8 of the WIPO Copyright Treaty authors of literary and artistic works, including computer programs,

shall enjoy the exclusive right of authorizing any communication to the public of their works, by wire or wireless means, including the making available to the public of their works in such a way that members of the public may access these works from a place and at a time individually chosen by them.³¹⁹

The Commission Report also referred to the WIPO Copyright Treaty in suggesting the addition of a communication-to-the-public right to the bundle of exclusive acts under Article 4 of the EC Software Directive.³²⁰ To date, such a provision has not been implemented in the EC Software Directive.³²¹

Irrespective of whether the software is distributed by way of transfer of a physical data medium or by online transmission, in either case the purchaser of the software will be enabled to dispose of a physical copy of that software.³²² Would a copy of the target program purchased via an online transmission on the purchaser's computer suffice to trigger exhaustion under the wording of the EC Software Directive?

Acts of distribution, both by way of transfers of tangible copies and online transmissions, require the reproduction of the original work which is made available to the public. When a work is distributed physically, it is the rightholder who makes the copy of the original program and then sells it to the purchaser-user. Uploads and downloads of programs³²³ create a temporary copy in the RAM or permanent storage of the hard drive of the server or computer. The user's role is

³¹⁸ See MARLY, *supra* note 5, at 242-43.

³¹⁹ See WCT, *supra* note 194, art. 8.

³²⁰ Commission Report, *supra* note 245, at 17.

³²¹ *But cf.* Ruffler, *supra* note 232, at 54 (mentioning that the legislators did not intentionally leave out online transmissions).

³²² See HOEREN in NICOLINI & AHLBERG, *supra* note 263, para. 12, at 693 (stating that from an economic point of view the way of distribution either by transfer of a tangible copy of the software or by online transmission does not make a difference for sellers and thus sellers often make use of both means of distribution of their software).

³²³ Computer programs are also frequently shared or transferred via e-mail, or in a bulletin board or chat forum.

passive in the first case (i.e., he receives a program copy from the rightholder), and active in the second case (i.e., he himself renders a copy of the rightholder's program³²⁴). A literal reading of Article 4(c) of the EC Software Directive, however, tells us that only the original program or a copy of that original program are subject to be distributed to the public by the rightholder. However, in an online transmission the (active) user does not receive the original, or a copy thereof, but the user himself has to make a copy by storing it on his computer.³²⁵ Again, online transmissions of computer programs do not satisfy the distribution criteria.

Further, some argue that since neither legislative history nor the literal wording of the EC Software Directive seem to trigger exhaustion in the event of online transmissions, that most national laws refer to exhaustion only in the context of transfer of physical data carriers.³²⁶

However, by reviewing how the term "distribution" is interpreted in the context of the legislative objective underlying the EC Software Directive, one may reach a different conclusion. With respect to a definition of "computer program", the drafters of the EC Software Directive were aware of future technology. In the first Commission Proposal it is spelled out that "it is not thought advisable to include a definition [of computer program] in the [EU Software] Directive to avoid it becoming outdated."³²⁷ In so doing, the EC Software Directive does not provide a definition of what is meant by a "computer program", and so avoids limiting a definition of computer programs to current technology.³²⁸ The same reasoning *per analogiam* may be the basis for a broad interpretation of the distribution right in a way as to reflect the fast-moving

³²⁴ In treating the Internet as a distribution channel, the reproduction right of the author is affected. *See* WIEBE in KUCSKO (ED.), *supra* note 233, at §40c [5.]. Reproductions as such are restricted pursuant to the EC Software Directive. *See* WALTER, *supra* note 191, at 168 et seq.

³²⁵ *See* MARLY, *supra* note 5, at 245.

³²⁶ *See, e.g.,* sec. 16(3) Austrian Copyright Act:

"Subject to section 16a the distribution right does not apply to works that are put into circulation with the consent of the rightholder by transfer of ownership in any member state of the European Community or any contracting state of the European Economic Area." (author trans.)

See also sec. 69(c)(3) German Copyright Act:

"The rightholder shall have the exclusive right to do or authorize to do the following: [...] (3) any form of distribution of the original computer program or copies thereof, including rental. If a copy of a computer program is put into circulation by way of sale in the territory of the European Union or another contracting party to the Agreement on the European Economic Area with the consent of the rightholder, the distribution right, except with respect to software rentals, shall be exhausted with respect to that copy." (author trans.)

³²⁷ *See Commission Proposal for a Directive on the Legal Protection of Computer Programs*, para.1.1, at 5, COM (1988) 816 final (Apr. 12, 1989).

³²⁸ *See* JONGEN & MEIJBOOM (EDS.), *supra* note 190, at 7.

technological developments without needing to amend the EC Software Directive each time. Thus, some argue that beyond the literal interpretation of the wording of the Directive, channels of exploitation, which were either not known or not commercially relevant at the time of the drafting the Directive, would automatically be subject to the rightholder's control as well.³²⁹ Furthermore, it can be argued that the wording of the EC Software Directive does not necessarily require the transfer of ownership of a tangible software copy. Pursuant to Article 4(c) it is "[t]he first sale [...] of a copy of a program"³³⁰ that triggers exhaustion. A contract for sale can also be concluded without the obligation of transferring a tangible piece of the copyrighted work.³³¹ Therefore, the minimum requirement for exhaustion to be triggered is the transfer of a perpetual right to use the target software in consideration for payment of a fee.³³² Regardless of the outcome of a literal interpretation of the EC Software Directive, at the European level the ratio underlying Article 4(c) shall be the decisive determinant.³³³

1.2.2 Database Directive

While it is not entirely clear under the EC Software Directive whether online transmissions trigger Community exhaustion, one must explore whether current European laws on copyright have been intended to cover economic realities such as new forms of exploitation.³³⁴ Or, do such new forms like online transmissions call for new concepts of protection of intellectual property? For example, online transmission on-demand is a new form of exploitation. The legal uncertainty regarding the nature and level of protection of on-demand transmissions of copyrighted works over networks was intended to be overcome by providing for harmonized protection at Community level.³³⁵

³²⁹ See MARLY, *supra* note 5, at 244.

³³⁰ Cf. the French version of Article 4(c) of the EC Software Directive: "*La première vente d'une copie d'un programme d'ordinateur dans la Communauté par le titulaire du droit ou avec son consentement épuise le droit de distribution de cette copie dans la Communauté [...]*" (emphasis added).

³³¹ See WALTER (ED.), *supra* note 191, art. 4 Software Directive, para. 28.

³³² See RÜFFLER, *supra* note 232, at 55.

³³³ See *id.* at 55 n.40.

³³⁴ See Infosoc Directive, *supra* note 200, recital 5, at 10.

³³⁵ Cf. HOEREN in NICOLINI & AHLBERG, *supra* note 263, para. 16, at 694 (arguing against the then mainstream opinion in literature and at a time when the Infosoc Directive has not been enacted that on-demand software for downloading shall be covered by the scope of the distribution right and as such being subject to exhaustion since downloading is the functional equivalent to transfers of physical copies).

For the first time in 1996, the Commission explicitly commented on exhaustion in Recitals 33 and 43 of the Directive on the legal protection of databases³³⁶ in the event of online transmissions. Within the field of service provision, exhaustion of the right of distribution shall not apply in the case of online databases. Online transmissions do not exhaust the right to prohibit re-utilization of either the database or a material copy of the database or a part thereof made by the recipient of the transmission with the consent of the rightholder. The Database Directive appears to be tailor-made for frequent updating of databases through online transmissions, as it constitutes services rather than a sales channel.³³⁷ The concept of distribution is related to the transfer of a material data carrier embodying the target program. In terms of the fundamental freedom of free movement of goods, exhaustion requires the transfer of title to a material data medium.³³⁸ Therefore, opponents argue that in contrast to the EC Software Directive, the Database Directive aims at regulating another market segment.³³⁹

1.2.3 Infosoc Directive

In 2001, by enacting the Directive on the harmonization of certain aspects of copyright and related rights in the information society, existing principles and rules shall be adapted so as to

³³⁶ Directive 96/9/EC of the European Parliament and of the Council of 11 March 1996 on the Legal Protection of Databases, 1996 O.J. (L 77) 20 [hereinafter Database Directive].

Recital 33 of the Database Directive reads in full text:

"Whereas the question of exhaustion of the right of distribution does not arise in the case of on-line databases, which come within the field of provision of services; whereas this also applies with regard to a material copy of such a database made by the user of such a service with the consent of the rightholder; whereas, unlike CD-ROM or CD-I, where the intellectual property is incorporated in a material medium, namely an item of goods, every on-line service is in fact an act which will have to be subject to authorization where the copyright so provides;"

Recital 43 of the Database Directive reads in full text:

"Whereas, in the case of on-line transmission, the right to prohibit re-utilization is not exhausted either as regards the database or as regards a material copy of the database or of part thereof made by the addressee of the transmission with the consent of the rightholder."

³³⁷ Following the recitals one may draw the conclusion that offline databases on CD-ROMs etc. have not been primarily focused on. *Cf.* Recital 22 of the Database Directive ("Whereas electronic databases within the meaning of this Directive may *also* include devices such as CD-ROM and CD-I" [emphasis added] and Recital 38 of the Database Directive: "Whereas the increasing use of digital recording technology exposes the database maker to the risk that the contents of his database may be copied and rearranged electronically, without his authori[z]ation[.]").

³³⁸ See SCHACK, *supra* note 209, para. 389, at 183; see also HABERSTUMPF in 1.2 MESTMÄCKER & SCHULZE (EDS.), *supra* note 224, §69c UrhG, para. 9, at 6.

³³⁹ See WALTER (ED.), *supra* note 191, at 171.

correspond with the circumstances of the information society.³⁴⁰ The Infosoc Directive explicitly grants to rightholders an exclusive right to make available to the public copyright works by way of interactive on-demand transmissions.³⁴¹ This right is not subject to exhaustion.³⁴² However, exhaustion of the distribution right will be triggered in the event of transfer of ownership of the original or a copy thereof by the rightholder or with his consent in the EC.³⁴³ On the basis of the wording of the Database Directive,³⁴⁴ the same ratio has been reiterated in Recital 29 of the Infosoc Directive³⁴⁵ by stating that:

[t]he question of exhaustion does not arise in the case of services and online services in particular. This also applies with regard to a material copy of a work or other subject-matter made by a user of such a service with the consent of the rightholder. [...] Unlike CD-ROM or CD-I, where the intellectual property is incorporated in a material medium, namely an item of goods, every online service is in fact an act which should be subject to authori[z]ation where the copyright or related right so provides.³⁴⁶

By citing Recital 29, opponents often assert that the Commission intended to draw a distinction between material copies and online services (including online transmissions).³⁴⁷ In so doing, the Commission would comply with the standing jurisdiction of the European Court of Justice according to which the exhaustion doctrine, as a rule, shall not apply to services.³⁴⁸ Accordingly,

³⁴⁰ With respect to the relationship between the Infosoc Directive and EC Software Directive it is made clear in Recital 20 as well as in Article 1(2)(a) that the Infosoc Directive is based on principles and rules already laid down, *inter alia*, in the EC Software Directive and the Rental Rights Directive.

³⁴¹ Interactive on-demand transmissions are characterized by the fact that members of the public may access them from a place at a time individually chosen by them. *See* Infosoc Directive, *supra* note 200, recital 25, at 12.

³⁴² *See* Infosoc Directive, *supra* note 200, art. 3 at 16.

³⁴³ *See id.* art. 4 at 16.

³⁴⁴ *See* Rüdfler, *supra* note 232, at 56 (arguing that Recital 33 of the Database Directive served as model for drafting Recital 29 of the Infosoc Directive); *but see* WALTER (ED.), *supra* note 191, at 171 et seq. (stating that the approach adopted by the Commission in the Database Directive has not been consistently followed by the Infosoc Directive where no distinguishing classification of a data transmission, as either a service or a distribution channel with respect to the scope of Community exhaustion, was made).

³⁴⁵ *See* WIEBE in KUCSKO (ED.), *supra* note 233, §40c [5.].

³⁴⁶ *See* Infosoc Directive, *supra* note 200, recital 29, at 12.

³⁴⁷ *See, e.g.*, Truiken J. Heydn, Michael Schmidl, *Der Handel mit gebrauchter Software und der Erschöpfungsgrundsatz [Trade with Used Software and the Doctrine of Exhaustion]*, 2 Kommunikation & Recht (K&R) [Communication & Law], at 76-77 (2006) (denying exhaustion in the case of online transmissions on the basis of article 3(3) and Recital 29 of the Infosoc Directive).

³⁴⁸ *See* Case C-203/02, *The British Horseracing Board Ltd and Others v William Hill Organization Ltd*, para. 59 (reference for a preliminary ruling from the Court of Appeal (England and Wales), [2004] E.C.R. I-10415).

opponents argue that the Community exhaustion doctrine set out in the EC Software Directive shall apply only to the sale of material copies, whereas any supply through online services shall not entail exhaustion.³⁴⁹ This approach has been facing severe criticism by proponents arguing in favor of applying exhaustion on an analogy basis in the case of online transmissions.

2. Two Different Distribution Models—One Exhaustion Doctrine?

Although at first sight the exhaustion doctrine laid down in Article 4(c) of the EC Software Directive covers only tangible copies of software, some argue that the effect of exhaustion under the EC Software Directive is likewise triggered by intangible transfers, such as downloads of software. Some proponents link exhaustion *per analogiam* to the first copy rendered by the purchaser-user, while others link it to the licenses as such.³⁵⁰ The general debate on whether the exhaustion doctrine laid down in Article 4(c) of the EC Software Directive is to apply by analogy to online transmissions of computer software basically centers on four arguments.

First, with respect to the relationship between the Infosoc Directive and EC Software Directive, it is made clear in Recital 20,³⁵¹ as well as in Article 1(2)(a),³⁵² that the Infosoc Directive is based on principles and rules already laid down, *inter alia*, in the EC Software Directive. Even if the Infosoc Directive was drafted with the above-asserted intention in mind, the Infosoc Directive *expressis verbis* shall not derogate the EC Software Directive.³⁵³

³⁴⁹ The Commission's approach also became a subject of discussion at the European Parliament. See answer by Commissioner Monti to Oral Question H-0436/95 by Arthur Newens (July 11, 1995), Debates of the EP (EN ed.) No. 466, p. 174.

³⁵⁰ See Andreas Wiebe, Clemens Appl, *Urheberrechtliche Zulässigkeit des Erwerbs von "gebrauchten" Softwarelizenzen in Österreich [Acquisition of "Used" Software Licenses under Austrian Copyright Law]*, Medien & Recht (M&R) [Media & Law], at 191 (2007) (F.R.G.).

³⁵¹ See Infosoc Directive, *supra* note 200, recital 20, at 11, reading in full text:

"This Directive is based on principles and rules already laid down in the Directives currently in force in this area, in particular Directives 91/250/EEC, 92/100/EEC, 93/83/EEC, 93/98/EEC and 96/9/EC, and it develops those principles and rules and places them in the context of the information society. The provisions of this Directive should be without prejudice to the provisions of those Directives, unless otherwise provided in this Directive." (quotations omitted).

³⁵² See Infosoc Directive, *supra* note 200, art. 1(2)(a) at 15, reading in full text:

"(2) Except in the cases referred to in Article 11, this Directive shall leave intact and shall in no way affect existing Community provisions relating to:

(a) the legal protection of computer programs;"

³⁵³ See Rüdfler, *supra* note 232, at 56.

Second, the rationale underlying Recital 29 of the Infosoc Directive (and Recitals 33 and 43 of the Database Directive³⁵⁴) does not work for online transmissions of computer software. Recital 29 refers to online-services on-demand rather than to digital transmissions of software.³⁵⁵ On-demand services require the users to pay a fee for each single download from the network or search in an online database. Online databases are frequently updated in order to enable users to search those updated databases.³⁵⁶ Access to such database requires an online connection. Transfers of software imply the transfer of the right to permanently use the software in consideration for a single license fee.³⁵⁷ Online transmissions of software are neither meant to communicate a software to the public, nor to grant the rightholder remuneration for each use made thereof.³⁵⁸ The definitions of "services" and "online-services" are dictated by common sense and were recently codified in the E-Commerce Directive.³⁵⁹ Since both Directives are inextricably interwoven with each other, the definitions laid down in the E-Commerce Directive

³⁵⁴ See Hoeren, *supra* note 209, at 9 (noting that Recital 29 of the Infosoc Directive closely mirrors Recital 33 of the Database Directive and therefore the rationale underlying the Database Directive can be referred to when interpreting Recital 29 of the Infosoc Directive).

³⁵⁵ See Olaf Sosnitzer, *Die urheberrechtliche Zulässigkeit des Handels mit "gebrauchter" Software* [Trading of "Used" Software under Copyright Law], 5 KOMMUNIKATION & RECHT [COMMUNICATION & LAW] 208 (2006) (F.R.G.).

³⁵⁶ See Hoeren, *supra* note 209, at 9-10.

³⁵⁷ See Rüdfler, *supra* note 232, at 56-57.

³⁵⁸ See WIEBE in KUCSKO (ED.), *supra* note 233, §40c [5.] (stating that the Infosoc Directive refers only to the use by means of an online connection, while the transfer of computer programs does not constitute a service and thus no online connection is needed for the permanent use of the program copies); see also Rüdfler, *supra* note 232, at 56.

³⁵⁹ Directive 2000/31/EC of the European Parliament and of the Council on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market, of 8 June 2000, 2000 O.J. (L 178) 1 [hereinafter E-Commerce Directive].

"Services" in the meaning of the E-Commerce Directive are defined as:

‘any Information Society service, that is to say, any service normally provided for remuneration, at a distance, by electronic means and at the individual request of a recipient of services.’

For the purpose of this definition:

- ‘at a distance’ means that the service is provided without the parties being simultaneously present,
- ‘by electronic means’ means that the service is sent initially and received at its destination by means of electronic equipment for the processing (including digital compression) and storage of data, and entirely transmitted, conveyed and received by wire, by radio, by optical means or by other electro-magnetic means,
- ‘at the individual request of a recipient of services’ means that the service is provided through the transmission of data on individual request."

See E-Commerce Directive, 2000 O.J. (L 178), article 2(a) at 8 referring to Directive 98/48/EC of the European Parliament and of the Council of 20 July 1998, amending Directive 98/34/EC laying down a procedure for the provisions of information in the field of technical standards and regulations, 1998 O.J. (L 217) 18, 21.

appear to apply to the same extent to the Infosoc Directive.³⁶⁰ The requirement of an online connection for accessing online databases, and the obligation of the database provider to warrant permanent accessibility to the database, characterizes online-databases as services.³⁶¹ Thus, the Infosoc Directive excludes exhaustion with respect to computer programs transferred via networks in the event that the program will be accessible over the network only on-demand.³⁶² All other online transmissions of computer software—in particular the occurrence of a single transmission granting the user the right to use the program for an unlimited period—are not subject to the Infosoc Directive.³⁶³ The single online transmission of a computer program enables the purchaser to use the program on a permanent basis without being required to connect every time. In the latter case, the online transmission is merely another technical means of distribution compared to the technical state-of-the-art distribution of software at the time of drafting the EC Software Directive (i.e., distribution of software in the form of tangible copies),³⁶⁴ and thus, exhaustion will be triggered on the basis of analogy to Article 4(c) of the EC Software Directive. Third, online transmission of computer software is often linked with software piracy. The Community exhaustion doctrine set forth in Article 4(c) of the EC Software Directive serves to protect *bona fide* third-party purchasers of tangible software copies. After the first transfer of the tangible program copy, the rightholder-transferor can probably recognize the copy rendered by himself. One may think for example of the various ways of packaging software. There are national laws that, by referring to the aforementioned argument, refuse to apply the exhaustion doctrine in the event of online transmissions of copyrighted computer programs.³⁶⁵ Furthermore, opponents of the analogy theory argue that after the online transmission of the target program, the rightholder would no longer be in the position to control the further distribution of that program to the same extent he would be in the case of a transfer of a physical copy of that program. Thus, the opponents conclude that online distribution would constitute a proper means

³⁶⁰ See Rüffler, *supra* note 232, at 57.

³⁶¹ See Hoeren, *supra* note 209, at 10 (characterizing the transfer of computer programs generally not to be a service, with the exception of transfer of computer programs "on-demand," when every single utilization of the program requires the user to connect to the respective network).

³⁶² The fee is paid for delivery of the respective on-demand service but not for granting the perpetual right to use the target software.

³⁶³ See Wiebe/Apl, *supra* note 354, at 191 (stating that the purchase of software licenses lacks the characteristic features of services); see also Hoeren, *supra* note 209, at 11-12 (characterizing the online transmission of a computer program as sale of the computer program in consideration for money).

³⁶⁴ See Rüffler, *supra* note 232, at 57.

³⁶⁵ See, e.g., ULRICH LOEWENHEIM in GERHARD SCHRICKER, URHEBERRECHT [COPYRIGHT LAW] §69c, para. 33 (3rd ed. 2006) (referring to German copyright law); see also WIEBE in KUCSKO (ED.), *supra* note 233, §40c [5.] (referring to Austrian copyright law).

of potential misuse of those digital copies and thus should not trigger exhaustion.³⁶⁶ For proponents of the analogy theory, the above arguments are applicable to transfers of tangible program copies, and as such, are not convincing enough to deny exhaustion to be triggered in the case of online transmission of software.³⁶⁷ Usually a physical copy of software like a CD-ROM is not handed over to the user for the purpose of running the software from that copy. Rather, once the target software has been installed (i.e., copied from the CD-ROM on the permanent storage of the user's computer), the user can redistribute that CD-ROM while (unlawfully) retaining a copy of the software on his personal computer. Computer programs distributed by way of online transmissions can be repeated infinitely, and likewise, computer programs contained in tangible data media can be copied without quantitative limitation.³⁶⁸ For example, the user can burn as many copies of the original CD-ROM as he wishes³⁶⁹ with the intention to sell them in a second step.³⁷⁰ Ultimately, European primary law ends this argument. Even in cases where online distribution of software may be misused by software pirates, the argument by itself does not impact a public interest, nor does it override the fundamental freedom of free movement of goods and services set forth in the EC Treaty or case law.³⁷¹

Lastly, the doctrine of exhaustion is immanent to copyright law³⁷² and cannot be undermined by arguing that online transmission of computer software is not an act of distribution, but instead is covered by the right of public performance, to which exhaustion would not apply.

In conclusion, the main argument raised by proponents of the analogy theory is that the circumstances underlying tangible transfers and non-tangible transfers are the same.³⁷³ In any case, the user-purchaser ends up with a copy of the target software stored on the computer.³⁷⁴

³⁶⁶ See ANDERL in KUCSKO (ED.), *supra* note 233, §16 [4.5.], §40c [5.] (stating that the rightholder cannot control whether the user sells a copy of the first downloaded copy while deleting his copy at the same time, or whether the user puts a further copy of the first downloaded copy into circulation).

³⁶⁷ See Hoeren, *supra* note 209, at 14 (arguing that the average user does not care whether he reproduces the target program by his CD/DVD burner or he downloads the target program from the website of the software author).

³⁶⁸ See WALTER (ED.), *supra* note 191, at 173.

³⁶⁹ See Rüffler, *supra* note 232, at 57 n.59 (citing G. Schneider, Head of Distribution for small enterprises at Microsoft Austria, who said that making a pirate copy of a computer program just needs few mouse clicks and less than one Euro spent for a blank CD-ROM).

³⁷⁰ See *id.* at 57.

³⁷¹ See Rüffler, *supra* note 232, at 58.

³⁷² See Hoeren, *supra* note 209, at 14.

³⁷³ See, e.g., Handig, *supra* note 240, at 4 (arguing that online-exhaustion can be justified by economic reasons); see WALTER (ED.), *supra* note 191, at 173 et seq.

3. Exhaustion and the Reproduction Right

As a consequence of increasing digital recording technology, the exclusive right of reproduction in the context of exhaustion with regard to online transmissions has recently become a significant issue. Exhaustion refers only to the distribution right but not to other exclusive rights;³⁷⁵ i.e., despite exhaustion of the distribution right the reproduction right of the software author remains unaffected. Is copying the target software by the first purchaser lawful? How are software copies rendered for or by the second purchaser treated under copyright law?

Copies of the target software remaining in the hands of the seller of the licenses should be deleted. If the first purchaser sells a single software license to the second purchaser, the copy installed on the first purchaser's computer memory should be deleted and re-installed on the second purchaser's computer memory. In the case of volume software licenses, the first purchaser can keep the (master) copy of the target software provided that he deletes access to the target software on as many workstations as select licenses were sold to the second purchaser.³⁷⁶ If the first purchaser sells the entire bundle of licenses to the second purchaser, he has to uninstall the target software from all workstations on which the target software has been run. After resale the target software will be re-installed on the second purchaser's workstation(s). To conclude, the reproduction right of the software author *de facto* "exhausts" to the extent necessary for redistribution by the first purchaser. Furthermore, the copy of the target software as possessed by the first purchaser (e.g. a copy stored on the hard drive) does not necessarily need to be transferred to the second purchaser. Rather, the first purchaser can make a copy of the target software and hand this copy over to the second purchaser without infringing the software author's exclusive reproduction right.³⁷⁷ However, the legal relationship remains to be reviewed if the first purchaser does not provide the second purchaser with the target software in tangible form.

³⁷⁴ See Hoeren, *supra* note 209, at 15 (referring to the online transmission as "functional equivalent" to the transfer of a material copy embodying the target software—also if a complete loss of data occurs).

³⁷⁵ See Hoeren, *supra* note 209, at 18.

³⁷⁶ See Wiebe/Appl, *supra* note 354, at 186.

³⁷⁷ See Hoeren, *supra* note 209, at 19.

With respect to mainframe systems,³⁷⁸ no additional copies of the target software need to be installed on the workstations.³⁷⁹ The second purchaser is entitled to use the target software on a certain number of workstations. In the case that the second purchaser downloads the target software by himself from the software author's website, the second purchaser has not explicitly been granted the right to do so by the software author. Notwithstanding the lack of entitlement by the software author, copyright law conveys the reproduction right to the second purchaser³⁸⁰ provided that he qualifies as "lawful acquirer" according to Article 5(1) of the EC Software Directive.³⁸¹

³⁷⁸ A mainframe system allows users to run the target software via a network from a mainframe where the target software is installed.

³⁷⁹ See Sosnitzer, *supra* note 359, at 209 (noting that in the reselling only part of the license, the number of workstations having access to the mainframe must be reduced accordingly while the target software stored on the mainframe must not be deleted by the first purchaser).

³⁸⁰ See Hoeren, *supra* note 209, at 19-20.

³⁸¹ See EC Software Directive, *supra* note 186, art. 5(1), at 44.

D. CONCLUSION

As in the United States and most other countries worldwide, copyright law is territorial (i.e., the copyright law of the country where protection is sought applies).³⁸² With respect to distribution of software in the United States and the EC the legal conceptions, as laid down in the Copyright Act, on the one hand and the EC Software Directive on the other, are based on the same legal structure. Both doctrines establish that transfer of ownership of a copy of software by the rightholder relinquishes some of the copyright owner's rights with respect to the use of that copy. However, interpretations and case law relating to the one or the other doctrine reflect different concerns underlying each legal regime.

Under U.S. law, a sale without restrictions or other transfer of ownership means that the purchaser of software has already fully compensated the copyright owner for the use of copyright bound into the software copy. When the copyright owner grants only limited use by licensing its software the market return will be limited accordingly. Thus, under the full compensation concept, software licensing shall not be subject to the first sale privileges. Generally, through different strategies copyright owners attempt to avoid the effects of the first sale doctrine, if not the doctrine itself. The substantial majority of reported cases dealing with software licensing hold that either (i) a licensee can never be the owner for the purpose of sections 109 and 117 of the Copyright Act, or (ii) a licensee is not an owner of a copy if the license terms give the licensee rights that are materially less than the rights that would follow from ownership of the copy, or (iii) ownership is to be reviewed on the basis of the economic realities underlying the particular transaction—irrespective of the extent to which the transferee's rights to use the copy are in fact restricted under the terms of the distribution agreement. Against that backdrop, how can a copyright owner reconcile these disparate decisions and distribute its software under a licensing agreement without triggering the consequences of the first sale doctrine? In other words, how can a copyright holder make sure that that the copy of its software is licensed and not sold?

If the wording of the distribution agreement without doubt grants only a license to the copy of the target software and imposes significant restrictions on the transferee's ability to redistribute that copy or prohibits transfers entirely, U.S. courts seem likely to qualify such distribution agreement

³⁸² See Lothar Determann, Aaron Xavier Fellmeth, *Don't Judge a Sale by its License: Software transfers under the First Sale Doctrine in the United States and the European Community*, 36 U.S.F. L. Rev. 1, at 70 (2001).

as a license rather than a sale.³⁸³ For the sake of clarity the copyright owner is advised to spell out in the licensing agreement that the software vendor is retaining title to the copyright as well to the particular license copy of the target software.³⁸⁴ However, there is still a risk that courts may hold otherwise. With *SoftMan* as precedent in the United States District Court for the Central District of California, courts facing the sales versus license debate now have the opportunity to rule either way. By relying on *SoftMan* courts may find software distributions as sales, grounded on precedent.

However, the paper doubts whether the Supreme Court will side in the future with the pro-sale *SoftMan* approach,³⁸⁵ especially as the software world is dominated by pro-licensing lobbying powers. District Judge Ware, in the *Stargate* judgment, stated that the single payment in consideration for a particular copy of software reflects "the value of the objective code that is burned on the CD-ROM".³⁸⁶ The payment is made for the value of the intellectual property embodied in the material object but not for the material data carrier, like a CD-ROM, that, of itself, is almost worthless.³⁸⁷ Also, the Federal Circuit in *DSC* disputed the concept of economic realities to determine a sale or license. Even though the economic realities of a transaction might suggest a sale, the *DSC* court held that it was not necessarily dispositive proof that the transfer was a sale when "the software is heavily encumbered by other restrictions that are inconsistent with the status of owner."³⁸⁸

The doctrine of exhaustion plays an equally important role in European intellectual property law. Yet the ECJ—unlike U.S. courts—appears to bother less with the legal nature of the respective distribution agreements than with the overriding objective to preserve the free movement and free competition of products protected by intellectual property rights. Notwithstanding the language of Article 4(c) of the EC Software Directive, which resembles the U.S.-like copy-ownership exemption model, European courts avoid a similar sale versus license debate by looking through

³⁸³ Cf. NTIA Report, *supra* note 271, at Part I.3.b ("If rights with respect to these new uses are not expressly granted or retained in license agreements, conflicts will arise between copyright owners and licensees.").

³⁸⁴ "License to the copy of the software" not "to the software."

³⁸⁵ See Yeh, *supra* note 72, at 374 (stating that the economic realities test implies a pro-sale approach, while in four out of four cases applying the restrictive terms test, the distribution agreement in question was held a license rather than a sale).

³⁸⁶ *Stargate*, 216 F.Supp. 2d at 1059-60.

³⁸⁷ See *id.*; see also 1 RAYMOND T. NIMMER, *supra* note 32, §1:115, at 1-305 (stressing that the copy of a particular software itself is not the important element of such a commercial deal).

³⁸⁸ *DSC*, 170 F.3d at 1062.

the form of the distribution agreement in question to the economic realities of the agreement. What the ECJ concerned most was the impairment of the principle of free movement of goods on the single European market by a decrease of cross-border software business. Because of the territorial nature of European copyright laws, neither sellers nor buyers would willingly take the risk to make their rights and obligations subject to different foreign copyright law regimes.³⁸⁹ Furthermore, *de facto* restraint on alienability of software would enable software vendors to control unfair competition. The goals of free movement of goods and free competition do not coexist that easily with the protection of intellectual property rights. While the essential purpose of intellectual property rights is to allow the copyright owner to obtain a national monopoly of exploitation as an incentive to creative endeavor, the essence of EC law is to remove all barriers to trade that may partition the single European market along national lines. This conflict is made possible by the EC Treaty (the Treaty of Lisbon, respectively), which provides that (i) national property regimes of Member States shall remain unaffected by EC rules, and (ii) the free movement rules shall not apply to measures serving enumerated national purposes, including the protection of industrial and commercial property, so long as such measures are not disguised means of arbitrary discrimination.³⁹⁰

On neither side of the Atlantic a clear picture of copyright in the digital network environment has emerged so far from previous discussions. Distribution of software via information superhighway networks, above all the Internet, entails potential proliferation of exclusive rights pertaining to the use of software.

To date, U.S. copyright laws do not provide for a digital first sale doctrine. United States government authorities do not seem to contemplate extending first sale privileges to digital copies, such as electronically distributed computer program copies. The refusal to amend the existing statutory doctrine in a way as to apply also to digital sales is mainly rooted in the different nature of software and traditional copyrighted works. Unlike a transaction involving conventional copyrighted goods, in which a tangible copy changes hands, online distributions

³⁸⁹ With respect to all kind of purchase contracts of goods and services the Council of the European Communities pointed out in the Council Directive 93/13/EC of 5 April 1993 on unfair terms in consumer contracts that a functioning internal market requires guidance for all member states as how to rule on distribution rights of software producers. *See* 1993 O.J. (L 95) recital 5, at 29 ("Whereas, generally speaking, consumers do not know the rules of law which, in Member States other than their own, govern contracts for the sale of goods or services; whereas this lack of awareness may deter them from direct transactions for the purchase of goods or services in another Member State.").

³⁹⁰ *See* EC Treaty, *supra* note 206, art. 30, at 47.

naturally result in a reproduction of the target software on the recipient's computer system. As indicated in the UCITA, the pivotal element of software transactions is enabling the licensee to use the target software. The software vendor can do so by either transferring to the licensee a tangible copy embodying the target software or making the target software available in digital format. If a digital copy is provided, running the software requires making of an at least temporary copy of that software. Irrespective of the existence and effectiveness of a forward-and-delete technology or deletion of the original copy by the transmitter itself, in principle the reproduction of the target software constitutes copyright infringement by the licensee. Making of such copy is only lawful (i) with the copyright owner's consent, (ii) if done for special purposes pursuant to section 117, or (iii) under the fair use privilege of section 107 of the Copyright Act. While distribution of copies made pursuant to section 117 is limited, according to the current statutes, copies made under the safe harbor of fair use may be freely distributed. One may argue that the interplay between section 107 and section 109 implies unwanted consequences. At the same time, it is doubtful whether the licensee's need to make a copy of the target software justifies that the first sale doctrine should not be applicable to digital software copies. Ultimately, the paper concludes that the narrow scope of the first sale doctrine—as currently interpreted in favor of the copyright owner society—is counterproductive in terms of the objective underlying copyright, as well as unduly restrictive to the information trade.

Like U.S. statutory law, EC law does not provide an express provision on exhaustion of digital works. However, by way of interpretation, European legislation allows for linking exhaustion *per analogiam* to copies of the original target software that are made for running the software. The main argument in favor of the analogy theory is that the copyright policy underlying tangible transfers and non-tangible transfers is the same. In any case, the purchaser ends up with a copy of the target software stored on its computer system. The essence of any software transaction is, from a user's view, to obtain the right to use the target software for an unlimited period, and from the rightholder's view, to get financially rewarded for licensing its software to the user.³⁹¹ Thus, exhaustion shall not hinge on the transfer of a physical data medium embodying the target software, but rather on the economic purpose of the transaction.³⁹² Applying exhaustion to the transfer of tangible software copies but not to online transmissions would result in an unintended

³⁹¹ See Handig, *supra* note 240, at 3 (stating that despite its intangible nature, software as such can be subject matter of purchase agreements).

³⁹² See Sosnitza, *supra* note 359, at 207.

outcome at the European level not only in terms of legal certainty, but also for software users and retailers. For example, software service packs are sold to upgrade application software already in use by the purchaser of the service pack. While the main software is usually delivered in tangible form, via a CD-ROM or DVD, service packs pertaining to the main software are often sold and transferred over the Internet. Assuming that exhaustion would apply to the tangible copy embodying the main software and not to the downloaded copy of the service pack software, the user could only resell the outdated main software which will render it economically worthless at the second-hand-market, and/or restrict *de facto* (as measure having equivalent effect) the free movement of goods in the EC. The example shows that the choice of technical means for distributing software—either on tangible data media or by downloading it from the Internet—should be deemed irrelevant as either of the distribution channels chosen will grant the user the right to use the software for an unlimited period of time. To date, in Europe, software retailers and end-users can refer to fairly persuasive authority suggesting the existence of a "digital exhaustion doctrine".

As long as neither the U.S. Supreme Court nor the ECJ has set a precedent in a copyright case involving the transmission of software, the question of whether the first sale/exhaustion doctrine may have a future in the digital age will continue being subject to the lobbying powers of copyright owners and secondary market players at both sides of the Atlantic.