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COPYRIGHT FIRST SALE AND THE OVER- RIDING ROLE OF CONTRACT

Raymond T. Nimmer*

I. INTRODUCTION

This paper deals with the relationship between the copyright law doctrine of “first sale,” and the general law and practice of contracts. In a fundamental sense, this is a very simple topic, although some commentators muddy the topic by arguing for policy positions that have not been and should not be enacted.

Under U.S. law, the relationship between contract and copyright law doctrine can be summarized in a few sentences. Contract law sets out doctrines that enable and enforce terms created by voluntary actions or agreements. Copyright law is a property rights system, the rules of which attach to particular subject matter (“works of authorship”) regardless of any voluntary act or agreement. In this sense, the two bodies of law are independent, and create parallel remedial or rights-creating systems.¹ Contractual terms can be established and enforced even though they differ from copyright terms simply because enforcement of those terms is grounded in the enforcement of contractual promises, and not in direct enforcement of property rights.

But contractual terms have a second relationship to copyright that emerges with the first sale doctrine. As with any property rights system, conveyance in whole or in part of interests in the copyrighted property hinges on the contract

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1. Indeed, as discussed later in this article, this separate character is also recognized in the cases that address whether copyright law preempts contract. *See, e.g., ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996); *Architectronics, Inc. v. Control Sys., Inc.*, 935 F. Supp. 425 (S.D.N.Y. 1996) (copyright did not preempt contract claim). *See also DaimlerChrysler Servs. N. Am., L.L.C. v. Summit Nat'l, Inc.*, 144 F. App'x 542 (6th Cir. 2005).

and the terms of the contractual transaction. In particular, under the so-called “first sale” doctrine, statutory law provides an exemption from certain aspects of the copyright property right, but only to persons who become “owners” of a copy. But it is the terms of the contract transferring the copy that determine whether ownership has been transferred.²

Thus, contract terms dominate both as to contract remedies and as to the existence of the property rights exemption. The question is not *whether* contract terms can control application of first sale rules, but *how* they can exercise that control. As we shall see, appellate courts hold that copy ownership has not been conveyed if the terms of the contract (license) limit the transferee’s right to use or transfer the work that forms the most valuable part of the copy in ways that are inconsistent with ownership.³ The determinative issue of whether there has been a first sale is whether there was an enforceable contract restricting use of the work in ways inconsistent with the rights of a first sale owner.⁴

First sale rules are best understood as defining the property rights consequences of a marketing decision made by the person that controls the copyright; that marketing decision is then incorporated in contract terms. If a rights owner elects to simply sell or give away copies, then first sale rules give the buyer certain limited rights, such as the right to resell the copy, *under property law*. But if the copyright owner (or its agent) elects not to sell copies, first sale rules do not apply. The first sale doctrine is simply a default rule applicable to property rights in reference to one type of market transaction. The doctrine does not require that works be transferred via sales of copies, but merely specifies the property rights consequences if a sale or gift occurs.

2. 17 U.S.C. §§ 109, 117 (2006).

3. See *Vernor v. Autodesk, Inc.*, 621 F.3d 1102, 1112 (9th Cir. 2010) (no first sale); *Wall Data Inc. v. L. A. Cnty. Sheriff's Dep't*, 447 F.3d 769, 785 (9th Cir. 2006) (licensee not an owner); *DSC Commc'ns Corp. v. Pulse Commc'ns, Inc.*, 170 F.3d 1354, 1360 (Fed. Cir. 1999) (no first sale); *Stenograph L.L.C. v. Bossard Assocs., Inc.*, 144 F.3d 96, 99 (D.C. Cir. 1998).

4. See *Vernor*, 621 F.3d at 1109.

II. THE CONTEXT

To understand the relationship between contract terms and first sale it is useful to understand the context in which the issue is debated. There are many aspects to this, but this paper focuses on only three themes relevant in our current context. Each revolves around a fundamental dispute about the proper role and the proper strength of intellectual property rights as a means to support and encourage creative works.

A. *Information Wars*

The first, and broadest, contextual theme concerns what I have elsewhere described as the “information wars.”⁵ Stated simply, generated in part by the explosion in the value of information assets in the digital era, there exist two diametric and sharply opposed views about the appropriate present and future role of intellectual property in reference to the creative or inventive enterprise. The political and policy debate between the two viewpoints is not limited to the United States, but crosses borders globally. Both sides are well-funded, and neither is often willing to compromise with the other’s view.

The one side, which I describe as the “rights restrictors” viewpoint, believes that strong intellectual property rights can often stifle creative work and disrupt or preclude the creation of efficient, relatively low-cost markets for information.⁶ Strong rights, according to this view, diminish the ability of subsequent parties to use part or all of the original work in their own subsequent works, or to use (e.g., copy or distribute) the entire work for purposes different than those intended for the original work.⁷ As a result of their belief in this premise, this group pushes to truncate or eliminate rights, and to expand exemptions or defenses. This they argue enables subsequent parties to use portions of an original work, or to use the entire work itself, to open secondary markets from which the copyright owner will

5. See RAYMOND T. NIMMER, *THE LAW OF COMPUTER TECHNOLOGY* § 1:2 (West 1997, 2010 Supp.). See generally ADRIAN JOHNS, *PIRACY: THE INTELLECTUAL PROPERTY WARS FROM GUTENBERG TO GATES* (2010).

6. NIMMER, *supra* note 5, § 1:2.

7. See, e.g., *Campbell v. Acuff-Rose Music, Inc.*, 510 U.S. 569, 578–79 (1994) (establishing the concept of transformative use as fair use).

derive no income. The argument is *not* that no intellectual property rights should exist, but that the rights should be tailored to provide only the *minimum* necessary support for original work. This group argues that, when in doubt, courts and legislators should err on the side of reducing rights, rather than expanding or preserving them. One author, describing a main theme followed by this group, commented that the belief is that, when copyright law is in actual or perceived conflict with any other social interest, the other interest should prevail.⁸

It is under this general banner that we see decisions such as the Ninth Circuit ruling in *Perfect 10 v. Amazon.com*.⁹ In that case, an online search engine copied images from other websites and reduced them to thumbnail images that were then used commercially on a visual search engine.¹⁰ All of this occurred without the permission of the copyright owner.¹¹ Although the court acknowledged that these facts presented a *prima facie* case of direct infringement, it held that this verbatim copying was a protected fair use, commenting:

Just as a “parody has an obvious claim to transformative value” because “it can provide social benefit, by shedding light on an earlier work, and, in the process, creating a new one,” a search engine provides social benefit by incorporating an original work into a new work, namely, an electronic reference tool. Indeed, a search engine may be more transformative than a parody because a search engine provides an entirely new use for the original work¹²

But the court’s reference to “transformative use” perverts the concept set out by the Supreme Court when it used this language in *Campbell v. Acuff-Rose Music*.¹³ The Court there

8. See James V. DeLong, *Defending Intellectual Property*, in *COPY FIGHTS* 17, 19 (Adam Thierer & Clyde Wayne Crews eds., 2002).

9. *Perfect 10, Inc. v. Amazon.com, Inc.*, 508 F.3d 1146, 1172 (9th Cir. 2007).

10. *Id.* at 1155–57.

11. *Id.* at 1157.

12. *Id.* at 1165 (citations omitted).

13. *Campbell v. Acuff-Rose Music, Inc.*, 510 U.S. 569, 579 (1994)

The central purpose of this investigation is to see, in Justice Story’s words, whether the new work merely “supersede[s] the objects” of the original creation, or instead adds something new, with a further purpose or different character, altering the first with new expression, meaning, or message; it asks, in other words, whether and to what

dealt with the use of only part of a work to create an entirely different work—a parody.¹⁴ In *Perfect 10*, by contrast, the defendant used a complete copy of the work, but for a purpose different from that intended by the copyright owner.¹⁵ The different purpose, however, did not transform the work but potentially preempted a market for the work that the rights owner might very well have decided to enter by direct participation or through licensing.¹⁶

More generally, the issue was not whether search engines provide a social benefit.¹⁷ The issue was whether copyright owners should be forced to contribute their works in full to the search engine for free in order to support this alleged social benefit. This issue was one of allocating potentially significant value between the copyright owner and the search engine aggregator. The Ninth Circuit shifted value away from content providers and to aggregators (search engine).¹⁸

The competing viewpoint to the rights restrictors, which I describe as “rights enhancers” viewpoint, believes that strong intellectual property rights are *essential* to preserving the innovation that has led to the modern explosion in information asset innovation, and its widespread distribution.¹⁹ The perspective is that strong protection of intellectual property is critical, especially with respect to the many contexts in which substantial time, cost and effort are involved in making the creative work and disseminating it.²⁰ This core premise leads to the observation that modern technology, while offering many new opportunities for creating and distributing information, also threatens the practical ability to enforce rights, thus weakening long-standing incentives established under copyright law.²¹ The

extent the new work is “transformative.”
Id. at 579.

14. *See id.* at 572.

15. *Perfect 10, Inc. v. Amazon.com, Inc.*, 508 F.3d 1146, 1165 (9th Cir. 2007).

16. *Id.* at 1168.

17. *See id.* at 1165. This same concept was recognized, but not resolved, in *Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd.*, 545 U.S. 913, 929–30 (2005).

18. *See Perfect 10*, 508 F.3d at 1165.

19. *See NIMMER*, *supra* note 5, § 1:2.

20. *See id.*

21. *Id.*

argument is that this effect should be offset by enhanced, tailored rights.²² It is not that there should be no exemptions or defenses, but that the balance to be established should be drawn in a manner favorable to creating or maintaining robust incentives for creative work.

In addition, the rights enhancer position objects to an increasing tendency in modern law to shift the value obtained from commercial use of creative works away from the creative author and towards aggregators, new technology companies, and individuals who “borrow” (copy) extensively from the work of others or simply make it broadly and freely available. The *Perfect 10* case discussed above is one such case.²³ But there are other illustrations. For example, in *Scranton Times L.P. v. Wilkes-Barre Publishing Co.*,²⁴ a case dealing with alleged misappropriation of online obituaries from a newspaper’s website, the court held that no state law misappropriation claim existed even though the defendant routinely copied the obituaries into its own website.²⁵ The court approached the issue from a perspective of whether the misappropriation claim survived copyright preemption. It concluded that no claim for this type of cause of action could survive unless it was proven that allowing the appropriation to continue would result in the content creator stopping the production of the content.²⁶ In this case, the court felt that publication of obituaries would continue as part of the ordinary business of a local newspaper.²⁷ But, of course, this holding, coupled with the belief that the obituaries were not copyrighted material, shifted value from the content publisher to third parties, such as aggregators and search engines.²⁸

22. *Id.*

23. *See generally* *Perfect 10, Inc. v. Amazon.com, Inc.*, 508 F.3d 1146 (9th Cir. 2007).

24. *Scranton Times, L.P. v. Wilkes-Barre Publ’g Co.*, 92 U.S.P.Q.2d (BNA) 1269 (MD Pa. 2009).

25. *Id.* at 1274–75.

26. *Id.* at 1275.

27. *Id.*

28. Significantly, for our purposes, the court held that an allegation of breach of an online contract stated a valid, not preempted claim. *Id.* at 1276–77. Also, the point is not that all reported cases adopt positions that create this shift, but simply that some do so. *See* *Barclay’s Capital Inc. v. Theflyonthewall.com*, 700 F. Supp. 2d 310, 348 (S.D.N.Y. 2010) (holding that an aggregator that collects and publishes financial news and other information

If this shifting of value in a digital world were to be broadly followed, it would greatly reduce or eliminate licensing revenue that might have arisen from new uses of works, such as with respect to thumbnail use in search engines, and transfer that value to search engines or other aggregators. The result would be a weakening of economic support for creative works by removing a potential source of income.

This paper is not the forum to fully evaluate the competing positions. It is clear, however, that reduced enforceability of rights and enhanced exemptions, whether caused by technology or law or policy decisions, reduces financial incentives for engaging in innovation and creating new works. This reduction in incentives is not always important. Some types of “creative” works are done on low budgets for relatively altruistic reasons. For example, I might film my dog sleeping and post the video on the Internet. My costs are minimal and my incentives to do this are not aimed at financial gain. Similarly, in writing this article, I am not engaged in a money-making enterprise. But economic incentives are important for other types of works, including the type of works that require investment and substantial resources that may not be created if a likelihood of financial return is compromised. The idea of reduced rights and thereby reduced incentives harms this type of development. The concept of weak rights is conducive to a community in which everyone is relatively free to “borrow” from or modify the works of others, what one author has described as “hive” development.²⁹ But the weakening of

from Wall Street through an online subscription news service was liable for misappropriation under the New York common law of unfair competition for the daily copying and distribution of several financial service firms' equity research trading recommendations prior to the market opening, and further holding that a copyright infringement claim was appropriate).

29. See generally JARON LANIER, *YOU ARE NOT A GADGET: A MANIFESTO* (Knopf 2010). See also *Fair Use Principles for User Generated Video Content*, ELECTRONIC FRONTIER FOUNDATION, <http://www.eff.org/issues/ip-and-free-speech/fair-use-principles-usergen>, (last visited Mar. 5, 2011)

Online video hosting services like YouTube are ushering in a new era of free expression online. By providing a home for “user-generated content” (UGC) on the Internet, these services enable creators to reach a global audience without having to depend on traditional intermediaries like television networks and movie studios. The result has been an explosion of creativity by ordinary people, who have

economically relevant income streams has a serious impact on industries that must invest to support the creation of new works. Indeed, one traditional and important copyright industry that requires resources and investment, the newspaper industry, is in the midst of a general failure, having lost many of its traditional income sources.³⁰

Within the broad debate, first sale issues are a frequently discussed topic. Some arguments equate first sale with protecting First Amendment issues. As we see below, first sale concepts do not do this. In fact, the exemptions from copyright infringement generated by a first sale are very narrow and deal mostly with the retransfer or display of a copy, and in the case of computer programs, several steps essential to personal use of the program.³¹ Further, the general ability of copyright (and other intellectual property rights regimes) to limit by contract copying or distribution that might otherwise be free speech or fair use, and the ability of persons to contract away the right to make statements publicly, are both well established.³²

The core of the first sale debate regarding transactions within the United States has to do with two issues. The first issue relates to secondary (e.g., resale) markets for tangible copies distributed initially with the authority of the rights owner. The issue is whether, through appropriately structured transactions, the copyright owner should be able to use copyright law coupled with contract law to help obtain value from secondary markets that involve the retransfer of copies, or whether first sale doctrine relegates the value in all secondary or subsequent markets for transfer of a copyrighted work to other parties, regardless of how the copyright owner structures the initial transactions.

enthusiastically embraced the opportunities created by these new technologies to express themselves in a remarkable variety of ways. *The life blood of much of this new creativity is fair use, the copyright doctrine that permits unauthorized uses of copyrighted material for transformative purposes.*

Id. (emphasis added).

30. See Richard Posner, *Are Newspapers Doomed*, THE BECKER-POSNER BLOG (June 29, 2008, 2:07 PM), <http://www.becker-posner-blog.com/2008/06/are-newspapers-doomed-posner.html>; Thomas C. Rubin, Chief Counsel, Intellectual Property Strategy, Microsoft Corp., *The Change We Need*, Prepared Remarks to the UK Association of American Publishers (Nov. 20, 2008) (on file with author).

31. See 17 U.S.C. §§ 109, 117 (2006).

32. See, e.g., *Davidson & Assocs. v. Jung*, 422 F.3d 630, 639 (8th Cir. 2005).

The issue is simple, but important, in this era of digital works. Copies of digital works are identical to the original and thus compete with the original work even if their transfer technically occurs in a “secondary” market. The secondary and retransfer markets for digital works are a potentially important source of value for digital copyright work creators and a potential threat even to their initial markets. If first sale concepts were interpreted to exclude copyright control in these markets regardless of the type of initial distribution, this result would shift further significant value to third parties and seriously undermine the economic incentives for creative work that copyright rules are intended to promote. A rights restrictor position argues that this is what should occur because expanding unencumbered secondary markets and uses promote significant social values. The rights enhancer position disagrees. The issue is not whether secondary markets are valuable, but whether rights owners should be denied all access to any part of the value they produce, if they choose to do so and the market accepts the choice.

The answer is apparent on the face of the Copyright Act: first sale doctrine excludes copyright owners from secondary market control *only* if they elect to *sell* or otherwise transfer copies in a manner that allows a transferee to become an owner of a copy, rather than licensing rights or making other similar transfers that do not convey copy ownership.³³ Indeed, § 109(d) provides: “The privileges prescribed by subsections (a) and (c) do not, unless authorized by the copyright owner, extend to any person who has acquired possession of the copy or phonorecord from the copyright owner, by rental, lease, loan, *or otherwise*, without acquiring ownership of it.”³⁴

The choice resides in the copyright owners’ marketing decision as to whether to convey or authorize conveyance of copy ownership, and in the market’s reaction to that decision. If a contrary position were intended, the first sale doctrine

33. As the Ninth Circuit pointed out, the “first sale” doctrine actually focuses on statutory privileges given to the owner of a copy. *UMG Recordings, Inc. v. Augusto*, 628 F.3d 1175, 1183 (9th Cir. 2011). In addition to a sale, copy ownership can be conveyed through a gift. *See id.* (holding that unsolicited, free CDs delivered to a large number of recipients with labels purporting to restrict use of the CDs in fact transferred title to the CDs).

34. 17 U.S.C. § 109(d) (emphasis added).

would have been described as the “first transferee” doctrine, and the right to redistribute a copy without infringing the property right would have been made applicable to anyone in “lawful possession” of a copy. But Congress never seriously considered this with respect to the general first sale doctrine in § 109 of the Copyright Act and specifically rejected it in reference to the parallel provisions of § 117 with respect to computer programs.³⁵

A closely related issue centers on whether the copyright owner, through appropriately structured transactions, can establish various differentiated chains of distribution to optimize its return. This involves what some have described as price discrimination—e.g., the ability of the copyright owner to transfer copies at one price or one set of conditions for full commercial use, while doing a separate distribution of the same work for a far lesser price or different conditions for a single, consumer use.³⁶ The ability to do this depends in part on controlling the secondary market for copies (e.g., preventing the one-use purchaser from reselling to a multi-use commercial user). But the issues are different. The ability to control chains of distribution has, in itself, a commercial value that gives the copyright holder the ability to optimize its return on the work and to optimize the availability of its product to others. This ability benefits society generally by creating a world in which a purchaser who needs only limited use does not need to pay a price that subsidizes others who need more broadly framed uses. Yet, some argue that this should not be allowed.

35. See U.S. DEPT. OF COMMERCE, FINAL REPORT OF THE NATIONAL COMMISSION ON NEW TECHNOLOGICAL USES OF COPYRIGHTED WORKS 12 (July 31, 1978), available at <http://digital-law-online.info/CONTU/PDF/Chapter3.pdf> (the proposed CONTU version provided that “it is not an infringement for the *rightful possessor of a copy* of a computer program to make or authorize the making of another copy or adaptation of that program . . .”). Congress, however, substituted the words “owner of a copy” into the final version. 17 U.S.C. § 117.

36. See, e.g., *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996) (distinguishing between distribution systems); *Adobe Sys. Inc. v. One Stop Micro, Inc.*, 84 F. Supp. 2d 1086 (N.D. Cal. 2000) (distinguishing between educational and commercial use distribution systems).

B. Market Setting

A second contextual theme that needs to be understood concerns how copyrighted works find their way to the marketplace. Let us put aside cases of pure theft or blatant and obvious infringement through the making and distribution of numerous unauthorized copies of the work. Then, let us put aside, for the moment, true gifts—not the so-called free software that comes with copyright-based restrictions,³⁷ but an actual, true gift.

Once these cases are eliminated, it should be apparent that most authorized distributions of copyrighted works occur in the context of a contract-based exchange. There is no doubt that Congress, in enacting the Copyright Act, understood this. The fact that contract terms are involved means simply that the decision to sell or not sell copies is a decision made by the property rights owner, and is either accepted or rejected by the commercial or consumer market into which the property rights owner first distributes its valuable work. This is not a unilateral choice by the copyright owner since its acceptability must be measured and accepted or rejected in the relevant market. But it is a choice made available to the rights owner.

Over the years, various copyright industries have made different marketing choices for the core of their industries. During the print era, book publishers chose to sell copies to distributors on a “sale or return” basis, thus allowing application of the first sale doctrine as to those distributors and leaving the copyright holders with no more than a contract claim if a resale by the distributor fell outside the scope of the distribution contract.³⁸ *During the print era*, newspapers sold physical copies to subscribers and on-the-street buyers, while licensing content from others to create

37. See NIMMER, *supra* note 5, § 1:90; see generally Greg Vetter, *The Collaborative Integrity of Open Source Software*, 2004 UTAH L. REV. 563 (analyzing legal restrictions, including copyright based restrictions, on certain open-source software).

38. See, e.g., *Christian v. Barricade Books, Inc.*, No. Civ. 02-408-B, 2003 WL 21146168 (D.N.H. May 15, 2003) (sale or return); *Paramount Pictures Corp. v. Carol Publ'g Grp., Inc.*, 25 F. Supp. 2d 372 (S.D.N.Y. 1998) (infringement issue; discusses sale or return format); *Kogan v. Longstreet*, 374 F. Supp. 47 (N.D. Ill. 1974) (jurisdiction issue; discusses sale or return format). See also *Van Valkenburgh, Nooger & Neville, Inc. v. Hayden Publ'g Co.*, 281 N.E.2d 142 (1972) (discussing action by an author against publisher for breach of contract).

the print publications.³⁹ Other copyright industries engaged in mixed distribution approaches.⁴⁰

In the digital era, all of the traditional content industries have moved to a mixed model of distribution and many new industries only use digital distributions subject to license agreements.⁴¹ While simple outright sales of copyright works continue to occur in some of the industries, the increasingly common method of distribution is online access or downloading, or a distribution under licenses related to tangible copies.⁴² There are many business reasons for using these methods. The implemented options are dazzling: licensed e-books in addition to sales of hard cover books, newspapers sold in paper form in addition to online editions, software provided on plastic medium and also made available for access in the Internet cloud, etc.

39. See, e.g., *Random House, Inc. v. Rosetta Books L.L.C.*, 283 F.3d 490 (2d Cir. 2002) (based on industry practice, grant of right to reproduce in book form had narrow meaning limited to print books); *Bruce v. Weekly World News, Inc.*, 310 F.3d 25 (1st Cir. 2002).

40. See, e.g., *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417 (1984) (broadcast television programs; copying is fair use); *Specht v. Netscape Commc'ns Corp.*, 306 F.3d 17 (2d Cir. 2002) (download software); *Trandes Corp. v. Guy F. Atkinson Co.*, 996 F.2d 655 (4th Cir. 1993) (software transferred in trade secret copies); *Adobe Sys. Inc. v. One Stop Micro, Inc.*, 84 F. Supp. 2d 1086 (N.D. Cal. 2000) (copies transferred; licensee not an owner of the copy); *Davidson & Assocs. v. Jung*, 422 F.3d 630 (8th Cir. 2005) (games transferred with option for online use).

41. See, e.g., *N.Y. Times Co. v. Tasini*, 533 U.S. 483 (2001) (articles digitized); *Register.Com, Inc. v. Verio, Inc.*, 356 F.3d 393 (2d Cir. 2004) (database available online); *Greenberg v. Nat'l Geographic Soc.*, 497 F.3d 1213 (11th Cir. 2007), *rev'd en banc*, 533 F.3d 1244 (11th Cir. 2008) (no violation of copyright when collective work author digitized prior magazine issues, but did so in a manner that users would see the articles in their original context); *Random House, Inc.*, 283 F.3d 490 (e-books); *Universal City Studios, Inc. v. Corley*, 273 F.3d 429 (2d Cir. 2001) (DVD distribution of motion pictures); UNITED STATES COPYRIGHT OFFICE, DIGITAL MILLENNIUM COPYRIGHT ACT SECTION 104 REPORT 5-9 (August 2001), available at <http://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf>.

42. See, e.g., *MDY Industries, L.L.C. v. Blizzard Entm't Inc.*, 629 F.3d 928 (9th Cir. 2010) (computer game); *Vernor*, 621 F.3d 1102 (software); *Register.Com, Inc.*, 356 F.3d 393 (database); *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147 (7th Cir. 1997) (computer); *Brower v. Gateway 2000, Inc.*, 676 N.Y.S.2d 569 (App. Div. 1998) (computer); *Schwartz v. Comcast Corp.*, No. 06-4855, 2007 WL 4212693 (3d Cir. Nov. 30, 2007) (cable service); *Briceno v. Sprint Spectrum, L.P.*, 911 So. 2d 176 (Fla. Dist. Ct. App. 2005) (terms of a cell phone agreement binding).

Thus, the basic transactional landscape is one with many different market options and decisions, some involving a sale of a copy. Unless the goal is to preclude this vibrant diversity, the issue is not *whether* a transaction can create or avoid a first sale and its effect on property law rights, but *how* that can occur and whether the copyright owner chooses that method. Perhaps an even more pertinent question is whether copyright should continue to support creative persons and entities by honoring their choices or the choices of the entities to which they have transferred rights.

C. Preemption

The third contextual theme resides in the belief or argument that the terms of the Copyright Act define a *delicate* balance that, as a matter of policy, cannot be altered by contract or other means.⁴³ In fact, the “balance” enacted under copyright law is not a delicate one, but it is a rough balance, moderated by indeterminate doctrines such as the meaning and scope of fair use,⁴⁴ what constitutes copying an idea as compared to an expression,⁴⁵ and what constitutes

43. See e.g., Pamela Samuelson, *The Copyright Grab*, WIRED 4, Jan. 1996, available at <http://www.wired.com/wired/archive/4.01/white.paper.html>; Anne K. Fujita, *The Great Internet Panic: How Digitization is Deforming Copyright Law*, 2 J. TECH. L. & POL'Y 1 (1996); Howard Besser, *Recent Changes in Copyright: Attacks Against the Public Interest*, RECENT CHANGES TO COPYRIGHT (Nov. 3, 2000), <http://besser.tsoa.nyu.edu/howard/Papers/copyright99.html>.

44. See, e.g., *Dellar v. Samuel Goldwyn, Inc.*, 104 F.2d 661, 662 (2d Cir. 1939) (explaining that because of its fluid nature, the fair use doctrine is one of “the most troublesome in the whole law of copyright”).

45. 17 U.S.C. § 102(b) (2006). As to how one approaches distinguishing an idea and expression, there are literally hundreds of cases. See generally *Plains Cotton Coop. Ass'n of Lubbock, Tex. v. Goodpasture Computer Serv., Inc.*, 807 F.2d 1256 (5th Cir. 1987); *Durham Industries, Inc. v. Tomy Corp.*, 630 F.2d 905 (2d Cir. 1980); *Sid & Marty Kroft Television Prods., Inc. v. McDonald's Corp.*, 562 F.2d 1157 (9th Cir. 1977). The primary case in this field talks about considering a work in terms of levels of abstraction in that at some level of abstraction, copying relates solely to the idea, rather than to the expression of it. See *Nichols v. Universal Pictures Co.*, 45 F.2d 119 (2d Cir. 1930)

Upon any work, and especially upon a play, a great number of patterns of increasing generality will fit equally well, as more and more of the incident is left out. The last may perhaps be no more than the most general statement of what the play is about . . . but there is a point in this series of abstractions where they are no longer protected since otherwise the playwright could prevent use of his ideas to which, apart from their expression, his property is never extended.

Id. at 121.

copying a fact as compared to an expression about a fact.⁴⁶ Equally important is the notion that whatever balance that copyright law sets out, it is a balance focused solely on *property law*, as articulated in the Copyright Act, and on efforts under state law to create equivalent rights. And, as we see below, that balance drawn in the Copyright Act defers to contract terms in reference to whether a first sale occurs.

The idea that the balance set out in copyright law cannot be altered by contract or other law, ultimately, is an argument based loosely on the idea that federal copyright (property) law preempts alternative solutions under other, non-property laws. Removed from simplistic policy positions or arguments, such as the assertion that interference with copyright law balance is unacceptable, the notion of federal preemption is grounded in the idea that, within the realm of its competence, federal rules can override state law. There are three conditions under which preemption might occur:

- state law is preempted if a federal law *expressly* provides for such preemption (express preemption);
- state law is preempted if federal law entirely and *exclusively occupies* a field and the state law attempts to intrude into that field (field preemption); and
- state law is preempted if a state law is *inconsistent* with and impedes the achievement of federal policy as expressed in federal law or regulation (conflict preemption).⁴⁷

Copyright law exclusively occupies the field of *property law* associated with copyright subject matter and rights

46. See *BUC Int'l Corp. v. Int'l Yacht Council Ltd.*, 489 F.3d 1129, 1144–45 (11th Cir. 2007) (stating that the merger doctrine does not preclude copyright for compilation of information about yachts listed for sale; originality to be determined by jury); *CDN Inc. v. Kapes*, 197 F.3d 1256, 1261 (9th Cir. 1999) (explaining that estimated prices of coins constituted expression, rather than unprotected facts); *Barclay's Capital Inc. v. Theflyonthewall.com*, 700 F. Supp. 2d 310 (S.D.N.Y. 2010) (copyright claim may exist); *Nautical Solutions Mktg. Inc. v. Boats.com*, No. 8:02-CV-760-T-23TGW, 2004 WL 783121, at *2 (M.D. Fla. April 1, 2004) (“Boat Rover’s momentary copying of Yachtworld’s public web pages in order to extract from yacht listings facts unprotected by copyright law constitutes a fair use . . .”).

47. See, e.g., *Saridakis v. United Airlines*, 166 F.3d 1272, 1276 (9th Cir. 1999). See also, *NIMMER*, *supra* note 5, § 3:59.

equivalent to copyright. It contains an express preemption provision, as § 301 states:

(a) [All] legal or equitable rights that are equivalent to any of the exclusive rights within the general scope of copyright . . . come within the subject matter of copyright [and] are governed exclusively by this title. [No] person is entitled to any such right or *equivalent right* in any such work under the common law or statutes of any State.

(b) Nothing in this title annuls or limits any rights or remedies under the common law or statutes of any State with respect to . . . activities violating legal or equitable rights that are *not equivalent* to any of the exclusive rights within the general scope of copyright⁴⁸

Properly, the cases have focused on the express statutory reference to the preemptive effect being limited to laws that purport to create rights *equivalent* to copyright law. The test for when this occurs concerns whether the state claim merely creates rights to prevent copying, distribution, or the like, or whether another, different element is involved in establishing the relevant rights under state law. This requires an analysis of the elements of the cause of action and of the substantive policy that sustains the claim under state law. In other words, a court must make a qualitative judgment as to whether the rights asserted are nonequivalent to copyright rights, and whether they are based on justifiable state-law interests as an independent policy. Or, the court must determine whether the asserted rights are instead a mere subterfuge for a state claim identical to copyright.

The most generally applied test is referred to as the “extra-elements” test.⁴⁹ The approach entails a two-part standard. It involves, first, determining whether the cause of action involves the subject matter of copyright and, second, if so, determining whether the cause of action protects rights that are “equivalent” to any of the exclusive rights of a federal copyright or requires proof of a qualitatively significant, additional element.⁵⁰ According to this test, “[if] one or more qualitatively different elements are required to constitute the state-created cause of action being asserted, then the right

48. 17 U.S.C. § 301 (2006) (emphasis added).

49. *Computer Mgmt. Assistance Co. v. Robert F. DeCastro, Inc.*, 220 F.3d 396, 404 (5th Cir. 2000).

50. *Daboub v. Gibbons*, 42 F.3d 285, 289 (5th Cir. 1995).

granted under state law does not lie 'within the general scope' of copyright and preemption does not occur."⁵¹

Under this standard, the vast majority of reported cases reach the obvious conclusion that properly stated contract claims are not preempted by copyright law.⁵² Protection of contractual and other relationships is a valid state-law interest independent of the property rights created under copyright law. Allegations that a contractual obligation or a confidence has been breached, allegations essential to a contract claim or a trade secret claim, go beyond those necessary for copyright infringement. The presence of qualitatively independent elements based on sustainable state policy removes the cause of action from the preemptive scope of copyright law.

For contract claims, the additional element is obvious. Contracts are based on agreements and enforceable promises. Enforcing the terms of these promises is not equivalent to enforcing property rights. The promise and the enforcement of that promise is the extra element that makes the contract and claims related to it different from the property rights themes of copyright law.

The Seventh Circuit Court of Appeals in *ProCD, Inc. v. Zeidenberg*,⁵³ the first appellate ruling dealing with the enforceability of shrink-wrap licenses, held that the shrink-wrap license was enforceable and that the contractual restrictions it placed on the use of a non-copyrightable database were not preempted by copyright law.⁵⁴ The court concluded that a contract and its enforcement do not create

51. See *Computer Mgmt. Assistance Co.*, 220 F.3d at 404; *Daboub*, 42 F.3d at 289; *Crooks v. Certified Computer Consultants, Inc.*, 92 F. Supp. 2d 582, 586 (W.D. La. 2000).

52. See *Lynn v. Sure-Fire Music Co., Inc.*, 237 F. App'x. 49, 54 (6th Cir. 2007) (holding that copyright did not preempt contract claims); *Davidson & Assocs. v. Jung*, 422 F.3d 630, 639 (8th Cir. 2005); *Grosso v. Miramax Film Corp.*, 383 F.3d 965, 968 (9th Cir. 2004) (an extra element precludes preemption of contract claim); *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996).

53. *ProCD, Inc.*, 86 F.3d 1447.

54. *Id.* at 1454–55. See also *Grosso*, 383 F.3d at 968 (an extra element precludes preemption of contract claim); *Telecom Technical Servs. Inc. v. Rolm Co.*, 388 F.3d 820, 833 (11th Cir. 2004) (stating that a claim requiring proof that defendants had violated the terms of the plaintiff's software license had an additional element that precluded preemption); *Lynn*, 237 F. App'x. at 54 (holding that copyright did not preempt contract claims); *Architectronics, Inc. v. Control Sys., Inc.*, 935 F. Supp. 425, 442–43 (S.D.N.Y. 1996) (holding that copyright did not preempt contract claim).

rights equivalent to copyright for purposes of preemption analysis.⁵⁵ The rights involved are entirely different. The court explained: "rights . . . equivalent to any of the exclusive rights within the general scope of copyright" are rights established by law.⁵⁶ This means that the preempted rights are those that restrict the options of persons who are strangers to the information owner. In contrast to a contractual right, a copyright is a right against the world. Contracts affect only their parties, and thus strangers may do as they please.

The court emphasized that the result does not change simply because the contract deals with limiting the use of information that is not protected under copyright law.⁵⁷ Illustrations of enforceable contracts relating to unprotected works, or related to creating restrictions beyond copyright language, abound, and according to the court, include customer list trade secrets, video store home use rentals, and LEXIS educational use licenses. Promises to pay for information assets may be enforced even though federal law offers no protection against third-party uses of that property. The contract terms are not precluded by copyright rules.

[E]nforcement of the contract . . . will not withdraw any information from the public domain. Everyone remains free to copy and disseminate all 3,000 telephone books that have been incorporated into ProCD's database. Anyone can add codes and zip codes. ProCD's rivals have done so. Enforcement of the shrinkwrap license may even make information more readily available, by reducing the price ProCD charges to consumer buyers. Whether a particular license is generous or restrictive, a contract may be enforced. The fact that property rights law does not preempt enforcement of contractual terms, whether embodied in shrinkwrap licenses, other commercial standard forms, or custom-negotiated agreement, has been recognized by all of the courts of appeal that have considered the question.⁵⁸

Other courts of appeals that have addressed this issue have held that contractual terms barring reverse engineering

55. *ProCD, Inc.*, 86 F.3d at 1454–55.

56. *Id.* at 1453.

57. *Id.* at 1454.

58. *Id.* at 1455.

that might be fair use are enforceable under contract law. This, for example, was the conclusion of the Court of Appeals for the Federal Circuit in *Bowers v. Baystate Technologies, Inc.*⁵⁹ In *Bowers*, the Federal Circuit held that the contract term forbidding reverse engineering was not preempted by copyright law and was enforceable.⁶⁰ Copyright policy did not limit the application of a “no reverse engineering” clause. Basically, the court distinguished between copyright policies applicable where issues center on property rights, and policies that support the enforcement of contractual relationships. The contract was fully enforceable.

The Court of Appeals for the Eighth Circuit confirmed this result in *Davidson & Assocs. v. Jung*.⁶¹ The court held that a shrink-wrap license that barred reverse engineering was not preempted by federal fair use law.⁶² The defendant had argued that this contract term impermissibly impinged on the licensee’s right to make fair use of the work.⁶³ The court said simply:

Appellants contractually accepted restrictions on their ability to reverse engineer by their agreement to the terms of the TOU [terms of use] and EULA. “[P]rivate parties are free to contractually forego the limited ability to reverse engineer a software product . . .” and “a state can permit parties to contract away a fair use defense or to agree not to engage in uses of copyrighted material that are permitted by the copyright”⁶⁴

Davidson and the other courts that enforce contracts, have it right. Copyright and its subject matter (property rights in intellectual property) may be different from other types of property law and subject matter. But there is at least one way that copyright is not different: it deals with property rights and leaves contracts, contract law, and

59. *Bowers v. Baystate Technologies, Inc.*, 320 F.3d 1317 (Fed. Cir. 2003) (contract precluded reverse engineering). See also *Meridian Project Sys., Inc. v. Hardin Const. Co., L.L.C.*, 426 F. Supp. 2d 1101 (E.D. Cal. 2006) (holding that copyright law did not preempt state law claim for breach of software end-user license and contract rights, including the right to prohibit reverse engineering, were not equivalent to exclusive rights within the general scope of copyright).

60. *Bowers*, 320 F.3d at 1324–25.

61. 422 F.3d 630 (8th Cir. 2005).

62. *Id.* at 638–39.

63. *Id.*

64. *Id.* at 639 (citation omitted) (quoting *Bowers*, 320 F.3d at 1325–26).

contract practice to the parties and to their agreements. Contracts are agreements that reflect market choices made by people acting in that market. Contracts are as important in developing and distributing creative works as property law. Indeed, contracts are more important.

Placed in our context, these decisions stand for the simple premise that the copyright “balance” is in fact a balance drawn in a manner that accepts the parties’ abilities to modify their relationship with respect to the copyright subject matter by agreements. The balance is neither immutable, nor perfect. Rather, it accepts the fact that contractual agreements can adjust rights. Parties can contractually agree to waive fair use privileges and can agree to use restrictions on subject matter that the Copyright Act covers. These contractual arrangements do not conflict with copyright law, but are part of the expected interaction between copyright and marketing choices by the copyright owner.

The absence of conflict is even more apparent in reference to first sale doctrines. As discussed below, the privileges created under this doctrine only arise if transfers of a copy convey ownership to the person in possession. But whether that occurs hinges on the contractual terms of the transfer. Contracts do not conflict with first sale concepts, but rather are an integral part of determining when, and if, first sale applies.

III. PROPERTY EXEMPTIONS OF A PERSON IN POSSESSION

In this setting, the interaction of contract and property (copyright) law hinges initially on choices made by the copyright owner as they are accepted (or rejected) in the consumer or commercial market into which the copyright owner chooses to distribute its copyrighted work. If the choice is to sell copies as compared to licensing rights, the Copyright Act provides that the choice to sell relinquishes a limited subset of otherwise exclusive copyright rights that are not relinquished under other choices.

The relevant terms of § 109 of the statute are:

- (a) Notwithstanding the [exclusive rights of the copyright owner], the *owner* of a particular copy . . . lawfully made under this title . . . is entitled, without the authority of the

copyright owner, to sell or otherwise dispose of the possession of that copy

. . .

(c) Notwithstanding the [exclusive rights of the copyright owner], the *owner* of a particular copy lawfully made under this title . . . is entitled . . . to display that copy publicly . . . to viewers present at the place where the copy is located.

(d) The privileges prescribed by subsections (a) and (c) do not, unless authorized by the copyright owner, extend to any person who has acquired possession of the copy . . . by rental, lease, loan, or otherwise, without acquiring ownership of it.⁶⁵

Similar, but somewhat broader coverage is provided for an *owner* of a copy of a computer program.⁶⁶

There are several conclusions apparent from the face of this language. Let us focus on two. Initially, it is obvious that the exemptions from the exclusive rights of the copyright owner given to the owner of a copy are very narrow. On the face of the basic language, this is not a broad exemption. It does not authorize the copy owner to make and distribute additional copies. It does not address what usages the copy owner may make of the work, nor does it enable the copy owner to make adaptations and change the work. It does not limit contractual rights. It does not address competition or antitrust issues and it does not address First Amendment interests. All of these and other interests are covered, if at all, by different law, including concepts of fair use. First sale, on the other hand, deals primarily with the conditions under which the property rights of the copyright owner are excluded or compromised with respect to a copy owner's ability to *redistribute that copy*. If a transferee takes ownership of a copy under a first sale, it can redistribute the particular copy without further permission from the copyright owner and without infringing the copyright owner's exclusive distribution right.

Even within this narrow scope, the concept of first sale is further limited by the fact that the exemption is only provided to persons who are "owners" of a copy of the work

65. 17 U.S.C. § 109 (2006) (emphasis added).

66. *Id.* § 117.

and then only with respect to the copy they “own.” Whether a transaction conveys ownership to the transferee depends on the terms of the contract involved in the transactional conveyance to the transferee. It is in this respect that contract terms dominate copyright property law, even as to property rights issues. The terms of the contract, or other transaction that conveys the copy, determine whether the transferee is an owner or a “person who has acquired possession of the copy . . . by rental, lease, loan, *or otherwise*, without acquiring ownership of it.”⁶⁷

Therefore, the property rights question regarding the first sale exemption hinges on whether the transactional (contract) terms, those that moved the copy to the initial transferee, trigger the copy ownership exemption. If the transaction does not convey ownership of a copy, then first sale exemptions are not present in property law or contract law.

The policy adopted in first sale doctrine is often misconstrued. The policy does not give everyone in lawful possession of a copy of a work the right to resell that work. If that were the case, then the statute should have referred to rights of the first transferee. But that is not what happened; rather, the exemption is a limited one. It gives freedom to resell a copy, under copyright property law, *only* to owners of a copy. What determines whether a transaction conveyed copy ownership in a transactional context are the terms of the contract. By the explicit terms of copyright law, contract terms govern the scope, or even the existence, of the first sale exemption.

Some argue that courts should, through a “common law” approach, expand on this statutory scheme.⁶⁸ That idea is simply wrong. It is wrong because it argues for supplanting congressional judgment with ad hoc judicial rulings. A legislative decision was made about the proper scope of an exemption for persons who receive a particular type of transfer (copy ownership). This policy decision should not be

67. *Id.* § 109(d) (emphasis added).

68. Jason Schultz, Assistant Clinical Professor of Law and Director of the Samuelson Law, Technology & Public Policy Clinic, University of California, Berkeley School of Law, Panel Discussion at the Santa Clara University Law Review and High Tech Law Institute Symposium: Exhaustion and First Sale in IP (Nov. 5, 2010).

undermined or altered by courts pursuing their own view of appropriate policy. If the transferee does not receive ownership of a copy, the exemption, or anything like it, does not exist.

IV. THE ROLE OF CONTRACT

So, what is the relationship between copyright and contract on this issue? Contract terms control whether the transferee becomes an owner *and* puts contractual restraints on what the transferee can do. Both aspects are important and they create parallel, but independent, remedial or obligation streams.

Contract terms create obligations between the parties to the contract that are independent of the property-based rights centered on copyright law.⁶⁹ As a result, breach of a contractual restriction yields a right to contractual remedies, even if the transaction created a first sale and the conduct is not infringement under property law. This contract claim is independent of whether a first sale occurred. However, the claim extends only to parties to the contract or the assignees who accept the contract.

To be specific, let us assume that a licensee obtains a copy through an enforceable contract that limits its right to transfer that copy and restricts use of the copy to "household purposes." The licensee nevertheless makes an unauthorized transfer or uses the work for commercial purposes. Regardless of whether the licensee is considered the owner of the copy (it should not be in this hypothetical), the acts that violate the terms of the contract constitute a breach of contract as between the licensee and licensor.

The contract terms also determine whether a transfer of ownership of a copy has occurred. This raises the core first sale issue under copyright law because it determines the scope of property rights as applied to subsequent transfers and transferees of the copy. Thus, in the foregoing hypothetical, whether the unauthorized transfer constitutes infringement of the distribution right and whether it gives the copyright owner a right of action against the transferee as well as the transferor under property law may hinge on

69. See, e.g., *DaimlerChrysler Servs. N. Am., L.L.C. v. Summit Nat'l, Inc.*, 144 F. App'x. 542, 548 (6th Cir. 2005).

whether the license contract terms conveyed ownership of the licensed copy.

A. *Enforceability of the Contract Terms*

The first question to consider is whether the contract terms are enforceable. Clearly, in most upstream or business-to-business (“commercial”) transactions, the enforceability of a properly drafted and agreed-to contract should seldom be questionable. Very few commentators would disagree with this. Further, once the initial, commercial contract neither makes a first sale, nor authorizes a subsequent first sale, first sale rules become irrelevant. There is no concept of a remote, good faith purchaser under copyright law as to property rights claims under copyright law.⁷⁰

The issue is not “whether” but “how” contract terms convey a copy without creating a transfer of ownership. Much of the debate about the use of contract terms to avoid a first sale has focused on two structural issues.

B. *Mass-market Licenses*

The first issue raised by rights restrictor advocates centered on whether a first sale can be avoided in mass market contexts under *any contractual context*. There have been many overlapping arguments purporting to support this position; all have failed in judicial and legislative venues. But two are relevant to the purposes of this article.

Early on, many academics and lawyers contested whether the use of what once were described as “shrink-wrap” license agreements could ever create an enforceable contract.⁷¹ Their argument was that the contract terms were

70. See, e.g., *Vernor v. Autodesk, Inc.*, 621 F.3d 1102 (9th Cir. 2010) (initial transfer not first sale; transferee cannot be an owner); *Microsoft Corp. v. Grey Computer*, 910 F. Supp. 1077 (D. Md. 1995); *Microsoft Corp. v. Harmony Computers & Elecs. Inc.*, 846 F. Supp. 208, 211 (E.D.N.Y. 1994).

71. See, e.g., Stephen Kyle Tapp & Daniel E. Wanat, *Computer Software Copyright Issues: Section 117 and Fair Use*, 22 MEM. ST. U. L. REV. 197 (1992); Robert A. Kreiss, Comment, *Section 117 of the Copyright Act*, 1991 BYU L. REV. 1497. See also Lothar Determann & Aaron Xavier Fellmeth, *Don't Judge a Sale by its License: Transfers Under the First-Sale Doctrine in the United States and the European Community*, 36 U.S.F. L. REV. 1 (2001); Dennis S. Karjala, *Federal Preemption of Shrinkwrap and On-Line Licenses*, 22 U. DAYTON L. REV. 511 (1997).

not enforceable and, therefore, could not create a relationship that was not a first sale. In essence, the position was that the contractual terms were ineffective because of an absence of assent or true bargaining. Some still claim to believe this to be true. But the case law has broadly held that, properly presented and assented to, these mass-market contracts are enforceable.⁷²

The pro-rights reasoning that supports this case law is simple: the vendor (copyright owner) can determine under what conditions it chooses to market its works—whether by sale, license, lease, or otherwise—and at what price. The customer/licensee can decide whether to accept those conditions or whether to purchase a different digital product. The result is that, even in the mass-market, contractual terms, properly presented and accepted by the transferee, can define whether the transaction conveys ownership. The only real issue is whether the terms are presented properly and assent is obtained.

Some academics and lawyers have argued that the terms, even if properly presented and accepted, entail a *unilateral* circumvention of the Copyright Act's first sale rule if they are allowed to be enforceable and, as a result, that they should be precluded.⁷³ This is simply wrong. This argument ignores the context in which transactions occur, in a marketplace. That marketplace involves many producers and many consumers. Therefore, terms that are objectionable and relevant to the consumer will not last in that marketplace, since other options are available.

72. See, e.g., *Bowers v. Baystate Techs., Inc.*, 320 F.3d 1317 (Fed. Cir. 2003), *cert. denied*, 123 S. Ct. 2588 (2003) (shrink wrap license was effective); *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147 (7th Cir. 1997) (contract enforceable based on use of computer without objecting to terms); *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996); *I.Lan Sys. Inc. v. Netscout Serv. Level Corp.*, 183 F. Supp. 2d 328 (D. Mass. 2002) (shrink wrap license enforceable under Article 2 of the Uniform Commercial Code); *M.A. Mortenson Co., Inc. v. Timberline Software Corp.*, 970 P.2d 803 (Wash. Ct. App. 1999), *aff'd*, 998 P.2d 305 (Wash. 2000) (license enforced).

73. See, e.g., Henry Sprott Long III, *Reconsidering the "Balance" of the "Digital First Sale" Debate: Re-examining the Case for a Statutory First Sale Doctrine to Facilitate Second-Hand Digital Media Markets*, 59 ALA. L. REV. 1183 (2008); John A. Rothchild, *The Incredible Shrinking First-Sale Rule: Are Software Resale Limits Lawful?*, 57 RUTGERS L. REV. 1 (2004); David A. Rice, *Licensing the Use of Computer Program Copies and the Copyright Act First Sale Doctrine*, 30 JURIMETRICS J. 157 (1990). Cf. Holly K. Towle, *The Politics of Licensing Law*, 36 HOUS. L. REV. 121 (1999) (calling for uniform legislation in the age of the Internet).

This is not a unilateral process. In fact, many modern mass market licenses today give the licensee greater rights than would occur under a simple sale, while regulating uses to which first sale doctrine does not apply. Indeed, one participant in the conference from which this paper emerged, commented that consumers do not make choices based on the nature of license terms.⁷⁴ This is most likely not true. But even if it were true, it does not mean that the terms are oppressive as to consumers or commercial transferees.

C. Single Payment Perpetual License

The second context where any serious debate exists about whether contract terms control first sale concerns licenses that deal with a work embedded in a tangible media, and that combine a single payment with a license that is perpetual as long as the licensee conforms to the terms of the license. The argument of rights restrictors is that this combination per se transfers ownership even if the contract limits the ability of the use of the digital work contained on the plastic medium.⁷⁵ The parallel position would be that if I lend you my car without specifically limiting how long you can continue to use it, but on the condition that you are not to take the car outside of Houston, you own the car. That is, of course, facially absurd.

The focus of this rights restrictor argument is on ownership of the plastic media. The statute gives first sale rights to the owner of a copy. The anti-rights position is that if you obtain the plastic medium for a single payment and are never contractually required to return the plastic, you own the plastic. So be it. But why does that matter? The rights restrictor argument, intended to reduce the scope of the rights of a copyright holder, misconstrues both the statute

74. Panelist discussing Copyright Issues, Afternoon Panel Discussion at the Santa Clara University Law Review and High Tech Law Institute Symposium: Exhaustion and First Sale in IP (Nov. 5, 2010).

75. See *DSC Commc'ns Corp. v. Pulse Commc'ns, Inc.*, 170 F.3d 1354, 1360 (Fed. Cir.1999) (describing and rejecting this approach as being overly simplistic). Interestingly, one source cited for this argument was a portion of a book I wrote in 1985, before any significant development in case law or practice. See RAYMOND NIMMER, *THE LAW OF COMPUTER TECHNOLOGY* (Warren, Gorham & Lamont 1985). The flaw in that early analysis, as I point out here and as appellate courts have uniformly concluded, is that focusing on ownership of the plastic focuses on the least valuable part of the copy.

and the nature of contractual terms. Every appellate court to consider the issue has rejected it.⁷⁶

First, it is important to consider whether the plastic medium is the primary concern. The first sale concept gives privileges to the owner of a “copy”. But the statute defines a copy not as the plastic alone, but as the plastic medium *with the copyright work* fixed to it. The language is as follows:

“Copies” are material objects . . . in *which a work is fixed* by any method now known or later developed, and from which the work can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device. The term “copies” *includes* the material object . . . in which the work is first fixed.⁷⁷

The “copy” is not simply the plastic medium, but the *combination* of the work *and* the plastic or other material object. Given that, all appellate courts that have addressed the issue have held that you are not the owner of a “copy” if the contractual transfer to you significantly restricts your right to use the most valuable part of the “copy”—the work embedded in it.⁷⁸ A license transaction that gives the licensee the right to use the work one time only is not a first sale of a copy, even if the transferee is never required to return the plastic medium on which the work is fixed. The transferor has not conveyed or received the full value of that copy that would be associated with a first sale. Would you pay the same amount for a single use license as you would pay for an unlimited use copy? Of course not. The transferee is not paying to acquire the plastic medium, but is acquiring the *copy*, the value of which consists primarily of the copyrighted work and the right to use it.

Regardless of the policy rationale for the first sale doctrine, limited use licenses do not convey ownership of a copy. Yet, the argument has been made that, as to copies, the statute recognizes only a sale or a lease (or rental). This, again, focuses solely on the tangible medium: the plastic. But the statute specifically provides otherwise, as § 109 of the

76. See, e.g., *Vernor v. Autodesk, Inc.*, 621 F.3d 1102 (9th Cir. 2010); *DSC Commc’ns Corp.*, 170 F.3d at 1360 (no first sale); *Stenograph L.L.C. v. Bossard Assocs., Inc.*, 144 F.3d 96 (D.C. Cir. 1998).

77. 17 U.S.C. § 101 (2006) (emphasis added).

78. See, e.g., *Vernor*, 621 F.3d 1102; *DSC Commc’ns Corp.*, 170 F.3d at 1360 (no first sale); *Stenograph L.L.C.*, 144 F.3d 96.

Copyright Act states: “The privileges prescribed by [the first sale doctrine] do not, unless authorized by the copyright owner, extend to any person who has acquired possession of the copy . . . from the copyright owner, by rental, lease, loan, or *otherwise*, without acquiring ownership of it.”⁷⁹ This language specifically recognizes that a transfer other than a lease, loan, or rental may not transfer ownership of a copy. The other option clearly encompasses a license of a digital work.

V. WHAT TERMS RESULT IN A TRANSFEREE NOT BEING AN OWNER?

The proper question is not *whether*, but *how* the terms of a contract can establish a transaction that does not entail a first sale. The genesis of first sale discussions is the Supreme Court decision in *Bobbs Merrill v. Straus*.⁸⁰ That case, decided in 1908, examined whether a notice below the copyright notice in a hard-cover book could restrict the resale price that was permitted for the particular copy.⁸¹ The Court held that the notice was not effective.⁸² But in that case, there was no contract argument presented to the Court. The Court commented:

The precise question . . . is, does the sole right to vend . . . secure to the owner of the copyright the right, after a sale of the book to a purchaser, to restrict future sales . . . because of a notice in the book that a sale at a different price will be treated as an infringement . . . ? [T]here is no claim in this case of contract limitation, nor license agreement controlling the subsequent sales of the book.⁸³

So, while *Bobbs Merrill* originated the first sale doctrine, it does not provide guidance on when *contract terms* create or fail to create a first sale. For that answer, we need to look to more recent contract-based decisions. There are two appellate court decisions that provide guidance.

The first case is *DSC Communications v. Pulse Communications*,⁸⁴ decided by the Court of Appeals for the

79. 17 U.S.C. § 109(d).

80. *Bobbs-Merrill v. Straus*, 210 U.S. 339 (1908).

81. *Id.* at 341–42.

82. *Id.* at 350–51.

83. *Id.* at 350 (emphasis added).

84. 170 F.3d 1354, 1360 (Fed. Cir. 1999).

Federal Circuit in 1999. This case involved separately licensed software embedded in communications system hardware. The software contract precluded transfer or sale of the software, and it also precluded reverse engineering. The Federal Circuit acknowledged that the idea of ownership in this context was unclear, but held that—given the legislative history of § 117 (the first sale section related to computer software)—ownership was different than “rightful possession”:

Unfortunately, ownership is an imprecise concept, and the Copyright Act does not define the term. Nor is there much useful guidance to be obtained from either the legislative history of the statute or the cases that have construed it. The National Commission on New Technological Uses of Copyrighted Works (“CONTU”) . . . [i]n its final report, . . . proposed a version of section 117 that is identical to the one that was ultimately enacted, except for a single change. The proposed CONTU version provided that “it is not an infringement for the *rightful possessor of a copy* of a computer program to make or authorize the making of another copy or adaptation of that program” Congress, however, substituted the words “owner of a copy” in place of the words “rightful possessor of a copy.” The legislative history does not explain the reason for the change, but it is clear from the fact of the substitution of the term “owner” for “rightful possessor” that Congress must have meant to require more than “rightful possession” to trigger the section 117 defense.⁸⁵

The court then rejected two polar positions on how to determine whether a person in possession of a copy was an owner. It first focused on an earlier Ninth Circuit decision that, it believed, had held that any transaction labeled as a license of a work did not transfer copy ownership.⁸⁶ This Ninth Circuit conclusion was consistent with commercial licensing practice. Commercial license agreements that involve delivery of a copy often do not address ownership of the copy or, if they do address it, state the seemingly obvious principle that a licensee is not an owner. Nevertheless, the

85. *Id.* at 1360 (emphasis in original) (citations omitted) (quoting U.S. DEPT. OF COMMERCE, PB-282141, FINAL REPORT OF THE NATIONAL COMMISSION ON NEW TECHNOLOGICAL USES OF COPYRIGHTED WORKS 30 (1978)).

86. *Id.* See *MAI Sys. Corp. v. Peak Computer, Inc.*, 991 F.2d 511 (9th Cir. 1993).

Federal Circuit concluded that an analysis based solely on the label given to the transaction was too blunt-edged, and that a more nuanced approach was needed.⁸⁷

The court also rejected the argument that a single-payment, perpetual license constitutes a sale or transfer of ownership of the copy—the plastic medium. Its comments on this point underscore the weakness in the sale argument:

[We think that view is] overly simplistic. The concept of ownership of a copy entails a variety of rights and interests. The fact that the right of possession is perpetual, or that the possessor's rights were obtained through a single payment, is certainly relevant to whether the possessor is an owner, but those factors are not necessarily dispositive if the possessor's right to use the software is heavily encumbered by other restrictions that are inconsistent with the status of owner.⁸⁸

The last part of this quotation signals the focus of the court. That focus was not centered on alleged ownership of the plastic medium, but on ownership of the copy, especially including the valuable rights in the work that is part of the copy. The court commented:

Each of the . . . agreements limits the contracting RBOC's right to transfer copies of the . . . software or to disclose the details of the software to third parties. . . . Such a restriction is plainly at odds with the section 109 right to transfer owned copies of software to third parties. The agreements also prohibit the RBOCs from using the software on hardware other than that provided by DSC. If the RBOCs were "owners of copies" of the software, section 117 would allow them to use the software on any hardware, regardless of origin. Because the DSC-RBOC agreements substantially limit the rights of the RBOCs compared to the rights they would enjoy as "owners of copies" of the . . . software under the Copyright Act, the contents of the agreements support the characterization of the RBOCs as non-owners of the copies of the . . . software.⁸⁹

87. *DSC Commc'ns Corp.*, 170 F.3d at 1360.

88. *Id.* at 1362.

89. *Id.* at 1361–62.

If the agreement does not give the transferee substantially all of the rights that it would have as a copy owner, the transaction does not convey copy ownership.⁹⁰

More recently, the Ninth Circuit visited the ownership question in *Vernor v. Autodesk*.⁹¹ *Vernor* involved a single payment perpetual software license that contained a number of limitations on the licensee's use of the software and its right to transfer the software.⁹² Copies of the software were sold to Vernor, who then offered them for resale on the eBay online auction system.⁹³ Vernor, who operated a resale business and did not use the software, did not assent to the license terms.⁹⁴ But the original licensee did.⁹⁵ The question was whether Vernor's intended resale was protected by the first sale doctrine.⁹⁶

The basic concept, accepted by the parties and the court, was that if the first transfer was not an authorized first sale and did not give the first licensee the right to make a first sale under the authority of the licensor, then Vernor was not protected by the first sale doctrine.⁹⁷ This is an application of traditional copyright doctrine: there is no concept of good faith purchaser in ordinary copyright law.⁹⁸ That doctrine exists because the rights involved are intangible in nature, while good faith purchase concepts typically focus on rights in tangible objects.

The District Court held that the single payment perpetual license terms controlled and that, as a result, the first transfer was a sale even though the license severely restricted use of the work.⁹⁹ The trial court's analysis hinged on a strange concept. It felt bound by its interpretation of an early Ninth Circuit case,¹⁰⁰ even though the much more

90. *Id.*

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

92. *Id.* at 1104.

93. *Id.* at 1105–06.

94. *Id.* at 1105.

95. *Id.*

96. *Id.* at 1106.

97. *Vernor v. Autodesk, Inc.*, 621 F.3d 1102, 1107–08 (9th Cir. 2010).

98. *Microsoft Corp. v. Harmony Computers & Elecs., Inc.*, 846 F. Supp. 208, 211 (E.D. N.Y. 1994); *see also* *Microsoft Corp. v. Grey Computer*, 910 F. Supp. 1077, 1083 (D. Md. 1995).

99. *Vernor*, 621 F.3d at 1111.

100. *See id.* (citing *United States v. Wise*, 550 F.2d 1180, 1190–92 (9th Cir. 1977)).

recent decisions in *MAI Systems Corp. v. Peak Computer*,¹⁰¹ and *Wall Data, Inc. v. L.A. County Sheriff's Department*,¹⁰² contradicted that early decision.¹⁰³

The Ninth Circuit reversed lower court's decision.¹⁰⁴ It adopted an integrated approach by reconciling its prior opinions,¹⁰⁵ and properly focused on the overall terms of the license and whether the license terms gave rights to the licensee equivalent to the owner of a copy.¹⁰⁶ The Ninth Circuit set out a more formulaic approach to distinguishing between a transfer of ownership and a license that does not transfer ownership than did the Federal Circuit in *DSC Communications*.¹⁰⁷ The Ninth Circuit's ruling stated: "We hold today that a software user is a licensee rather than an owner of a copy where the copyright owner (1) specifies that the user is granted a license; (2) significantly restricts the user's ability to transfer the software; and (3) imposes notable use restrictions."¹⁰⁸ The court's analysis did not conclude that these three elements were the only elements that make a license transaction not a sale of a copy, but that they clearly indicate a license, rather than a transfer of copy ownership. This is a correct decision.

In the particular case, the court held that there was no transfer of copy ownership:

Autodesk retained title to the software and imposed significant transfer restrictions: it stated that the license is nontransferable, the software could not be transferred or leased without Autodesk's written consent, and the software could not be transferred outside the Western Hemisphere. The [license agreement] also imposed use restrictions against the use of the software outside the Western Hemisphere and against modifying, translating,

101. *MAI Systems Corp. v. Peak Computer, Inc.*, 991 F.2d 511 (9th Cir. 1993).

102. *Wall Data, Inc. v. L.A. Cnty. Sheriff's Dep't*, 447 F.3d 769 (9th Cir. 2006).

103. *Compare Vernor v. Autodesk, Inc.*, 621 F.3d 1102, 1111 (9th Cir. 2010) (citing *Wise*, 550 F.2d at 1190–1192) with *MAI Systems Corp.*, 991 F.2d at 518–19 and *Wall Data, Inc.*, 447 F.3d at 784–85.

104. *Vernor*, 621 F.3d 1102.

105. *Id.* at 1110–11.

106. *See id.* at 1109.

107. *Compare id.* at 1111 with *DSC Commc'ns Corp. v. Pulse Commc'ns, Inc.*, 170 F.3d 1354, 1360 (Fed. Cir.1999).

108. *Vernor*, 621 F.3d at 1111.

or reverse-engineering the software, removing any proprietary marks from the software or documentation, or defeating any copy protection device. Furthermore, the [license agreement] provided for termination of the license upon the licensee's unauthorized copying or failure to comply with other license restrictions.¹⁰⁹

The focus of ownership issues is not simply of ownership of the plastic medium, but whether the transaction gave rights in the work that is part of the copy and that are consistent with copy ownership.

It is important to recognize that *DSC Communications* and *Vernor* were referring to the effect of *contractual* restrictions on use of the digital work. This was underscored by the Ninth Circuit's holding in *UMG Recordings, Inc. v. Augusto*,¹¹⁰ a case decided shortly after *Vernor*. In *Augusto*, music publishers distributed unsolicited, free CDs to a large number of people, including reviewers and radio stations.¹¹¹ The CDs had labels that purported to restrict their use. One label said "for promotional use only", while another suggested that "acceptance" of the unsolicited CD would constitute acceptance of the limited terms, but gave no indication of what process or actual act would indicate assent to terms.¹¹² The law suit was not brought against the original recipients, but against a third party reseller who had obtained some of the CDs.¹¹³ There was no proof relating to contractual assent by the original recipients; indeed, the CDs were sent without any controls or tracking and it is doubtful that the original recipients could even be identified.¹¹⁴ The court reached the obvious conclusion:

Because the record here is devoid of any indication that the recipients agreed to a license, there is no evidence to support a conclusion that licenses were established under the terms of the promotional statement. Accordingly, we conclude that UMG's transfer of possession to the

109. *Id.* at 1111–12.

110. *UMG Recordings, Inc. v. Augusto*, 628 F.3d 1175 (9th Cir. 2011). The Ninth Circuit held that unsolicited, free CDs delivered to a large number of recipients with non-contractual labels purporting to restrict use of the CDs transferred title to the CDs. *Id.* at 1183.

111. *Id.* at 1177.

112. *Id.* at 1177–78.

113. *Id.* at 1178.

114. *Id.* at 1180.

recipients, without meaningful control or even knowledge of the status of the CDs after shipment, accomplished a transfer of title.¹¹⁵

This conclusion was buttressed by a federal statute providing that, in the case of unsolicited delivery of products, the recipients can treat the product as a gift and as their own property¹¹⁶—a position inconsistent with the restrictive notices.¹¹⁷

Overall, *Augusto* simply restates the concept set out in *Bobbs-Merrill*: non-contractual notices do not suffice to prevent a first sale. This may stand for a principle that might create concerns among some in the open source community who believe that the licenses used there are non-contractual in nature. That principle is that the presence of a non-contractual notice may be insufficient to limit the transfer of ownership. This is certainly true in circumstances where the product is not solicited and the record is devoid of any proof that license terms were accepted, except by silence.

VI. THE POLICY ISSUE

Combining *DSC Communications* and *Vernor*, the clear message is that the proper focus on ownership issues is not on the relatively irrelevant plastic medium, but on the rights in the work and whether the rights conveyed rise to a level consistent with ownership of the copy. This premise is consistent with the congressional judgment in both of the first sale exemptions.¹¹⁸ It creates a setting in where if the rights owner chooses to do so, and can obtain acceptance of the relevant contractual terms in the market, the rights owner can use its property rights to manage how the copies are used and redistributed.

This is a correct policy result. It allows the copyright owner to attempt to optimize commercialization of its work by making judgments about how best to market the work. Whether this in fact results in higher economic return depends on the quality of the work and the quality of the marketing choice that the copyright owner makes. But the

115. *Id.* at 1182.

116. 39 U.S.C. § 3009 (2006).

117. *UMG Recordings, Inc. v. Augusto*, 628 F.3d 1175, 1180–81 (9th Cir. 2011).

118. 17 U.S.C. §§ 109, 117 (2006).

rule places the choice in the proper hands and provides the best opportunity to enhance the incentives for creating new works. Certainly it is a better policy choice than artificially narrowing the copyright owner's options.

So, what is the contrary policy?

The primary contrary position argues that copyright owners' rights should be narrow, and that owners should not be allowed to expand their rights through the use of contract terms.¹¹⁹ This is the rights-restrictors argument earlier discussed.¹²⁰ At its core is the premise that the minimum rights necessary should be all the support that copyright law gives to creators of copyrighted works.¹²¹ One variation of this argument is that contracts should not be allowed to "override" the policy in the first sale doctrine that Congress enacted. Allegedly, that statutory policy is one that frees up distribution and use after a first distribution. But as we have seen before, this is not the policy that Congress adopted. Instead, the statute limits the right to redistribute to persons who become owners of a copy and, then, only as to that particular copy.¹²² So the statutory policy decision actually makes the property rights, in this respect, specifically subject to the terms of the contract.

One other contrarian argument merits attention. This is the view that the first sale doctrine should not be subject to narrowing by contract because to do so allows copyright owners to interfere with "secondary" markets (i.e. markets in which transferees resell licensed works for a profit). The argument is that allowing copyright owners to use property rights to control resale loses value for resellers.¹²³ The reasoning is that these secondary markets are important for consumers who can obtain "used" goods for lower prices and that this social benefit would be forfeited if copyright owners were able to prevent resale of copies, by choosing to do so through properly structured transactions.¹²⁴

119. NIMMER, *supra* note 5, § 1:2.

120. *See supra* text accompanying notes 19–22.

121. NIMMER, *supra* note 5, § 1:2.

122. 17 U.S.C. § 109.

123. This, in essence, was what the reseller in the *Vernor* case argued—"you have no right to prevent me from purchasing and reselling copies of your software." *Vernor v. Autodesk, Inc.*, 621 F.3d 1102, 1115 (9th Cir. 2010).

124. *Id.*

The actual reasoning is that value created in secondary markets should be given to parties other than the copyright owners. In a world of paper and other non-digital works, the idea that control of a used copy (secondary market) should not necessarily be subject to access by copyright owners made sense. Clearly, a used book does not have the same value or the same market as a new book, and does not typically compete in fact with new books. But, as we are increasingly a digital information society, the difference between “used” and “new” copies is increasingly immaterial. When this is true, cutting out the copyright owner’s interest in influencing or obtaining value from secondary markets also significantly affects the marketability of its product in the initial market. This potentially creates a double loss of economic incentives that is justified by neither the statute, nor the basic policy of copyright law.

VII. SUMMARY AND CONCLUSION

As stated at the beginning of this article, for transactions within the United States, the relationship between contract terms and the copyright law concept of first sale is quite simple to label as matter of current law and of proper policy.

The relationship works in two directions. First, nothing in the Copyright Act or in the doctrine of first sale prevents parties from agreeing, through a valid contract, to establish different use restrictions or privileges from those set out under copyright law. Copyright law does not preempt these contractual arrangements, nor do they disturb the balance set out in copyright law. That balance contemplates that rights owners (if they choose to do so) may obtain economic benefits from their creative work by bringing those works to the market under economic terms of their choosing. This balance necessarily assumes the presence of contractual relationships that shape the market and the economic terms.

The relationship between contract and first sale also functions in a second direction, and here the parameters are even clearer than in the first. Contractual terms determine the applicability of first sale doctrine as a matter of copyright law. This is because Congress chose to limit the privileges under first sale to persons who have become an owner of a copy and the process of obtaining ownership of a copy

involves, in virtually all commercial cases, a contractual arrangement sufficient to convey ownership. The presence or absence of a first sale ownership privilege thus depends on the terms of a contract. This result is specifically grounded in the copyright statute itself. It is also grounded in appropriate policy, since it enables copyright owners to establish differentiated channels of distribution and to obtain some value from secondary markets, if they choose to do so, provided the market accepts the methodology they use.

Thus, the question is not whether contract terms can control the applicability of first sale doctrine, but how they can be used to do so—e.g., what terms prevent or establish the presence of a first sale (copy ownership)? As we have seen, both the Ninth Circuit and the Federal Circuit Court of Appeals have focused on terms that relate to the transferee's right to use or transfer the work. The two courts phrased their approach in slightly different terms, but they are consistent on a fundamental point: a transferee is not an owner of a copy if the contract restricts us of the most valuable part of the copy (the work) in ways that are inconsistent with the rights that would be associated with ownership.

So, in both directions, properly established contracts and their terms govern over the application of the concept of first sale.