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Why Sell What You Can License?, Contracting Around Statutory Protection of Intellectual Property

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WHY SELL WHAT YOU CAN LICENSE? CONTRACTING AROUND STATUTORY PROTECTION OF INTELLECTUAL PROPERTY

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INTRODUCTION

Owners of intellectual property can choose to sell the intellectual property, license the intellectual property, sell products that embody the intellectual property, or license products that embody the intellectual property. Traditionally, owners of intellectual property chose one of the first three options, resulting in a publicly-legislated intellectual property regulation system reflective of this norm. Now, however, intellectual property owners increasingly choose to license products that embody their intellectual property and use privately-legislated licenses to augment their intellectual property rights and circumvent publicly-legislated restrictions. This private legislating activity is not new, but it was not until the software industry's maturation that licenses of chattels embodying intellectual property became an accepted norm. Such licenses historically were used to augment the protection of ideas and expressions otherwise difficult to protect under intellectual property law.[1] Recently, however, the use of private legislation to circumvent and frustrate public legislation has expanded, due to the success of software licenses, and now owners of many types of intellectual property are relying on private legislation, rather than public legislation, to regulate users' rights in their chattels.

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[1] Using contracts to augment intellectual property protection first gained popularity with the use of software licenses at a time when statutory protection for software was close to non-existent:

> Historically, the purpose of "licensing" computer program copy use was to employ contract terms to augment trade secret protection in order to protect against unauthorized copying at a time when, first, the existence of a copyright in computer programs was doubtful, and, later, when the extent to which copyright provided protection was uncertain.

Softman Prods. Co. v. Adobe Sys., Inc., 171 F. Supp. 2d 1075, 1083 (C.D. Cal. 2001) (citing Rice Decl. ¶ 6).

The Maryland State Bar Association provides one example of this use of private legislation. In an effort to circumvent the publicly-legislated restrictions on its intellectual property rights, the Maryland State Bar Association does not sell its *Maryland Lawyers Manual*, an annual directory of lawyers and judges, to its members, but rather licenses it to them.[2] Bar Association members receive their copy of the *Manual* shrink-wrapped with a contract "meant to be binding on anyone who breaks the plastic seal. Among its terms: No reselling, loaning, or giving away the book."[3] Public legislation restricts the rights of copyright owners after the first sale of the book, denying them any control over the reselling, loaning, or sharing of the sold copyrighted material.[4] Private legislation allows the Maryland State Bar Association to circumvent the first sale restriction and to control the use of the directory after it has been sold. If a lawyer who is not a member of the Maryland State Bar wishes to look up information about a judge in his firm's copy of the *Manual*, she may not borrow a copy from the firm library without breaching the contract. This is hardly an isolated example. Chattels, traditionally thought of as being sold, are now regularly licensed. These chattels include agricultural goods, musical recordings, artwork, and digital cameras. These licenses withhold warranties, circumvent the first sale doctrine, frustrate fair use exemptions, obstruct the on-sale bar, and remove other proprietary rights.

One of the most disturbing aspects of this trend is the characterization of many sales as licenses. If an agreement is characterized as a license but is actually a sale, then the private legislation cannot circumvent the publicly-legislated rights granted the consumer and any privately-legislated restrictions are not binding. So how to determine whether an agreement is a sale or a license? Applying the traditional normative justifications for the protection of contractual interests to such ambiguous agreements can help determine the intention of an agreement and whether the parties intended the transaction to be a license or a sale.

Neither the traditional norms of contract law nor the policies behind the protection of intellectual property support enforcement of agreements that exist primarily to frustrate public legislation. The public and specific individuals suffer the effects of licenses that fall into this category. Privately-legislated licenses do have a role in the commercialization of intellectual property and products that embody intellectual property. However, a balance must be struck between protecting intellectual property owners' right to contract and protecting the public's interest in the promotion of the

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[2] Ed Foster, *Sneakwrap Abounds*, INFOWORLD, Oct. 25, 2002, *available at* http://www.infoworld.com/article/02/10/25/021028opgripe_1.html.

[3] Lorraine Woellert, *Throw This Book—But Don't Share It*, BUS. WK., Dec. 9, 2002, at 8.

[4] 17 U.S.C. § 109 (2000).

progress of science and the useful arts. Some licenses promote progress, while others retard it.

The use of private legislation to augment rights may be necessary, but its use to circumvent public legislation upsets this ever-precarious balance. The balance that currently exists reflects the traditional practices of selling intellectual property, licensing it, or selling chattels that embody it. That precarious balance is upset by licensing products that embody intellectual property. The norms of licensing such products are being set by those who benefit most from a balance tilted towards the right to contract and so do not reflect the public's interest in the promotion of "the progress of science and useful arts"—that is, innovation.[5] By licensing such chattels instead of selling them or their intellectual property, owners can acquire interests that may not be socially beneficial.

Section I of this Article discusses the expansion of the private legislation model. Section II provides numerous examples of the ways that private legislation is being used to circumvent public legislation. Section III explores factors helpful in understanding what rights accompany the transfer of chattel and whether a given transaction is a sale or a license. Finally, Section IV considers the legitimate purposes of privately-legislated licenses.

I. THE EXPANSION OF THE PRIVATE LEGISLATION MODEL

In 1997, Homan McFarling[6] bought soybean seed from Jimmy Sanders's seed shop in Ecru, Mississippi.[7] As he had done every year of his farming life, McFarling purchased a variety of soybean seeds.[8] When the farming season concluded, he evaluated his yield and saved some of the most profitable seed for use the next year, including a genetically modified seed developed by Monsanto.[9] For this time-honored practice,[10] Monsanto

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[5] U.S. CONST. art. I, § 8, cl. 1, 8 ("The Congress shall have Power . . . To 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").

[6] Homan McFarling farms 5,000 acres in rural Mississippi. His father and grandfather were both farmers on that land, and he and his three sons are partners in the family farm. Interview with Homan McFarling, near Tupelo, Miss. (Jan. 2005).

[7] When the author visited Jimmy Sanders's seed shop, no one would speak with her about McFarling. The employee with whom the author did speak stated that licensing seed was the norm and that, in fact, Jimmy Sanders's seed shop sold no seed without an accompanying agreement limiting the purposes for which the seed could be used. Interview with unidentified employee of Jimmy Sanders's seed shop, in Ecru, Miss. (Jan. 2005).

[8] Interview with Homan McFarling, near Tupelo, Miss. (Jan. 2005).

[9] Farmers save seed for many reasons. Every year new hybrids and new varieties of seed are produced with specific varieties developed for different climates and different growing environments

sued McFarling. Monsanto argued that it had not sold the seed to McFarling but instead had only granted him a "limited use license" to use the seed for one generation.[11] The courts found that McFarling's actions breached the license.[12]

In 2002, a consumer licensed a digital camera subject to a clause stating that anyone in the consumer's household could use the camera but that

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(e.g., resisting cocklebur weed in Mississippi or foxtail weed in North Dakota). Some of these varieties will succeed, and some will fail. Therefore, to reduce risk of low yield and profitability, rather than gamble on one variety of seed, farmers choose to plant their fields with multiple varieties. McFarling spent months reviewing seed descriptions and determining which varieties to purchase. At the end of each growing season, McFarling determined which variety had the highest yield and saved enough of that seed to plant roughly fifty percent of his acreage the next year. He would plant the other fifty percent with new varieties that he purchased. Before the introduction of genetically modified seed, this was standard farming practice. If the new seed did not work as the developers hoped, the seed that had previously worked would likely work well again. On the other hand, if a new variety produced a higher yield, then McFarling would reap some of that benefit, and he would save the new variety of seed for the following year. Interview with Homan McFarling, near Tupelo, Miss. (Jan. 2005).

[10] Saving seed promotes biodiversity and protects the farmer as well as the agricultural industry. Prior to the introduction of genetically modified seed, saving seed was the usual practice among farmers since time immemorial. *Cf.* Seedsaving and Seedsavers' Resources, http://homepage.tinet.ie/~merlyn/seedsaving.html (last visited Oct. 17, 2005). The Plant Variety Protection Act specifically states that:

> [I]t shall not infringe any right hereunder for a person to save seed produced by the person from seed obtained, or descended from seed obtained, by authority of the owner of the variety for seeding purposes and use such saved seed in the production of a crop for use on the farm of the person, or for sale as provided in this section.

7 U.S.C. § 2543 (2000).

[11] Monsanto Co. v. McFarling, No. 4:00CV84 CDP, 2002 WL 32069634, at *3-4 (E.D. Mo. Nov. 5, 2002), *aff'd*, 302 F.3d 1291, 1293 (Fed. Cir. 2002). Since the sale to McFarling, Monsanto has changed its notification, and in 2004, a farmer purchasing seed from Monsanto received the seed in a bag carrying the following language:

> This seed carries a limited license under U.S. patent . . . 5,352,605 . . . solely to produce a single commercial crop in one and only one season. This license does not extend to the seed from such crop or the progeny thereof by propagation or seed multiplication. The use of such seed or the progeny thereof for propagation or seed multiplication . . . is strictly prohibited.

Monsanto Co. v. Good, No. Civ.A.01-5678 FLW, 2004 WL 1664013, at *2 (D.N.J. July 23, 2004) (citing Mem. in Supp. of Monsanto Company's Mot. for Partial Summ. J.). The 2003 Monsanto Technology/Stewardship Agreement stated that it was a limited use license and grants its signatories limited rights:

> A limited use license to purchase and plant seed containing Monsanto Technologies ("Seed") and apply Roundup agricultural herbicides and other authorized non-selective herbicides over the top of Roundup Ready crops (see TUG [Technical Use Guide] for details regarding authorized non-selective products). Monsanto retains ownership of the Monsanto Technologies including the genes (for example, the Roundup Ready gene) and the gene technologies.

2003 Monsanto Technology/Stewardship Agreement, *available at* http://www.mindfully.org/GE/2003/Monsanto-Technology-Agreement2003.htm. This license operates for a period of one year on all Monsanto genetically modified seed.

[12] *See McFarling*, 2002 WL 32069634, at *4-5.

the camera could not be lent to anyone else.[13] If the consumer wished to have a stranger take a family picture, she would have to breach the license or use a different camera.[14]

In 2003, George Hotelling licensed a song from the iTunes Music Store,[15] an Internet service that allows users to license songs and albums and download them to their computers.[16] iTunes is, essentially, the next generation of the neighborhood record store, with one very important difference: instead of purchasing a music work, users purchase a limited use license to play the song or album for "personal, noncommercial use."[17] Hotelling attempted to resell an iTunes song on eBay, and found that the listing violated eBay's "Downloadable Media Policy."[18] eBay differentiates between the purchasers of an album based on the medium of the album. Owners of a digital copy of a music work who wish to sell the work on eBay must also own the copyright in the work.[19] Owners of a physical copy

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13 Foster, *supra* note 2. One example of such a license is found accompanying the Canon EOS-1D digital camera. The license for firmware that comes with a Canon EOS-1D digital camera states that the consumer shall not "assign, sublicense, sell, rent, lease, loan, convey or otherwise transfer to any third party, or copy, duplicate, translate or convert to another programming language the Software, except as expressly provided herein." Canon EOS-1D Mark II N Firmware License Agreement, *available at* http://web.canon.jp/Imaging/eos1dm2n/eos1dmk2n_firmware-e.html (last visited Sept. 17, 2006). The software is embedded in the camera, and the camera cannot operate without it. As the licensor cannot loan, convey, or otherwise transfer the software to another, the licensor cannot lend the camera to anyone else—even to take a family picture. Furthermore, Canon uses the license to disclaim all support obligations; the software could render the camera useless and Canon would have no obligation to fix it. *Id.*

14 *See* Canon EOS-1D Mark II N Firmware License Agreement, *available at* http://web.canon.jp/Imaging/eos1dm2n/eos1dmk2n_firmware-e.html (last visited Sept. 17, 2006).

15 Heather Green, *You Bought a Song. Now Try to Sell It*, BUS. WK., Sept. 29, 2003, at 14.

16 On August 30, 2005, the iTunes website stated, "Forget About Shrink-wrap. If you've ever been frustrated by Compact Disc packaging—rip-stop shrink-wrap, that nasty top cap of seriously adhesive plastic—welcome to the age of digital music. No broken fingernails, no tape sticking on your fingers. Just good clean music, delivered straight to iTunes." Apple Computer, Inc., iTunes Music Store, http://www.apple.com/itunes/store/buy.html (last visited Aug. 30, 2005). Perhaps the consumer can forget about shrink-wrap, but not about shrink-wrap licenses. iTunes' Terms of Service, to which all its customers must agree, state that the iTunes Service "include[s] a security framework using technology . . . that limits . . . usage of Products to certain usage rules established by Apple and its licensors." Apple Computer, Inc., iTunes Music Store Terms of Service, http://www.apple.com/legal/itunes/us/service.html [hereinafter iTunes Terms of Service] (last visited Sept. 17, 2006). Perhaps realizing the irony in its statement, Apple has since removed the "Forget About Shrink-Wrap" language from its website.

17 iTunes Terms of Service, *supra* note 16.

18 eBay, Inc., Downloadable Media Policy, http://pages.ebay.com/help/policies/downloadable.html (last visited July 15, 2006) ("Only copyright owners are permitted to sell items or products which are intended to be delivered to the buyer by electronic download through the Internet. Sellers who own the copyrights to this downloadable media being sold must state this fact in their listings and must be able to prove this ownership to eBay.").

19 *Id.*

of a music work who wish to sell the work on eBay may do so whether they own the copyright or not.

Each consumer above exchanged consideration for a chattel without purchasing or receiving title to the chattel.[20] Instead, each received a license to use the chattel.[21] A license is a contract between two parties, one of whom owns intellectual property (the licensor) that the other (the licensee) wishes to use.[22] A licensee owns neither the ideas nor the expression of such ideas associated with that intellectual property and may only use the intellectual property in the manner allowed by the license.[23]

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[20] Examples abound of intellectual property owners restricting the rights of consumers through licenses. The few examples in this Section illustrate the issues associated with a failure to regulate the use of contracts to expand the rights of intellectual property owners. Other equally expansive licenses exist are not discussed herein—for instance, the particularly draconian license offered by the manufacturer of the TemplateMaster™ woodworking tool. The license agreement contains the following clauses:

> You may: a. use the Product (or any of the working templates produced using the Product or Process) in only one shop by the original purchaser only; b. make one (1) copy of the instructions for backup purposes, provided that you reproduce all proprietary notices on the copy; and c. use the Process described in the instruction book (multiple US patents pending) only with the original Product provided with the instruction book.
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> You may not: a. allow individuals that did not purchase the original Product use the Product or any templates produced using the Product or Process described (without specific written permission from the Stots Corporation); b. modify, translate, reverse engineer, create derivative works based on, or copy (except for the backup copy) the instruction book; c. rent or lease the Product, templates produced using the Product and the Process, any rights granted by this license agreement, or accompanying documentation in any form to any person without the prior written consent of Stots which, if give, is subject to the transferee's consent to the terms and conditions of this license; d. remove any proprietary notices, labels, or marks on the Product, documentation, and containers; and e. copy the Product using the Process (or any other means).
>
> All rights, title, interest, and all copyrights to the documentation, and any copy made by you remain with Stots. Unauthorized copying of the Product or the documentation, or failure to comply with the above restrictions, will result in automatic termination of this license and will make available to Stots other legal remedies.

Stots Corp., TemplateMaster™ License Agreement, *available at* http://www.stots.com/agree.htm (last visited Sept. 17, 2006). According to the tool's license agreement, if Mrs. Madden licenses the TemplateMaster™, then other members of her household, including Mr. Madden, may not use it without the prior written consent of the tool's manufacturer. *See id.*

[21] For purposes of this Article, a sale is defined as a transfer of title and all associated rights, while a license involves a transfer of rights but not of title. Bauer & Cie v. O'Donnell, 229 U.S. 1, 16 (1913) ("There was no transfer of a limited right to use this invention, and to call the sale a license to use is a mere play upon words.").

[22] This Article does not address the more traditional use of a license of the intellectual property itself; rather, it addresses the licensing of chattels that benefit from the intellectual property.

[23] Historically, licensors limited only the geographic scope or the field of use scope of intellectual property. *See, e.g.*, Adams v. Burke, 84 U.S. 453 (1873) (geographic limitation on a patent licensee). A licensee of the "Air Jordan" mark, for example, might have been limited to use of the mark only in California or only on baseball gloves. As the scope of licenses has expanded, so has the scope of limitations, and now it is conceivable that a license could be entered into for the use of the "Air Jordan" mark on sneakers that would limit the licensee from wearing the sneakers while playing basketball.

The public policy behind the protection of intellectual property seeks to balance competing interests. Traditionally, agreements regulated the sharing of intellectual property itself, securing for the owners the exclusive right to control their intellectual property as envisioned by the Constitutional Convention of 1787.[24] Licenses of intellectual property maintained the balance, and courts have distinguished these licenses from sales and other contracts, deferring to the perceived bargain licensees entered into, because they viewed such licenses as encouraging both the development and sharing of information.[25] However, as the scope of licenses has expanded beyond their traditional use—licensing patents, trademarks, and copyrights—to licensing the chattels that embody the intellectual property (e.g., agricultural goods, writings, and other physical goods). The balance appears to be shifting towards the owners of intellectual property and away from the public interest. As private interests realize the limits of the publicly-legislated protection available to intellectual property owners and the value of private legislation in augmenting intellectual property protection, the norm is shifting from one relying on public legislation for protection to one relying on private legislation.[26]

The use of contracts to privately legislate control over chattels that embody intellectual property is fundamentally different from the publicly-legislated grant of rights. Recognizing this distinction, the Supreme Court has emphasized the limitations that public legislation places on the rights of intellectual property owners to control their works after the first sale, while pointing out that such limitations might not be controlling if the limitations had been privately legislated.[27] In 1913, the Supreme Court reiterated this

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[24] U.S. CONST., art. 1, § 8, cl. 1, 8 ("The Congress shall have Power . . . To 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").

[25] One of the parties thought to benefit the most from a license is the independent inventor, who may have the spark of genius but lack the capital needed to market his invention. Through a licensing arrangement, the independent inventor could profit from his spark of genius while society profits from the innovation as introduced by the licensee. *Cf.* U.S. DEP'T OF ENERGY & THE LICENSING EXECUTIVES SOCIETY, MAKING THE LICENSING DECISION 1 (1998), *available at* http://www.expertson.com/New_Product_Development/Making%20Licensing%20Decision.pdf.

[26] Sharon Sandeen accurately frames the ongoing academic debate about the propriety of using contracts to acquire rights beyond those granted statutorily:

> Those who question the use of private ordering to expand the scope of intellectual property rights generally argue that since intellectual property laws reflect a careful balancing of competing interests, including the public's interest, contracts that attempt to alter the balance should not be enforced. Those who promote the use of contracts to fill the gaps of intellectual property law invoke the principle of freedom of contract and argue that individuals and companies should generally be free to order their private relationships any way they see fit.

Sharon K. Sandeen, *A Contract by Any Other Name is Still a Contract: Examining the Effectiveness of Trade Secret Clauses to Protect Databases*, 45 IDEA: J.L. & TECH 119, 122-23 (2005).

[27] *See* Bobbs-Merrill Co. v. Straus, 210 U.S. 339, 350 (1908).

point with respect to the publicly-legislated limits placed on patents, differentiating between the scenario where "the owner of a patent granted a license to the defendant to manufacture and sell harrows embodied in the invention covered by the patent" and the scenario where "a patentee . . . parted with a patented machine by passing title to a purchaser."[28] In the license scenario, the owner was allowed to control the resale price of the licensed article, while the patentee who sells an article "has placed the article beyond the limits of the monopoly secured by the patent act" and cannot regulate the resale price.[29]

Intellectual property owners were slow to recognize and take advantage of the benefits of this distinction. Public legislation provided intellectual property owners with a strong and robust set of rights, and rather than look elsewhere for protection of their rights, intellectual property owners sought to expand those publicly-legislated rights. It was not until the development of computer software that the use of private legislation began to take off. Arguing that federal and state statutory protection of software was inadequate, software developers turned to privately-legislated protection for their property through the use of licenses.[30]

Software expedited the expansion of the use of private legislation "[b]ecause software is different [and] traditional copyright practices do not always fit."[31] Books *can* be shrink-wrapped—and on rare occasion were, with the accompanying privately-legislated controls—but consumers bring with them a preconceived notion of a set of rights when they purchase books, one that does not limit the consumer's use of the book. No such notion, however, existed for software. Software was new, difficult to protect, expensive to develop, and easy to replicate.[32] As a result, the software industry promulgated a standard of private legislation, whereby licensing products that embody intellectual property and allow the intellectual property owner to retain title became the norm. Reflecting this shift, a new language developed to describe software licenses, arising out of the difficulty of facilitating contracts between corporations and consumers when there may be no privity between the two. Commonly referred to as "shrink-wrap" licenses, "click-wrap" licenses, or "browse-wrap" licenses, these software

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28 Bauer & Cie v. O'Donnell, 229 U.S. 1, 14, 17 (1913).

29 *See id.* at 17.

30 *See, e.g.*, Adobe Sys. Inc. v. One Stop Micro, Inc., 84 F. Supp. 2d 1086, 1091-92 (N.D. Cal. 2000).

31 Christian H. Nadan, *Software Licensing in the 21st Century: Are Software "Licenses" Really Sales, and How Will the Software Industry Respond?*, 32 AIPLA Q. J. 555, 574 (2004).

32 *See generally* Ronald J. Mann, *Do Patents Facilitate Financing in the Software Industry?*, 83 TEX. L. REV. 961 (2005) (describing the role that patents play in the software industry).

licenses do not appear to meet many of the normal expectations of contract law.[33]

Developers promulgated software licenses under the doctrine that software was different, but in enforcing these licenses the courts did not rely on that argument.[34] And once the private legislation model of the software industry proved profitable and beneficial, other industries began to adopt private legislation. As a result, licenses are now widely used as a device to circumvent public legislation.

Owners of intellectual property now use licenses to transfer chattels without transferring many presumed rights, including the right to transfer the chattel to another, the right to possession and use without temporal limit, the right to display the chattel in public,[35] and the right to public performance.[36] Such circumvention gives intellectual property owners the potential to acquire rights, monopolistic in nature, that can be used to influence the market and hinder competition, and as long as the owners retain

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33 *See* James R. Maxeiner, *Standard-Terms Contracting in the Global Electronic Age: European Alternatives*, 28 YALE J. INT'L L. 109, 111 n.7 (2003), stating:

> "Shrink-wrap" licenses are licenses printed on the packaging of software and other computer information delivered to licensees in tangible media (e.g., computer diskettes of some kind). The package is wrapped in a clear-read-through shrink-wrap plastic. The buyer of the computer information is deemed to have assented to the terms of the license by ripping open the shrink-wrap. "Click-wrap" licenses are licenses shown in electronic form or made available to users on computer screens to users [sic]. Before the user is permitted to use the online service or the computer program, the user must agree to the license terms. The user assents to the standard terms by clicking with the mouse. The term "click-wrap" arose by analogy to "shrink-wrap." Online licenses are typically in "click-wrap" form, but there is yet another form of online license that is asserted: "browse-wrap." The theory of a browse-wrap license is that the user is informed that use of the Internet site amounts to the user's assent to the site's stated terms.

34 The same cannot be said for the legislatures. In fact, in 1990 President Bush signed into law the "Computer Software Rental Amendments Act," publicly endorsing the use of licenses to circumvent the first sale doctrine with respect to software. *See* Computer Software Rental Amendments Act of 1990, Pub. L. No. 101-650, § 805, 104 Stat. 5089, 5136 (codified as amended at 17 U.S.C. § 205 (2000)); *see also* 37 C.F.R. § 201.26 (2004) (implementing regulations). Section 109 of the copyright law was amended to prohibit the rental, lease, or lending of a computer program for direct or indirect commercial gain unless authorized by the owner of copyright in the program, thus placing this circumvention in the public legislation domain. 17 U.S.C. § 109 (2000). As to why the publicly-legislated exception to the first sale doctrine codified in 17 U.S.C. § 109 was limited to software, the only explanation that can be given is that legislators viewed software as different. How exactly software is different from written works or musical works or films is unclear. While software may be easier to pirate than, say, a book, the legal harm in both cases is comparable.

35 When a consumer purchases a piece of artwork, she purchases the right to display the work in public. *See* 17 U.S.C. § 106(5) (2000). Some artists now limit these rights with a license that includes terms regulating display of the artwork.

36 With the purchase of a book or a CD, the consumer also purchases the right to read the book aloud or to play the album on a CD player in the middle of the school cafeteria. *See id.* Some licenses now include terms restricting these rights.

title and do not seek to disguise a sale as a license, courts have been deferential in their approach to these licenses. Such deference has resulted in further expansion of the private legislation model.

II. THE PRIVATE LEGISLATION MODEL

Enforcing privately negotiated agreements that circumvent public legislation vitiates the existing statutory scheme of intellectual property protection. Although there is a strong societal interest in protecting the freedom to contract, that freedom is limited. When contracts are used to circumvent the law, courts simply refuse to enforce them. But the deference granted by the courts in enforcing licenses does not take into account the broad impact of the private legislative models in use. Before the norm shifts to a licensing model, careful consideration must be given to how to balance the interests of the public and of intellectual property owners in promoting the development of intellectual property. Licenses have their place, but the use of licenses to circumvent the first sale doctrine, withhold warranties, obstruct the on-sale bar, frustrate fair use, and withhold many other rights from the possessors of chattels must be scrutinized.[37] The private legislative models containing terms that withhold rights from the possessors of chattels promote the agenda of the private interests drafting the licenses. Before these terms become standard, further thought must be given to their effects.

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[37] There is another article to be written on the regulation of such clauses. Some have argued that such licenses should be unenforceable as unconscionable and that use of licenses to circumvent public legislation frustrates the purpose of the public legislation and such licenses are therefore preempted. Courts are notoriously reluctant to apply such arguments to contracts. Furthermore, this article does not argue that these contracts are unconscionable, that they are unenforceable for lack of assent, or that they are contracts of adhesion. Those arguments have been made before, in the context of software. *See* Mark A. Lemley, *Intellectual Property and Shrinkwrap Licenses*, 68 S. CAL. L. REV. 1239, 1251 (1995) (citing Vault Corp. v. Quaid Software Ltd., 655 F. Supp. 750, 761 (E.D. La. 1987), *aff'd*, 847 F.2d 255 (5th Cir. 1988); Foresight Res. Corp. v. Pfortmiller, 719 F. Supp. 1006, 1010 (D. Kan. 1989)). This article also does not address the argument that because a breach of contract claim is a state law claim, to the extent that the contract claim conflicts with federal intellectual property laws, the state claims are preempted. *See* Sandeen, *supra* note 26, at 154-55; SQL Solutions, Inc. v. Oracle Corp., No. C-91-1079 MHP, 1991 WL 626458 at *3 (N.D. Cal. Dec. 18, 1991) ("[S]tate law must be applied in a manner that does not conflict with federal copyright law and policy."). The use of private agreements as discussed in this article does not conflict with federal intellectual property laws but rather contracts around them. *See* Nat'l Car Rental Sys., Inc. v. Computer Assocs. Int'l, Inc., 991 F.2d 426 (8th Cir. 1993). The federal intellectual property protection system does not dictate how states should govern contracts and licensing issues relating to the use, distribution, and ownership of intellectual property. There is no express statutory preemption issue. To be sure, allowing the transfer of chattels without the accompanying transfer of rights frustrates the policy behind the statutory intellectual property system but is not preempted by it. The role of these arguments remains to be explored further in another article.

This Section delineates several ways that the balance is shifting from protecting the public interest to protecting the intellectual property owner's interest.

A. *Circumventing the First Sale Doctrine*

Under the first sale doctrine, once a chattel that benefits from intellectual property is sold, the intellectual property owner cannot rely on its intellectual property rights to restrict the purchaser's use or redistribution of the chattel.[38] If the chattel is licensed rather than sold, the first sale doctrine does not apply. The doctrine is "grounded in the common-law principle that restraints on the alienation of tangible property are to be avoided in the absence of clear congressional intent to abrogate this principle."[39] Circumvention of this doctrine through private legislation allows intellectual property owners to create monopolies that are, so far, seemingly blessed by the courts through their endorsement of the distinction between licenses and sales.

The impact of this circumvention on the public's rights is startling. For example, by licensing instead of selling seed, Monsanto can impose significant post-transfer restrictions on the use of the seed, as it did in the *McFarling* case discussed above, thereby completely vitiating the first sale doctrine.[40] Ten years ago, not a single variety of genetically modified soybean seed was on the market; today, Monsanto's genetically modified soybean seed accounts for over 85 percent of all soybean seed planted.[41] Farmers' rights to the seed they reap are thus significantly diminished when compared to the rights farmers had ten years ago. Monsanto has successfully defended its license, bringing nearly one hundred lawsuits and receiving over $15 million in recorded judgments through 2005.[42]

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[38] There is one exception. If the product in question is patented, then post-sale restrictions may be placed on the product if such restrictions are reasonably related to the patent and are less than the scope of the patent itself. Mallinckrodt, Inc. v. Medipart, Inc., 976 F.2d 700, 708-10 (Fed. Cir. 1992).

[39] U.S. COPYRIGHT OFFICE, A REPORT OF THE REGISTER OF COPYRIGHTS OFFICE PURSUANT TO § 104 OF THE DIGITAL MILLENNIUM COPYRIGHT ACT vii (2001), *available at* http://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf.

[40] See Monsanto Co. v. McFarling, No. 4:00CV84 CDP, 2002 WL 32069634 at *3 (E.D. Mo. Nov. 5, 2002).

[41] Roundup Ready soybeans are genetically engineered to withstand the application of an herbicide that kills soybeans. The Roundup Ready seeds were planted on eighty-seven percent of soybean acreage in the United States last year. *Pioneer Hi-Bred is Accused of Price Fixing*, GRAND FORKS HERALD, Feb. 6, 2006, § FRM, *available at* 2006 WLNR 2038555.

[42] Press Release, Ctr. for Food Safety, Monsanto Assault on U.S. Farmers Detailed in New Report (Jan. 13, 2005), *available at* http://www.centerforfoodsafety.org/press_release1.13.05.cfm.

The application of the first sale doctrine differs slightly in the context of copyright law,[43] patent law,[44] and trademark law,[45] and therefore, the impact on each field is discussed in greater detail below.

1. Copyright Law

"The whole point of the first sale doctrine is that once the copyright owner places a copyrighted item in the stream of commerce by selling it, he has exhausted his exclusive statutory right to control its distribution."[46] Codified at 17 U.S.C. § 109, the U.S. Copyright Act reads in part, "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." [47] The first sale doctrine, as its name indicates, applies only to lawful owners of a copy, not licensees of a copy. A licensor has a different set of rights than an owner.

Intellectual property owners, such as Apple, use this distinction to their advantage, contracting around the statutory restrictions on the limitation of resale rights. When a consumer such as Hotelling[48] purchases a song from Apple's iTunes, he does not purchase a copy of a musical work but only a limited use license to play the copy for "personal, noncommercial use" and has no "commercial or promotional use rights" in the music.[49] This limited transfer of rights means that Apple or Apple's licensors retain the title to the copy a user has licensed and control all future distribution rights. The user has therefore purchased a license to play the copy on his computer but not the right to resell or otherwise distribute the copy. If the user had gone to Tower Records and purchased the same musical work on a CD, for instance, she would have received title to the copy she purchased, and her future distribution rights would have been protected under the first sale doctrine. The owner of the CD's copyright, be it Tower Records or a third party, would have exhausted its right to control the CD's distribution.

Private legislation is used to enhance the intellectual property owner's rights while restricting the licensee's rights. If a consumer purchases a piece of art, for example, the copyright owner can restrict the public display of the work, but no more: the copyright owner may not otherwise restrict

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43 *See* 17 U.S.C. § 109(a) (2000).

44 *See* B. Braun Med., Inc. v. Abbott Labs., 124 F.3d 1419, 1426 (Fed. Cir. 1997).

45 Sebastian Int'l, Inc. v. Longs Drug Stores Corp., 53 F.3d 1073, 1075 (9th Cir. 1995) (per curiam).

46 Quality King Distribs., Inc. v. L'anza Research Int'l, Inc., 523 U.S. 135, 152 (1998).

47 17 U.S.C. § 109 (2000).

48 *See supra* notes 15-17 and accompanying text.

49 iTunes Terms of Service, *supra* note 16.

the display of the work.[50] If the work is sold, the first sale doctrine gives the new owner of a copy "the right to display that copy publicly . . . to viewers present at the place where the copy is located" and to transfer the copy without limitation.[51] However, if a consumer licenses a piece of artwork, the licensor controls the rights that transfer with the artwork. The license may restrict the licensee's rights to display and transfer the work. For instance, the artist may wish to prevent the licensee from displaying the artwork in the licensee's garage or from lending the artwork to a friend. Owners can use private legislation to restrict the licensee's rights in circumvention of public legislation. Such clauses restricting the rights of the licensee to display or transfer the artwork may be used to circumvent the first sale doctrine and to augment the rights of the copyright owner in a manner not envisioned by public legislation.

How did this "critical distinction between statutory rights and contract rights" come to exist?[52] Congress enacted the publicly-legislated first sale doctrine in response to resale limits that copyright owners attempted to place on their products.[53] 17 U.S.C. §109 transfers to the purchaser of a chattel all rights over distribution, disposition, and transfer of that expression of the copyright.[54] The first sale doctrine, as the doctrine codified in § 109(a) is known, thus places significant limitations on the exclusive rights of the copyright owner.[55] As codified, however, the doctrine does not

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[50] 17 U.S.C. § 101 (2000) ("To perform or display a work "publicly" means: (1) to perform or display it at a place open to the public or at any place where a substantial number of persons outside of a normal circle of a family and its social acquaintances is gathered; (2) to transmit or otherwise communicate a performance or display of the work to a place specified by clause (1) or to the public, by means of any device or process, whether the members of the public capable of receiving the performance or display receive it in the same place or in separate places and at the same time or at different times.").

[51] *Id.* § 109(a), (c).

[52] Quality King Distribs., Inc. v. L'anza Research Int'l, Inc., 523 U.S. 135, 143 (1998) (citing Bobbs-Merrill Co. v. Straus, 210 U.S. 339, 350 (1908)). As the courts see it, the distinction is that the statutory prohibition applies to limitations on future sales, whereas licensors are free to impose such limitations and circumvent the statute because they are not selling the chattel and are therefore not exhausting their rights to the chattel.

[53] For example, in *Bobbs-Merrill*, the owner of the copyright on a book attempted to restrict the price at which the book could be resold by placing a notice in the front of each book: "The price of this book at retail is one dollar net. No dealer is licensed to sell it at a less [sic] price." 210 U.S. at 341. The Supreme Court found that allowing such a restriction on the downstream distribution of the book extended the operation of the copyright statute beyond what the legislators had intended. *Id.* at 351.

[54] Novell, Inc. v. Unicom Sales, Inc., No. C-03-2785 MMC, 2004 WL 1839117, at *7 (N.D. Cal. Aug. 17, 2004) (quoting *Quality King*, 523 U.S. at 152 ("[T]he whole point of the first sale doctrine is that once the copyright owner places a copyrighted item in the stream of commerce by selling it, [the owner] has exhausted his exclusive statutory right to control its distribution.")).

[55] Softman Prods. Co. v. Adobe Sys., Inc., 171 F. Supp. 2d 1075, 1083, n.10 (C.D. Cal. 2001) (quoting Step-Saver Data Sys., Inc. v. Wyse Tech., 939 F.2d 91, 96 n.7 (3d Cir.1991) (citations omitted)

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."[56] In codifying the distinction between statutory rights and contract rights, Congress sought to strike a balance between encouraging copyright owners to commit the expression of their ideas to the public and protecting the rights of the public. One way to protect the public interest was the policy behind the first sale doctrine: prevent copyright owners from imposing "price or other conditions on the ability of the owner of a copy of a work to dispose of that copy."[57] Allowing circumvention of the first sale doctrine through contract frustrates the policy behind the first sale doctrine, as licenses are used to impose price and other restrictions on the rights of the licensees, and tilts the balance of rights in favor of the copyright owner and away from the public.

At the time Congress passed Section 109(a) of the Copyright Act, Congress did not anticipate the expanded use of private legislation and therefore declined to regulate this important aspect of copyrights.[58] The use

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> When . . . licenses were first developed for software, it was, in large part, to avoid the federal copyright law first sale doctrine . . . . Under this doctrine, one could purchase a copy of a computer program, and then lease it or lend it to another without infringing the copyright on the program . . . . Consumers, instead of purchasing their own copy of the program, would simply rent a copy of the program, and duplicate it . . . . [S]oftware producers wanted to sue the companies that were renting the copies of the program to individual consumers, rather than the individual consumers. The first sale doctrine, though, stood as a substantial barrier to successful suit against these software rental companies, even under a theory of contributory infringement. By characterizing the original transaction between the software producer and the software rental company as a license, rather than a sale, and by making the license personal and non-transferable, software producers hoped to avoid the reach of the first sale doctrine and to establish a basis in state contract law for suing the software rental companies directly. Questions remained, however, as to whether the use of state contract law to avoid the first sale doctrine would be preempted either by the federal copyright statute (statutory preemption) or by the exclusive constitutional grant of authority over copyright issues to the federal government (constitutional preemption). Congress recognized the problem, and, in 1990, amended the first sale doctrine as it applies to computer programs and phonorecords. As amended, the first sale doctrine permits only non-profit libraries and educational institutions to lend or lease copies of software and phonorecords. (Under the amended statute, a purchaser of a copy of a copyrighted computer program may still sell his copy to another without the consent of the copyright holder.)

56 *See Novell*, 2004 WL 1839117, at *10 ("Accordingly, the Court finds that the [Agreement] is a license, rather than a sale, and the first sale doctrine has no application . . . .").

57 Letter from Bernard R. Sorkin, Senior Counsel, Time Warner, Inc., to U.S. Copyright Office and Nat'l Telecomms. & Info. Admin., *available at* http://www.copyright.gov/reports/studies/dmca/comments/Init029.pdf (regarding the possible effects of Title I of the DMCA on the first sale doctrine as codified in Section 109 of the Copyright Law).

58 Lemley, *supra* note 37, at 1282 ("[T]he Committee Report to section 109(a) of the Copyright Act indicates that Congress anticipated that private parties might contract out of a first sale right." (citing H.R. REP. NO. 94-1476, at 79 (1976) ("This does not mean that conditions on future disposition of copies or phonorecords, imposed by a contract between their buyer and seller, would be unenforceable between the parties as a breach of contract, but it does mean that they could not be enforced by an action for infringement of copyright."))). *See also* Nadan, *supra* note 31, at 634, n.268, (citing H.R.

of private legislation tips the balance of rights in favor of copyright owners, who retain copyright, retain title to the copy of the work, and receive the benefits associated with the transfer of the chattel. Although the issue of private legislation was raised during the drafting of the Digital Millennium Copyright Act ("DMCA"), Congress did not change Section 109, despite the acknowledgement of concerns relevant to circumventing the first sale doctrine.[59] The DMCA's Executive Summary states that legislators found "no convincing evidence of present-day problems. In order to recommend a change in the law, there should be a demonstrated need for the change that outweighs the negative aspects of the proposal."[60] However, in some fields the incentives to circumvent statutory protections have exceeded incentives to have the ability to bring an action for copyright infringement.[61] As a result, the use of licenses has increased greatly. Yet there has been no market correction for the lesser transfer of rights associated with a license versus a sale, as can be seen from the iTunes example—the license fee for an album on iTunes is about the same as the price for an album at Tower Records. Market correction, furthermore, will be slow to come because many licensors are unaware that they are purchasing a license, with limited rights, rather than ownership. Copyright owners now have the ability to profit from the copyright and to prevent those to whom the tangible expression of the copyright has transferred from exercising rights that they may expect to have. As the norm shifts to the use of licenses, the enforceability of terms whose primary purpose is to circumvent public legislation must be questioned.

2. Patent Law

Patent protection is usually limited to the first sale, meaning that the patent holder loses rights to any royalty after the initial sale of the patented

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Rep. No. 94-1476, at 79 (1976) (relevant section reprinted as "Historical Note" to 17 U.S.C. § 109 (2000)).

59 U.S. COPYRIGHT OFFICE, A REPORT OF THE REGISTER OF COPYRIGHTS OFFICE PURSUANT TO § 104 OF THE DIGITAL MILLENNIUM COPYRIGHT ACT xv (2001), *available at* http://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf ("Another prevalent concern was that licenses are being used increasingly by copyright owners to undermine the first sale doctrine and restrict other user privileges under the copyright law. These commentators argue that this trend is displacing the uniformity of federal copyright law with a wide variation of contract terms that must be evaluated and interpreted. This poses a particular challenge to large institutions, such as universities and libraries, in determining legal and acceptable use in any given work.").

60 *Id.* at xx.

61 *See generally* David A. Rice, *Licensing the Use of Computer Program Copies and the Copyright Act First Sale Doctrine*, 30 JURIMETRICS J. 157 (1990).

product. Therefore, the patent holder does not have any right to control subsequent sales because the patent rights have been "exhausted." Once a patent becomes "exhausted" the initial purchaser may resell the goods without infringing on the patent held by the original seller.[62]

The main difference between the first sale doctrine in patent law and copyright law is that the doctrine only applies to unconditional sales of patented devices.[63] Courts have allowed restrictions on the future rights of the purchaser of a chattel that embodies patented ideas even when the chattel is sold if notice is given of the restrictions, such restrictions are within the scope of the patent grant, and the patent rights have not yet been exhausted.[64] Furthermore, if a party violates a restriction on a sale, the patent holder can sue that party for patent infringement, which is likely to be a more lucrative action than breach of contract for violating a license restriction.[65]

The fact that patent owners can place downstream restrictions on sold chattels that benefit from patented ideas has not prevented the use of private legislation to regulate downstream use from keeping pace with the use of such licenses on chattels that benefit from copyrights. The terms in licenses of chattels that benefit from patents have two primary purposes behind them: one legitimate and one suspect. Licenses may be used to augment public legislation by clarifying what restrictions are being placed on the chattel, or licenses may be used to circumvent public legislation by restricting the downstream use of the chattel in a manner not commensurate with the scope of the patent.

The use of licenses to augment public legislation fits the traditional norm driving contract law. Such licenses are economically efficient, allowing parties to negotiate what restrictions they wish to place on downstream use and to set the potential outcomes for breach, decreasing the overall

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62 Hillary A. Kremen, *Caveat Venditor: International Application of the First Sale Doctrine*, SYRACUSE J. INT'L L. & COM. 161, 162 (1997) (citations omitted).

63 B. Braun Med., Inc. v. Abbott Labs., 124 F.3d 1419, 1426 (1997) ("[A]n unconditional sale of a patented device exhausts the patentee's right to control the purchaser's use of the device thereafter. The theory behind this rule is that in such a transaction, the patentee has bargained for, and received, an amount equal to the full value of the goods.").

64 *See* Mallinckrodt, Inc. v. Medipart, Inc., 976 F.2d 700 (Fed. Cir. 1992) (finding limitation to single use only within field of use); *Braun*, 124 F.3d at 1426; Ariz. Cartridge Remfrs. Ass'n v. Lexmark Int'l, Inc., 421 F.3d 981 (9th Cir. 2005) (upholding Lexmark's post-sale restrictions on printer cartridges).

65 In a suit for patent infringement, "damages may be enhanced up to three times the compensatory award." Read Corp. v. Portec, Inc., 970 F.2d 816, 826 (Fed. Cir. 1992) (citing 35 U.S.C. § 284 (2000)). In a suit for breach of contract, damages must reflect the intentions of the parties at the time they entered into the contract and cannot be punitive—in other words, they can only be compensatory. E. Allan Farnsworth, FARNSWORTH ON CONTRACTS § 12.8 (C) (2d ed. 1998).

transaction costs in light of the possibility of future breach. As long as such restrictions are within the scope of the patent, traditional contract norms would dictate that they should be enforceable. The parties can thus use the bargaining process to shift risks in a manner that is in accord with the restrictions that could be placed on the same items in a sale.

On the other hand, as long as "the overall effect of the license" does not "restrain competition unlawfully in an appropriately defined relevant market,"[66] a license may be used to circumvent public legislation by placing downstream restrictions not limited to the scope of the patent grant.[67] Patent owners are choosing to explore this less-defined area of market restraints, which is why licenses of chattels that embody patented ideas are keeping pace with licenses that embody other types of intellectual property. As private legislation seeks to circumvent established case law on the restraints available after the first sale of an article that benefits from the protection given to patents, the balance between public rights and owners' rights tilts in favor of the owners and away from the public.

3. Trademark Law

The first sale doctrine, as applied to trademarks, limits "the producer's power to control the resale of its product."[68] Under the first sale doctrine, after the sale of a product that bears a trademark, the trademark owner cannot rely on its trademark rights to restrict the purchaser's use or redistribution of the expression.[69] So instead of selling chattels, trademark owners

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[66] *Mallinckrodt*, 976 F.2d at 706 (quoting Windsurfing Int'l, Inc. v. AMF, Inc., 782 F.2d 995, 1001-02 (Fed. Cir. 1986)).

[67] Richard H. Stern, *Post-Sale Patent Restrictions After* Mallinckrodt*—An Idea in Search of Definition*, 5 ALB. L.J. SCI. & TECH. 1, 14 (1994) (footnotes omitted).

> Consider the doctrine of repair and reconstruction, obliquely involved in the *Mallinckrodt* case. Under the patent law, the owner of a product has an unlimited right to repair the product by replacing one or more worn or otherwise unsatisfactory parts (elements) of the product. Sometimes, however, purchasers of patented devices exasperate patentees by refurbishing the devices instead of buying new ones—even where the patentee makes it clear to the customers by the construction of the device that the seller expects them to replace worn-out element A of the combination A + B + C, but not to replace B when it wears out. Nevertheless, this conduct is not patent infringement, because the Supreme Court has held that the "mere replacement of individual unpatented parts, one at a time, whether of the same part repeatedly or different parts successively, is no more than the lawful right of the owner to repair his property." Hypothesize a case, however, in which the seller labels the device: "Licensed for use only until element B wears out." Under the *Mallinckrodt* decision, that label would provide a detour around the Supreme Court's rulings on repair.

Id. (quoting Aro Mfg. Co. v. Convertible Top Replacement Co., 365 U.S. 336, 346 (1961)).

[68] Sebastian Int'l v. Longs Drug Stores Corp., 53 F.3d 1073, 1075 (9th Cir. 1995).

[69] Softman Prods. Co. v. Adobe Sys. Inc., 171 F. Supp. 2d 1075, 1092 (C.D. Cal. 2001) ("Under the first sale doctrine, resale by the first purchaser of the original article under the producer's trademark

have chosen to use the private legislation model and license products bearing trademarks.[70] By licensing chattels and using private legislation to circumvent public legislation, trademark owners are able to control the trademark's use, even after receiving compensation for the chattels.

This use of private legislation allows the owner of the trademark to receive compensation for the product and still exercise control over it downstream.[71] Such circumvention erodes the very foundation of the publicly legislated restrictions on intellectual property, encouraging monopolistic behavior by the trademark owner.

B. *Foiling Fair Use Exceptions*

Accompanying a copyright is the right to prevent others from copying the protected idea, except when such copying is a fair use of the ideas expressed in the copyrighted work. The "fair use doctrine," as this restriction is known, is codified in Copyright Act section 107.[72] Determining which uses are fair and which infringe on the rights of the copyright owner can be difficult and has led copyright owners to challenge the fair use doctrine and to use private legislation to protect their works.[73]

With increasing frequency, copyright owners are licensing their copyrighted works, using private legislation to circumvent the fair use doctrine. Companies are using such licenses to curtail the rights of licensees—for instance, both Microsoft and Network Associates have attempted to use

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is generally neither trademark infringement nor unfair competition." (citing *Sebastian*, 53 F.3d at 1074)).

70 Initially, trademark owners sought to contract around the first sale doctrine by placing restrictions in the sales contract. Behr Auto., Inc. v. Mercedes-Benz of N. Am., Civ. A. No. 85-0295, 1985 WL 6417, at *8 (E.D. Pa. Dec. 30, 1985). However, that approach failed as courts held that post-sale restrictions were not enforceable, because the first sale exhausted the trademark owner's rights. McDonald's Corp. v. Shop At Home, Inc., 82 F. Supp. 2d 801, 811 (M.D. Tenn. 2000).

71 When McDonald's attempted to do just this, however, the Middle District of Tennessee held that it would be "inequitable to allow McDonald's to set up a supply chain that shields it from liability yet allows it to exercise control over the goods while in the supply chain." *McDonald's*, 82 F. Supp. 2d at 811-12.

72 17 U.S.C. § 107 (2000).

73 Some uses are fair, while others are clearly not. If someone other than the copyright owner wishes to include an excerpt from a copyrighted work in a review of the work, such copying is fair use. If a professor wishes to make a photocopy of a section of a copyrighted work for research for an article she is working on, public legislation dictates that she should be able to do so. If a satirist wishes to incorporate some (but not all) elements of a copyrighted work in a parody of that work, public legislation dictates that she should be able to do so. On the other hand, if one author copies all of another's copyrighted work without permission, this is not a fair use. It is the scenarios in-between that cause the most confusion.

licenses to prevent criticism of copyrighted works by licensees. Microsoft Agent comes with a license clause that prevents users from using the software to "disparage Microsoft, its products or services."[74] Network Associates sought to prevent its customers from publishing reviews of Network Associates' antivirus software.[75] The enforceability of such clauses has not been tested, but the licensee does not have the same rights as a purchaser.[76]

Licenses serve two primary purposes in the field of the fair use doctrine—one purpose is to augment public legislation, a laudable and legitimate purpose, and the other is to circumvent public legislation, a nefarious purpose. If the primary purpose of private legislation is to delineate the agreement reached by the parties and to augment the guidelines of 17 U.S.C. § 107—in other words, that the licensee may not copy more than ten percent of the article or use the article in more than one presentation without seeking permission from the copyright owner—then the license fits within traditional contract norms and does not expand the copyright owner's rights. Such a contract may reduce subsequent enforcement costs between parties—a legitimate reason for such an agreement. Neither the public's rights nor the licensee's rights are harmed by this agreement, and there is a strong public interest in enforcing such private legislation. On the other hand, if the primary purpose for using private legislation is to circumvent the fair use doctrine and restrict the public's rights to copy protected works, then the license should not be enforced.[77] For instance, a license could state that the licensee cannot copy any part of a copyrighted work, though such copying may be fair use if the licensee had purchased the

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[74] License and Distribution Agreement (Microsoft Agent), http://www.microsoft.com/msagent/licensing/DistLicenseV2.asp (last visited July 11, 2006); James Gleick, *Fast Forward: It's Your Problem (Not Theirs)*, N.Y TIMES, May 10, 1998, § 6, at 16, *available at* http://www.around.com/agree.html ("[T]he agreement that comes with Microsoft Agent, software that lets users create cute interactive animated figures, holds that you may not use the characters 'to disparage Microsoft, its products or services.'").

[75] Gleick, *supra* note 74, at 16 ("Customers who download Network Associates' antivirus software 'agree'—click—to clauses designed to give the company control of press coverage: 'The customer shall not disclose the results of any benchmark test to any third party without Network Associates' prior written approval'; and 'the customer will not publish reviews of the product without prior consent.'").

[76] The New York Attorney General's office prosecuted Network Associates for including the language quoted in note 75 *supra*, which suggested to consumers that a New York statute gave Network Associates the ability to prosecute consumers for publishing reviews. The court found that no damages could be determined for this act, but issued a narrowly worded injunction that prohibited Network Associates from including identical language in future licenses. People v. Network Assocs., Inc., 758 N.Y.S.2d 466, 471 (Sup. Ct. 2003). Network Associates has since changed its license.

[77] Many copyright owners view the fair use doctrine as a restriction on the rights of the copyright owners and not as a public privilege. *See* Jonathan Rosenoer, *Information & Infrastructure*, CYBERLAW, July, 1994, *available at* http://www.cyberlaw.com/cylw794.html.

work.[78] The licensor could require the licensee to pay a separate royalty to copy each chapter of a manual, a level of control not permitted under the fair use doctrine. To enforce such private legislation could have the effect of granting copyright owners a monopoly in the expression of their ideas, removing material from the public domain and harming the public. Freedom to contract is not unlimited and can be abused. Licenses have the potential to tilt the balance in favor of the reward granted to the copyright owner and away from the public interest in having copyrighted works eventually enter the public domain and thus deserve close scrutiny. It is, therefore, crucial to evaluate the purpose behind each license in determining whether the license should be enforced or not.

One particularly difficult area to determine the true purpose behind the license and the scope of fair use is the doctrine of reverse engineering. There is an increased concern among copyright owners that purchasers of chattels expressing copyrighted ideas are reverse engineering the chattels and then using that knowledge to vitiate the copyright and circumvent the ideas expressed in the copyrighted works. It is unclear whether reverse engineering is fair use or not and, therefore, whether it is copyright infringement or not.[79] As a result, copyright owners are licensing their works with terms that seek to prevent reverse engineering. Some courts have found such clauses enforceable.[80] If a clause preventing reverse engineering merely reinforces the DMCA's ban on circumvention of technological protection measures, then the clause should be enforced, as it does not erode the foundations of copyright law.[81] However, if a clause preventing reverse engineering seeks to circumvent the fair use doctrine, and in doing so, it expands the copyright owner's rights, shifting the balance between the owner's rights and the public interest, then it should not be enforced.

What the courts have not contemplated in enforcing contract clauses circumventing the fair use doctrine is the slippery slope facing society. How is the public interest served by allowing circumvention of the fair use doctrine through prevention of reverse engineering or through prevention of disparaging comments on a copyrighted work? How are licensees to be made aware of the limited rights they acquire with a license as opposed to a purchase? A balance must be maintained between the rights of the public and the intellectual property owner, and public legislation needs to reflect

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78 17 U.S.C. § 107 (2000).

79 Chris Sprigman, *Should Software Companies Be Able Through Contracts, to Prevent Competitors from "Reverse Engineering" Their Products?*, Sept. 26, 2002, *available at* http://writ.news.findlaw.com/commentary/20020926_sprigman.html.

80 Bowers v. Baystate Techs., Inc., 320 F.3d 1317, 1325-26 (Fed. Cir. 2003) ("[C]ase law indicates the First Circuit would find that private parties are free to contractually forego the limited ability to reverse engineer a software product under the exemptions of the Copyright Act.").

81 17 U.S.C. § 1201 (2000).

that balance as the courts interpret private legislation. The failure to enforce limits on the near-monopolistic rights of intellectual property owners will erode such limits and leave the public at the mercy of monopolies controlled by intellectual property owners.

C. *Obstructing the On-Sale Bar*

If an invention is on sale more than one year before the inventor files a patent application, the inventor is statutorily barred from receiving a patent.[82] The publicly-legislated on-sale bar, codified at 35 U.S.C. § 102, arises when the invention is "the subject of a commercial offer for sale."[83] "A sale is 'a contract between parties to give and pass rights of property for consideration which the buyer pays or promises to pay the seller for the thing bought or sold.'"[84]

A corporation may license an invention without triggering the on-sale bar because it is not selling the invention.[85] A license may commercialize an invention, but because a license is not a sale, it does not raise the on-sale bar, creating an incentive for patent owners to privately legislate the transfer of chattels. Patent owners can thus increase profits by testing the market for products with licenses and filing for patents only on those products that succeed in the market.[86] Despite this, the courts continue to treat private legislation that circumvents the on-sale bar as if it did not undermine the policies behind the bar. For example, in 1985 the Federal Circuit said:

> [I]t is important to recognize that exempting licenses under a patent from the on-sale bar is not inconsistent with traditional policies underlying that doctrine, including: (1) [the] policy against removing inventions from the public domain which the public justifiably comes to believe are freely

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82 35 U.S.C. § 102(b) (2000).

83 Pfaff v. Wells Elec., Inc., 525 U.S. 55, 67 (1998).

84 Zacharin v. United States, 213 F.3d 1366, 1370 (Fed. Cir. 2000) (quoting In re Caveney, 761 F.2d 671, 676 (Fed. Cir. 1985)).

85 Elan v. Andrx Pharms., Inc., 366 F.3d 1336, 1341 (Fed. Cir. 2004) ("An offer to enter into a license under a patent for future sale of the invention covered by the patent when and if it has been developed . . . is not an offer to sell the patented invention that constitutes an on-sale bar." (citing *In re* Kollar, 286 F.3d 1326, 1331 (Fed. Cir. 2002))). The Federal Circuit has "held that merely granting a license to an invention, without more, does not trigger the on-sale bar of § 102(b)." *Kollar*, 286 F.3d at 1330-31 (citing Mas-Hamilton Group v. LaGard, Inc., 156 F.3d 1206, 1217 (Fed. Cir. 1998)).

86 In addition, it is worth noting that there might be a potentially lucrative impact on the length of the patent term. The patent term is based on the date of filing, so if the date of filing can be postponed for a year or two through this practice, then the term may be similarly extended for a year or two. However, the on-sale bar is not the only bar to patentability, a factor that must be considered in evaluating this scenario.

> available due to commercialization; (2) [the] policy favoring prompt and widespread disclosure of inventions to the public; and (3) [the] policy of giving the inventor a reasonable amount of time following sales activity to determine whether a patent is worthwhile.[87]

Twenty years later, the Federal Circuit still relied on the argument that a license does not commercialize an invention and therefore does not trigger the on-sale bar:[88]

> [A]lthough an inventor may economically benefit somewhat from licensing his invention at the time of granting the license, such as by up-front fees or advance royalties, the real benefit from commercializing an invention occurs when the invention is actually utilized commercially or made available to the public, and the grant of a license, albeit accompanied by some payment, is only part of the pre-commercialization process aimed at making the invention commercial. The on-sale bar is not implicated by such activities. The grant of a license thus does not conflict with the policies underlying the on-sale bar.[89]

Licenses can commercialize an invention. Granted, some agreements that purport to be licenses are actually sales, some contracts that purport to be sales are actually licenses, and in both of these cases, it is clear what the outcome of entering into such an agreement more than a year before filing for a patent should be.[90] However, some licenses have the potential to commercialize an invention. Monsanto's license of genetically modified seed[91] to McFarling is one such license. This license involved an embodiment of Monsanto's invention that was publicly available, that retarded the objective of making inventions available to the public, and that provided

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87 *Kollar*, 286 F.3d at 1333–34 (citing *Caveney*, 761 F.2d at 676) (citations omitted).

88 It is worth noting that a simple disguise of a "sales price as a licensing fee . . . would not avoid triggering the on-sale bar." *Elan*, 366 F.3d at 1341.

89 *Kollar*, 286 F.3d at 1334.

90 Group One, Ltd. v. Hallmark Cards, Inc., 254 F.3d 1041, 1047-48 (Fed. Cir. 2001) ("There may be instances in which a license is tantamount to a sale, and in which a bar may arise from a license. When a product, such as a computer program, is transferred to a customer in a transaction that is tantamount to a sale, the transaction may under commercial law nevertheless still be a license. The transaction is structured as a license (a "shrink wrap" license) so that the seller can restrict what the "buyer" does with the program, in particular, to ensure that it is not duplicated and distributed to others who have not paid the seller for the product. The product is, however, just as immediately transferred to the "buyer" as if it were sold. Notwithstanding the provisions of such a license, it is not contemplated that the product will ever be returned to the seller.").

91 The seed was patented and the on-sale bar was never an issue here, but this provides an excellent example of what could happen.

economic benefits to Monsanto.[92] At the same time, this license was not tantamount to a sale and thus does not fit the Uniform Commercial Code's definition of a sale.[93] According to the Federal Circuit such a license could not trigger the on-sale bar, despite its commercialization of the invention.

Rather than distinguish between licenses and sales, courts could better serve the public by looking at whether the invention is the subject of a commercial offer and whether the invention is ready for patenting. The circumvention of the on-sale bar is inconsistent with the policy behind the on-sale bar, allowing the inventor to benefit from making its work available to the public before providing the public with the benefit of the publication of its invention. The language governing a transaction should not regulate the patentability of an article. Even if a license is not tantamount to a sale, if the intent is to commercialize the invention, the publicly-legislated on-sale bar should apply.

D. *Withholding Warranties*

The traditional model of contract law is an agreement between two parties reached after a process of negotiation and bargaining.[94] However, with respect to routine transactions, such as the sale of goods, transaction costs associated with negotiation often outweigh the sale's benefits, resulting in the completion of the transaction without the protection afforded by the bargaining process. Recognizing the absence of such protections and their necessity, the Uniform Commercial Code publicly legislated protection for merchants purchasing goods.[95] These protections include an implied warranty of merchantability[96] and an implied warranty of fitness for a particular purpose.[97] Providing an incentive for private legislation, parties can contract around these warranties; however, if they choose to do so, such exclusions must be both reasonable and made clear during negotiations.[98]

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92 *See supra* notes 40-42 and accompanying text.

93 "A 'sale' consists in the passing of title from the seller to the buyer for a price." U.C.C. § 2-106(1) (1998).

94 E. Allan Farnsworth, FARNSWORTH ON CONTRACTS 295-6 (3d ed. 2003); BLACK'S LAW DICTIONARY 341 (8th ed. 2004).

95 Other routine transactions are not subject to U.C.C. Article 2, and are therefore not given this same level of protection. U.C.C. § 2-106 states that "[i]n this Article unless the context otherwise requires 'contract' and 'agreement' are limited to those relating to the present or future sale of goods." U.C.C. § 2-106(1) (1998).

96 *Id.* § 2-314.

97 *Id.* § 2-315.

98 *Id.* § 2-316.

When a good is licensed, however, it is not sold, and license agreements carry with them no implied warranties.[99]

The Federal Circuit has repeatedly stated that a license is not a sale of goods[100] and therefore the UCC is inapplicable, endorsing the idea that chattels may be transferred without transferring all rights, such as warranties associated with the transfer of chattel, and thus private legislation may be used to circumvent public legislation.[101]

Expansion of the use of licenses in the transfer of chattels has also led to an expansion of the scope of such licenses. As a result of the incentives provided by the courts in their distinctions between sales and licenses and in their willingness to allow parties to contract around warranties, warranty disclaimers have been appearing with increasing breadth and frequency in

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[99] Nonetheless, several states interpret Article 2 of the U.C.C. to apply to transactions not involving the sale of goods. *See, e.g.*, Murphy v. McNamara, 416 A.2d 170 (Conn. Super. Ct. 1979); Owens v. Patent Scaffolding Co., 354 N.Y.S.2d 778 (Sup. Ct. 1974), *rev'd on other grounds*, 376 N.Y.S.2d 948 (App. Div. 1975). Some states apply Article 2 by analogy to cases involving "the same considerations that gave rise to the Code provisions." Glenn Dick Equip. Co. v. Galey Constr., Inc., 514 P.2d 1184, 1190 (Idaho 1975) (quoting Note, *The Uniform Commercial Code as a Premise for Judicial Reasoning*, 65 COLUM. L. REV. 880, 888 (1965)). Furthermore, most states have adopted Article 2A, which warrants leases of goods. However, leases are not licenses, and at the time Article 2A was drafted and adopted, software developers argued that software was intangible and therefore should not be covered by Article 2A. Pamela Samuelson & Kurt Opsahl, *How Tensions Between Intellectual Property Policy and UCITA are Likely to Be Resolved*, *in* ECOMMERCE: STRATEGIES FOR SUCCESS IN THE DIGITAL ECONOMY 741, 753-54 (Practicing Law Inst. 1999). Instead, it was argued, a separate Article should be drafted to address licenses. *Id.* This was Article 2B, but it was never adopted. *Id.* Article 2B was never endorsed by the American Law Institute ("ALI"), and therefore never codified as part of the U.C.C. Undaunted, the forces behind Article 2B pushed forward with a new freestanding Uniform Computer Information Transactions Act ("UCITA"), which was adopted only by Virginia and Maryland, and which incorporates many of the provisions contemplated by Article 2B. Few states have applied either Article 2 or Article 2A to licenses, even licenses of goods, except by analogy. *See, e.g.*, Upper Deck Co. v. Breakey Int'l, No. 03 Civ.8978 MGC, 2004 WL 2980190, at *3 n.2 (S.D.N.Y. Dec. 22, 2004).

[100] Lamle v. Mattel, Inc., 394 F.3d 1355, 1359, n.2 (Fed. Cir. 2005) ("[A] license for intellectual property . . . is not a sale of goods.") (citing Novamedix, Ltd. v. NDM Acquisitions Corp., 166 F.3d 1177, 1182 (Fed. Cir. 1999)).

[101] *Novamedix*, 166 F.3d at 1182 ("The world of commercial transactions is not limited to the binary world . . . in which an agreement that passes title to Article 2 goods must be either a contract for sale of goods or a contract for sale of services. Many commercial transactions are not governed by Article 2 of the UCC: sale of land or securities, assignment of a contract right, or granting a license under a patent or copyright, to name just a few. The mere fact that title to Article 2 goods changes hands during one of these transactions does not by that fact alone make the transaction a sale of goods."). Previously, in the same *Novamedix* opinion, the Federal Circuit stated:

> [I]f the language of the agreement reflects an intention of the parties to create a contract for the sale of goods, their intention should be given effect. If the parties intended the settlement agreement to be a contract for the sale of goods, then by law they intended to include warranties of fitness and merchantability, since the New York UCC implies those warranties in every merchant's contract for the sale of goods unless they are conspicuously disclaimed.

Id. at 1181.

licenses. Such clauses neither have to be reasonable nor do they have to be made clear during negotiations. In fact, they do not have to be included at all—but Apple's iTunes Terms of Service contains one example of such a disclaimer:

> You expressly agree that your use of, or inability to use, the service is at your sole risk. The service and all products and services delivered to you through the service are (except as expressly stated by Apple) provided "as is" and "as available" for your use, without warranties of any kind, either express or implied, including all implied warranties of merchantability, fitness for a particular purpose, title, and no infringement.[102]

This clause limits the exposure of the rights owner, allowing it to control litigation risk factors. In an industry not adequately covered by statutory schemes, such as software once was, it may have been sensible to enforce such provisions that trade away risk to help the unprotected industry attract investment and grow. But in a more developed field, such as art or music, with sufficient statutory protection through patent, trademark, or copyright law, this tradeoff becomes questionable. It remains unanswered whether or not such a provision that lacks the notification required of a warranty disclaimer in a sale of goods is enforceable. At a minimum, the inclusion of such a term deters the chattel's possessor from seeking satisfaction from the owner of the rights in the chattel should it fail.[103]

E. *Effects of Bankruptcy*

Another right affected by the use of private legislation to transfer chattels without title is the right to continue using the chattel upon a bankruptcy declaration by the title owner. As described above, a license gives a right to use a chattel, title to which the owner retains. In most licenses of chattels, neither the intellectual property owner nor the consumer considers license revocation. However, upon a declaration of bankruptcy by the intellectual property owner, a debtor may have the right to terminate the license and sell the property subject to the license.

In an analogous matter involving the rights of a lessee upon the lessor's bankruptcy, the Seventh Circuit held that the courts could terminate the rights of any lessee in a bankruptcy matter and sell the property subject to the lease, and the only recourse for the lessee would be compensation

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102 iTunes Terms of Service, *supra* note 16.

103 The enforceability of these clauses has been discussed but not settled with regards to software. *See* Step-Saver Data Sys., Inc. v. Wyse Tech., 939 F.2d 91 (3d Cir. 1991); Ariz. Retail Sys., Inc. v. Software Link, Inc., 831 F. Supp. 759 (D. Ariz. 1993); Lemley, *supra* note 37, at 1252.

"for the value of its leasehold—typically from the proceeds of the sale."[104] The licensee, however, must take steps to protect its interests in order to obtain such compensation, and presumably would become an unsecured creditor when seeking recourse after a declaration of bankruptcy. This scenario has not yet been litigated in the area of licenses, but some hypothesize that the reasoning of the lessor's bankruptcy scenario could extend to cover the rights of a licensee.[105] If, instead of licensing the chattel, the consumer purchased it, then title would transfer to the consumer and bankruptcy of the intellectual property owner would have no impact on the consumer's rights in the chattel. This is one more right a licensee gives up when it exchanges consideration for transfer of a chattel without all of the accompanying rights.

F. *Further Restrictions on Proprietary Rights*

In addition to the limitations detailed above, owners of intellectual property are using licenses to impose numerous additional limitations on those to whom chattels are transferred without the accompanying title. Such licenses not only restrict the rights of licensees, but also extend the copyright owner's rights in potentially lucrative ways. Clauses containing such restrictions are often found when intellectual property owners feel that the value of the expression of the protected idea exceeds the reward promised by public legislation.

One such clause is a limit on the ability of the licensee to transfer the copyrighted material to another, whether that transfer is temporally limited or not. The introduction to this Article described such a term in the license under which the Maryland Lawyer's Manual is distributed.[106] As justification for these terms, copyright owners argue, for instance, that limiting the ability to distribute the Maryland Lawyer's Manual protects State Bar members' privacy. However, in addition to protecting the privacy of its members—an unlikely outcome at best—the license also has the potential

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104 Precision Indus., Inc. v. Qualitech Steel SBQ, Inc., 327 F.3d 537, 548 (7th Cir. 2003).

105 Peter N. Tamposi, *Tenants Beware—Your Lease Rights May Be Subject to Termination by the Bankruptcy Court*, 22 AM. BANKR. INST. J. 30, 30 (2003), *available at* http://www.allbusiness.com/periodicals/article/1088173-1.html. *See* Warren E. Agin, *Here Today and Gone Tomorrow: Section 365 and the Unfortunate Intellectual Property Licensee*, 1 No. 9 ANDREWS BANKR. LITIG. REP. 4 (August 27, 2004), *available at* http://www.swiggartagin.com/articles/code_365n.pdf.

106 That license prohibited one from "reselling, loaning, or giving away the book." Woellert, *supra* note 3, at 8.

to increase the number of copies of the Manual sold by circumventing the first sale restriction.[107]

The 1859 Agreement that purchasers of the *Dun & Bradstreet Reports* signed in order to receive the books is an early example of an owner using private legislation to circumvent public legislation for its own economic benefit:

> On February 1, 1859 The Mercantile Agency's Reference Books, of the United States and British Provinces: Containing Ratings of the Principal Wholesale Merchants (Together with Some Retailers) and Manufacturers for the Year 1859 appeared on the market . . . . The contract [subject to which the book was distributed] obligated the subscriber to keep the book on the designated premises of the firm, in a secure place, available without notice on the call of the Agency representative, and to surrender the book at the end of the year's subscription to the Agency. Not only did the subscriber agree to keep the book secure, he also pledged to keep the information confidential. [The Agency] even equipped the volumes with lock and key.[108]

Other owners who view their proprietary information as being more valuable than the protections granted by public legislation have placed other restrictions on licensees' rights. For instance, licensees of GloFish, a genetically modified form of Zebra fish that have a fluorescent glow, are prevented from encouraging the GloFish to propagate.[109] This license is modeled after the licenses used for agricultural goods, with a distinct difference: the purpose of purchasing agricultural goods is propagation. When Monsanto licenses its seed, it prevents the licensee from using the progeny for unauthorized purposes.[110] But unlike GloFish, Monsanto does not attempt to prevent licensees from propagating the seed in the first place. The purpose of purchasing GloFish is to display them, and the licensor therefore seeks to transfer only those rights necessary for the licensee to display the GloFish. The fish are not shipped sterile, and it may be difficult for the li-

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107 For instance, what if instead of the Maryland Lawyers Manual, it was J.K. Rowling who sought to license her books, thereby restricting the right of licensees, including libraries, to loan the books to others?

108 JAMES D. NORRIS, R.G. DUN & CO., 1841-1900: THE DEVELOPMENT OF CREDIT-REPORTING IN THE NINETEENTH CENTURY 53-54 (1978).

109 The GloFish license agreement reads, in part:

> By accepting these fish, and as part of the consideration therefor [sic], the recipient agrees: (1) not to, breed or propagate these fish, permit or encourage others to breed or propagate these fish, or otherwise intentionally engage in any activity that may result in or lead to the breeding or propagation of these fish by anyone without the express written consent of Yorktown; (2) not to sell or transfer these fish to anyone in the State of California, or to possess or otherwise engage in any activity that results in the possession of these fish in the State of California.

Yorktown Technologies, L.P., GloFish Fluorescent Fish License Notice, *available at* http://www.glofish.com/license.htm.

110 *See supra* note 11 and accompanying text.

censees to prevent propagation and therefore to avoid breaching the contract. Given the nature of fish, the licensee may breach the contract's terms simply by displaying several fish in the same tank.

Intellectual property owners are limiting the proprietary rights that are transferred with chattels and in so doing are hindering the progress of science and the useful arts. For example, artists will no longer be able to take their "form[] from the lines of life itself, [and watch that form as it] twists and extends and accumulates and spits and drips and is heavy and coarse and blunt and sweet and stupid as life itself."[111] This discussion above covers only a few of the many examples of licensing terms limiting proprietary rights.[112] The balance continues to be skewed in favor of intellectual property owners and against potential licensees, hindering progress and frustrating the purposes of both private and public legislation.

III. PRIVATELY-LEGISLATED TRANSFER OF RIGHTS: LICENSE OR SALE?

Private legislation has tilted the balance between the rights of owners and the rights of users towards owners by augmenting owners' rights, restricting users' rights, and circumventing public legislation. These advantages have induced intellectual property owners to expand the scope of licenses ever further and characterize as licenses transactions that may, in fact, be sales. "In certain situations, a 'license'...may be tantamount to a sale."[113] Licenses that fall under this subterfuge are shams—seeking to

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111 CLAES OLDENBURG, STORE DAYS: DOCUMENTS FROM THE STORE, 1961, AND RAY GUN THEATER, 1962 (1967).

112 For instance, Rodgers & Hammerstein prevents their licensees from changing the gender or race of characters in their performances. R&H Theatricals, Frequently Asked Questions, http://www.rnh.com/theatricals/index.php?page=faqs (last visited July 8, 2006) ("Changing the show, by making alterations in the music, lyrics, book, gender of a character, orchestrations or vocal arrangements, is a violation of the author's rights."). *Cf.* Ylan Q. Mui, *Colorblind Casting Roils "Big River": Licensing Group Objects to Md. School's Musical*, WASH. POST, May 21, 2005, at B01 ("[U]ntraditional reverse casting has provoked the ire of the Rodgers and Hammerstein Organization, which licenses the rights to the musical created by Roger Miller. It forbade the teenagers to perform the song 'Muddy Water' from the musical that was broadcast last night on C-SPAN . . . 'That's taking a liberty that one could argue is not appropriate to what the authors of that musical are trying to convey about the novel,' said Bert Fink, spokesman for R&H Theatricals. 'To ignore the racial component of Huck Finn does a disservice to the story.' . . . 'The ethnicity of the characters of Huckleberry Finn and Jim cannot be questioned,' wrote Charles Scatamacchia, director of professional licensing for R&H, in a letter to Cappies co-founder Judy Bowns. 'Huck is clearly a free, white boy and Jim is clearly a black slave.'").

113 *In re* Kollar, 286 F.3d 1326, 1331 n.3 (Fed. Cir. 2002). The example given by the court of such a situation was "a standard computer software license." *Id.*

place restrictions on consumers when such restrictions are not enforceable due to the many publicly-legislated rights described in this Article.

The problem with sham licenses is the chilling effect that they have on risk-averse, rule-abiding customers. It can be very difficult for consumers to determine whether they are buying or licensing chattels, particularly when faced with a confusing agreement such as the one in the recent *Lexmark* case, which stated: "Opening of this package . . . confirms your acceptance of the following *license agreement.* The [item] is *sold* at a special price subject to a restriction that it made be used only once."[114] Is the agreement a sale or a license, and what rights transfer along with the chattel? Applying the traditional normative justifications for the protection of contract interests to agreements governing the transfer of chattel can help determine what the principal purpose of the agreement is, and therefore what rights transfer. Several factors are relevant:

* What are the terms of the contract?

* What is the nature of the intellectual property and the character of the commercial embodiment? [115]

* How is the pricing structured, what rights are transferred, and when does the transfer take place?[116]

* What is the intellectual property owner's established policy or marketing program of maintaining its intellectual property?[117]

The below discussion analyzes these factors.

A. *The Terms of the Contract*

The first step to take in determining whether a contract is a license or a sale is to evaluate the contract's terms. To "determine the terms of a contract a court must ascertain the parties' intent based on the language they

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114 Ariz. Cartridge Remfrs. Ass'n v. Lexmark Int'l, Inc., 421 F.3d 981, 983 (emphasis added).

115 Georgia-Pacific v. U.S. Plywood Corp., 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970), *modified, sub nom.* Georgia-Pacific v. U.S. Plywood-Champion Papers, Inc., 446 F.2d 295 (2d Cir. 1971).

116 Adams v. Burke, 84 U.S. 453, 456 (1873) ("[W]hen the patentee, or the person having his rights, sells a machine or instrument whose sole value is in its use, he receives the consideration for its use and he parts with the right to restrict that use . . . . That is to say, the patentee or his assignee having in the act of sale received all the royalty or consideration which he claims for the use of his invention in that particular machine or instrument, it is open to the use of the purchaser without further restriction."). *Cf.* Microsoft Corp. v. Dak Indus., Inc., 66 F.3d 1091, 1095 n.2 (9th Cir. 1995).

117 *See Georgia-Pacific*, 318 F. Supp. at 1120 (listing fifteen doctrinal criteria pertinent to determining a reasonable royalty when no established royalty exists).

used."[118] The terms reflect the "language, content and intent" of the contract, and the courts will correspondingly consider these in delineating the nature and the scope of the contract.[119]

If the contract's plain meaning is unambiguous, then courts will uphold that interpretation and treat the agreement as a license or a sale.[120] It is common, however, for the plain meaning of a transaction to be difficult to determine and to differ from at least one party's characterization of the transaction.[121] Even when a contract expressly states that it is a license or it is a sale, the "circumstances surrounding the transaction" may contradict the express language of the document, and so courts must look to the substance of the agreement, not merely its language.[122] Furthermore, "no particular language is required to be present in order for an offer of a license to constitute an offer for sale of the licensed product."[123]

In order to determine the contract's terms, the court will determine by an objective standard whether there was a meeting of minds between the parties and what the parties agreed upon.[124] "Mutual assent is the bedrock of

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118 Consarc Corp. v. Marine Midland Bank, N.A., 996 F.2d 568, 573 (2d Cir. 1993) (citing Slatt v. Slatt, 447 N.E.2d 1099, 1100 (N.Y. 1985)).

119 Nadan, *supra* note 31 at 611 (quoting Adobe Sys., Inc. v. Stargate Software Inc., 216 F. Supp. 2d 1051, 1055-56 (N.D. Cal. 2002) ("The Court looks to the language, content, and intent of the [contract], in determining whether its terms affect a sale or license of the software."). *See generally* Rice, *supra* note 61.

120 Novamedix, Ltd. v. NDM Acquisition Corp., 166 F.3d 1177, 1182 (Fed. Cir. 1999) ("In interpreting a contract, '[w]ords and phrases are given their plain meaning. Rather than rewrite an unambiguous agreement, a court should enforce the plain meaning of that agreement.'" (quoting Am. Express Bank Ltd. v. Uniroyal, Inc., 164 A.D.2d 275, 277 (N.Y. 1990))).

121 *See* Novell, Inc. v. Unicom Sales, Inc., No. C-03-2785, 2004 WL 1839117, at *9 (N.D. Cal. Aug. 17, 2004) (citing United States v. Wise, 550 F.2d 1180, 1190 (9th Cir. 1977)).

122 Softman Prods. Co. v. Adobe Systems, Inc., 171 F. Supp. 2d 1075, 1085 (C.D. Cal. 2001). The court must look at "the substance rather than the form of licensing agreements." *Id.* (citing Rice, *supra* note 61). Several courts have held license agreements to be sales. *See* Step-Saver Data Sys., Inc. v. Wyse Tech., 939 F.2d 91, 99-100 (3d Cir. 1991); Downriver Internists v. Harris Corp., 929 F.2d 1147, 1150 (6th Cir. 1991); RRX Indus., Inc. v. Lab-Con, Inc., 772 F.2d 543, 546 (9th Cir. 1985); Applied Info. Mgmt., Inc. v. Icart, 976 F. Supp. 149, 155 (E.D.N.Y.1997); Novell, Inc. v. CPU Distrib. Inc., No. H-97-2326, 2000 U.S. Dist. Lexis 9975, at *8 n.4 (S.D. Tex. May 4, 2000).

123 Elan Corp., PLC v. Andrx Pharms., Inc., 366 F.3d 1336, 1341 (Fed. Cir. 2004) (citing RESTATEMENT (SECOND) OF CONTRACTS § 33(3) (1981)).

124 Amber Hatfield Rovner, *Practical Guide To Application Of (Or Defense Against) Product-Based Infringement Immunities Under the Doctrines of Patent Exhaustion and Implied License*, 12 TEX. INTELL. PROP. L.J. 227, 276 (2004) ("[T]he Federal Circuit held in *Jazz Photo Corp.* that the "single use only" wording on the disposal cameras was descriptive rather than an enforceable contractual restriction because there was no evidence of a "meeting of the minds" where the purchaser (and those obtaining the purchaser's discarded camera for refurbishing and resale) understood that the patentee licensed the disposable camera for use with a single roll of film.") (citing Jazz Photo Corp. v. Int'l Trade Comm'n., 264 F.3d 1094, 1108 (Fed. Cir. 2001)).

any agreement to which the law will give force."[125] The parties' intent may be difficult to ascertain from the evidence, and the court may be forced to extrapolate intent from an evaluation of the relevant terms of the contract.[126] In addition, intent may be shaped by assumptions at the time the parties entered into a contract. These assumptions include knowledge of industry custom,[127] trade usage,[128] the course of dealings between the parties,[129] and the commercial relationship between the parties.[130] "Merely labeling a transaction as a lease or license does not control."[131]

B. *The Nature of the Intellectual Property and the Character of its Commercial Embodiment*

In order to determine the intent of the parties, the court must do more than look at the contract's terms. It must also look at the context of the contract—evaluating the nature of the intellectual property, the duration of the contract, the duration of the term of the intellectual property, and the character of its commercial embodiment.[132]

The nature of the intellectual property is reflected in the ideas and expression of such ideas addressed by the agreement's terms. What features of the chattel does the contract's language address, what is the nature of the

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125 *Softman*, 171 F. Supp. 2d at 1087 (quoting Specht v. Netscape Commc'ns Corp., 150 F. Supp. 2d 585, 596 (S.D.N.Y.2001)).

126 *Id.* at 1085 ("The Court finds that the circumstances surrounding the transaction strongly suggests that the transaction is in fact a sale rather than a license.").

127 Rice, *supra* note 61, at 172.

128 Softman Prods. Co. v. Adobe Sys., Inc., 171 F. Supp. 2d 1075, 1086 (C.D. Cal. 2001) (quoting RAYMOND NIMMER, THE LAW OF COMPUTER TECHNOLOGY, § 1.18[1], 1-103 (1992)); Rice, *supra* note 61.

129 Rice, *supra* note 61, at 172. One court took particular note of the fact that the patentee had a general policy of not licensing to its competitors, and therefore, would be reluctant to license the patent to a strong competitor who had a reputation for price cutting in order to obtain enhanced market share. Ajinomoto Co. v. Archer-Daniels-Midland Co., No. 95-218, 1998 WL 151411 (D. Del. Mar. 13, 1998). Courts will interpret the intent of the parties as well as the language of any document purported to be an offer for a license in determining whether the offer is truly an offer to license the patent or merely an offer for sale of the patented product.

130 In *Softman*, one factor that played into the court's determination that the contract was a sale and not a license was the fact that "Adobe sells its software to distributors." *Softman*, 171 F. Supp. 2d at 1086. In other words, the commercial relationship between the parties is that of retailer to retailer, an unlikely set-up for a license. *See* Georgia-Pacific v. U.S. Plywood Corp., 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970), *modified, sub nom.* Georgia-Pacific v. U.S. Plywood-Champion Papers, Inc., 446 F.2d 295 (2d Cir. 1971) (listing as a relevant factor in determining the royalty of a license whether "they are competitors in the same territory in the same line of business, or . . . inventor and promoter.").

131 *Softman*, 171 F. Supp. 2d at 1086 (quoting NIMMER, *supra* note 128, at § 1.18[1], 1-103).

132 *Georgia-Pacific*, 318 F. Supp. at 1120.

device, and how is it designed?[133] If the agreement between the parties exists to protect an asset, such as a trade secret or other subject matter not subject to the same level of protection as other intellectual property assets, then a court is more likely the find the agreement is a license and not a sale. Further, if the agreement exists to protect an asset that is easily imitable or reproducible, such as a plant or software program, then the agreement is more likely to be enforceable as a license.[134]

What is the duration of the term of protection of the intellectual property relative to the term of the contract? [135] Is the contract term for a shorter period of time than the duration of the protection term?[136] This corresponds to the traditional definition of a license. Or is the contract a perpetual license, one with no limits as to its duration, requiring no renewal? If so, then the contract is more likely to be construed as a sale.[137]

Is the product one with established profitability and demonstrable commercial success, and does the price set forth in the contract reflect the costs of a sale or a license of the product?[138] Is the product one that would lend itself to being licensed (e.g., is it extremely expensive to purchase, readily reusable, and something that one might only need for a short time)?[139] Or is it perishable, inexpensive, or a single-use item and thus more likely to be sold?[140] Has a market developed to manufacture or service the item that the intellectual property owner may wish to control?[141] Is there a

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133 *See generally* John W. Osborne, *A Coherent View of Patent Exhaustion: A Standard Based on Patentable Distinctiveness*, 20 SANTA CLARA COMPUTER & HIGH TECH L.J. 643 (2004).

134 *See also* Softman Prods. Co. v. Adobe Sys., Inc., 171 F. Supp. 2d 1075, 1086 (C.D. Cal. 2001) (citing Rice, *supra* note 61, at 172) (delineating factors to evaluate in determining whether a software agreement is a license or a sale, including "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.").

135 *See Softman*, 171 F. Supp. 2d at 1085 ("The Court finds that the circumstances surrounding the transaction strongly suggests that the transaction is in fact a sale rather than a license . . . . The license runs for an indefinite term without provisions for renewal."); *Georgia-Pacific*, 318 F. Supp. at 1120.

136 One example might be chattel that benefits from a patent with fifteen years of protection left—if the contract is for five years then the owner of the chattel probably did not envision transferring complete ownership in the chattel to the purchaser.

137 *Softman*, 171 F. Supp. 2d at 1085; Georgia-Pacific v. U.S. Plywood Corp., 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970), *modified, sub nom.* Georgia-Pacific v. U.S. Plywood-Champion Papers, Inc., 446 F.2d 295 (2d Cir. 1971).

138 *Georgia-Pacific*, 318 F. Supp. at 1120.

139 One example would be a fetal Doppler monitor, for use during a pregnancy. Such an item has limited home use (six months), is relatively expensive, and can easily be reused. This is a classic example of an item that lends itself readily to being licensed, as opposed to being sold.

140 For instance, a bag of potato chips.

141 Fred von Lohman speculates that auto manufacturers may someday seek to license cars to consumers and require licensees to use certified mechanics to modify the cars and certified parts to

secondary market for used chattels?[142] Would selling or licensing the intellectual property promote the other assets of the intellectual property owner? [143] These questions should be answered in determining the parties' intent.

C. *The Pricing Structure, Rights Transferred, and Timing of the Contract*

Despite that fact that the parties to a contract may have signed a document that "labels itself a 'license' and calls the payments 'royalties,'" if the reality of the exchange indicates otherwise, courts will find, at the minimum, that it is a question of fact whether the transaction was a sale or a license.[144] The economic context of the exchange reflects the circumstances of the transaction and the circumstances surrounding the transaction.[145] These circumstances include the rights that are transferred, the consideration exchanged for those rights, and the timing of this transfer.[146]

What rights are transferred under the agreement? [147] Have sufficient rights been transferred so as to constitute a sale? [148] If the agreement places no restrictions on use of the chattel and the product can be transferred, copied, sold, reverse-engineered, etc., then it is likely that complete ownership of the product has transferred and that the parties intended a sale. But if there are redistribution restrictions,[149] geographic restraints,[150] or strictures

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repair the cars. J.D. Biersdorfer, *By Tearing Open That Cardboard Box, Are You Also Signing on the Dotted Line?*, N.Y. TIMES, Oct. 3, 2005, at C4.

142 It is not clear which way this factor will cut, but it is a factor to be considered. The intellectual property owner may wish to control the price of its product and prevent it from being resold, as in the iTunes example, and therefore seek to license consumers. On the other hand, consumers may wish to take advantage of that secondary market, as in the case of music, and seek to purchase the chattel rather than license it. *See* Microsoft Corp. v. Dak Indus., Inc., 66 F.3d 1091, 1095 n.2 (9th Cir. 1995).

143 Georgia-Pacific v. U.S. Plywood Corp., 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970), *modified, sub nom.* Georgia-Pacific v. U.S. Plywood-Champion Papers, Inc., 446 F.2d 295 (2d Cir. 1971).

144 Applied Info. Mgmt., Inc. v. Icart, 976 F. Supp. 149, 155 (E.D.N.Y. 1997).

145 *See, e.g.*, Bauer & Cie v. O'Donnell, 229 U.S. 1, 16 (1913) ("[I]n view of the facts certified in this case, as to what took place concerning the article in question, it is a perversion of terms to call the transaction in any sense a license to use the invention.").

146 *See* Osborne, *supra* note 133; Rice, *supra* note 61.

147 Adobe Sys., Inc. v. One Stop Micro, Inc. 84 F. Supp. 2d 1086, 1091 (N.D. Cal. 2000) ("The[] numerous restrictions imposed . . . indicate a license rather than a sale because they undeniably interfere with the reseller's ability to further distribute the software.").

148 Osborne, *supra* note 133; *see also* Microsoft Corp. v. Dak Indus., Inc., 66 F.3d 1091, 1095 n.2 (9th Cir. 1995); Softman Prods. Co. v. Adobe Sys., Inc., 171 F. Supp. 2d 1075, 1086 (C.D. Cal. 2001) (citing Rice, *supra* note 61, at 172) (delineating factors to evaluate in determining whether a software agreement is a license or a sale).

149 For instance, Adobe sells its software products both as individual products and as bundled suites. A purchaser of a license to use the suite is prohibited from selling the individual components separately. Upon purchase of a suite, the purchaser agrees to a license that permits transfer of all rights

about reverse-engineering the product or copying it,[151] then the parties have transferred only limited rights, and the agreement is more likely a license.[152] One clear indication that the transferred rights are limited in their scope is language to the effect that "any rights not expressly granted are reserved."[153] Is the "user . . . required to return the copy to the vendor after the expiration of a particular period"? [154] If so, the contract is more likely a license; if not, a sale.

What consideration do the parties exchange for the transferred rights? How does the consideration compare to that in other contracts?[155] Is the transaction a "lump sum sale" [156] or a series of payments,[157] perhaps structured as a royalty rate paid per usage? [158] An example of a lump sum sale might occur when "the purchaser . . . obtains a single [product] for a single

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"to the Use of the Software to another person or legal entity provided that (a) [the user] also transfer [the license], the Software and all other software or hardware bundled or pre-installed with the Software." *Softman*, 171 F. Supp. 2d at 1082.

150 Novell, Inc. v. Unicom Sales, Inc., No. C-03-2785, 2004 WL 1839117, at *11 (N.D. Cal. Aug. 17, 2004) (citations omitted) ("The agreement grants the right to use the software . . . only within the customer's organization . . . . The limited rights . . . as set forth in the [agreement] describe a license . . . rather than a sale.").

151 An agreement characterized as a sale by the parties was found to be a license and not a sale by the court when the agreement "prohibited the licensee from copying or duplicating" the products. *Novell*, 2004 WL 1839117, at *9 (citing United States v. Wise, 550 F.2d 1180, 1190 (9th Cir. 1977)). In *Novell*, the license permitted copying of the product "for use only by [the licensing parties'] students and employees." *Novell*, 2004 WL 1839117, at *9.

152 *See also Softman*, 171 F. Supp. 2d at 1086 (citing Rice, *supra* note 61, at 172) (delineating factors to evaluate in determining whether a software agreement is a license or a sale, including "licenses under which subsequent transfer is neither prohibited nor conditioned on obtaining the licensor's prior approval (only subject to a prohibition against rental and a requirement that any transfer be of the entity.)"). An agreement characterized as a sale by the parties was found to be a license and not a sale when the agreement "purported to transfer only limited rights for the exhibition or distribution of the films for a limited purpose and for a limited time." *Novell*, 2004 WL 1839117, at *9 (citing *Wise*, 550 F.2d at 1190).

153 *Cf. Novell*, 2004 WL 1839117, at *11 (citing *Adobe*, 84 F. Supp. 2d at 1091) ("The agreement expressly states that any rights not expressly granted are reserved to Novell . . . . The limited rights in the software, as set forth in the Software License, describe a license in the software, rather than a sale.").

154 Softman Prods. Co. v. Adobe Sys., Inc., 171 F. Supp. 2d 1075, 1086 (C.D. Cal. 2001) (quoting NIMMER, *supra* note 128, at § 1.18[1], 1-103).

155 Georgia-Pacific v. U.S. Plywood Corp., 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970), *modified, sub nom.* Georgia-Pacific v. U.S. Plywood-Champion Papers, Inc., 446 F.2d 295 (2d Cir. 1971).

156 *Softman*, 171 F. Supp. 2d at 1085.

157 *See also id.* at 1086 (citing Rice, *supra* note 61, at 172 (delineating factors to evaluate in determining whether a software agreement is a license or a sale, including "pricing and payment schemes that are unitary not serial.")).

158 Adams v. Burke, 84 U.S. 453, 456 (1873); *Softman*, 171 F. Supp. 2d at 1086 ("If a transaction involves a single payment giving the buyer an unlimited period in which it has a right to possession, the transaction is a sale.").

price, which the purchaser pays at the time of the transaction, and which constitutes the entire payment for the 'license.'"[159] Is the agreement structured around the quantity of units exchanged or the duration of the chattel's use?[160] The stronger the relationship between the exchange of consideration and the transfer of rights, the more likely it is that the nature of the contract reflects that relationship.

The timing of the exchange is one aspect of the analysis of the relationship between the exchange of consideration and the transfer of rights. "The transfer of a product for consideration with a transfer of title and risk of loss generally constitutes a sale."[161] If a single product is exchanged for a single sum of consideration and at the time of the exchange all rights and risks associated with that product are also exchanged, then the exchange is presumed to be a sale.[162] If at the time of the exchange the risk of loss and the right of ownership were not exchanged, the contract may be a license. If the contract states that all chattels must be returned or destroyed at the "expiration of the contract term," then only a limited ownership has transferred, not the rights in the product, and the agreement should be construed as a license.[163] Even if the agreement states that it is a license, if the situation is such that "[t]he product is . . . just as immediately transferred to the 'buyer' as if it were sold," then the agreement should be construed as a sale and not as a license.[164]

D. *Protection and Maintenance of Intellectual Property*

Does the owner license others to use the intellectual property, or does it grant licenses only under special conditions designed to preserve the in-

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159 *Softman*, 171 F. Supp. 2d at 1085.

160 Microsoft Corp. v. Dak Indus., Inc., 66 F.3d 1091, 1095 n.2 (9th Cir. 1995).

161 Softman Prods. Co. v. Adobe Sys., Inc., 171 F. Supp. 2d 1075, 1086 (C.D. Cal. 2001) (citing VWP of Am., Inc. v. United States, 175 F.3d 1327, 1338-39 (Fed. Cir. 1999)).

162 *Softman*, 171 F. Supp. 2d at 1085 ("The Court finds that the circumstances surrounding the transaction strongly suggests that the transaction is in fact a sale rather than a license. For example, the purchaser commonly obtains a single copy of the software, with documentation, for a single price, which the purchaser pays at the time of the transaction, and which constitutes the entire payment for the 'license.'").

163 *See* Novell, Inc. v. Unicom Sales, Inc., No. C-03-2785, 2004 WL 1839117, at *9, *11 (N.D. Cal. Aug. 17, 2004) (citing United States v. Wise, 550 F.2d 1180, 1190 (9th Cir. 1977)). An agreement characterized as a sale by the parties, was found to be a license and not a sale by the court when the agreement "required the return of the [products] at the expiration of the contract term." *Wise*, 550 F.2d at 1190. A separate agreement was found to be a license when the agreement "expressly requires return or destructions of the software if the license is terminated." *Id.*

164 *In re* Kollar, 286 F.3d 1326, 1330-31 (Fed. Cir. 2002) (quoting Group One, Ltd. v. Hallmark Cards, Inc., 254 F.3d 1041, 1053 (Fed. Cir. 2001) (Lourie, J., concurring)).

tellectual property? [165] If the owner has previously sold chattels and never before engaged in a license, then it is presumed that additional agreements are also for the sale of chattels. But this is only a presumption; proper evidence—for example, that the owner harbored concerns about a particular consumer and thus did not wish to transfer rights to that consumer—may disprove it.

E. *Economic Realities*

"It is well-settled that in determining whether a transaction is a sale, a lease, or a license, courts look to the economic realities of the exchange."[166] Even after analyzing all of the issues described above, whether an agreement is construed as a license or a sale will turn on each agreement's economic realities. The purpose of contract law is to provide, in advance of any dispute, predictable outcomes for negotiating parties. Delineating the economic realities is a difficult proposition, and courts' clarity can aid consumers in the negotiating process and help assure that if the parties both have bargaining power, there will be some understanding of the terms of the bargained-for exchange. In order to reduce the chilling effect of the unknown, parties should carefully consider these factors when they draft and review contracts. It may be beneficial, at times, to enter into a license, but consumers should be aware of their rights and the fact that they are only acquiring possession of the chattel, not of the title nor of the rights accompanying the chattel, and that they, in fact, are not purchasing the item.

IV. WHY ALLOW PRIVATE LEGISLATION?

There may be a good argument that parties can contract around some of these rules in some circumstances. But federal intellectual property law is a comprehensive regulatory scheme that can and does place limits on such contracts. Of course, this does not mean that there is no role for contracts in the intellectual property realm. Licensing remains critical to the efficient use of intellectual property.[167]

What role should private legislation play in the transfer of chattels that benefit from intellectual property? Some argue that private legislation has

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[165] Georgia-Pacific v. U.S. Plywood Corp., 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970), *modified, sub nom.* Georgia-Pacific v. U.S. Plywood-Champion Papers, Inc., 446 F.2d 295 (2d Cir. 1971).

[166] *Softman*, 171 F. Supp. 2d at 1085 (citing Microsoft Corp. v. Dak Indus., Inc., 66 F.3d 1091, 1091 (9th Cir. 1995). *See also* Wise, 550 F.2d at 1190.

[167] Lemley, *supra* note 37, at 1291.

no role and that all private legislation affecting the rights of those who possess chattels that embody intellectual property should be unenforceable.[168] Others argue for a national body of regulation governing private legislation as it applies to licenses. This approach has been attempted twice (UCC Article 2B and UCITA) without success. A third and more workable solution would be for courts to enforce contracts based on their primary purpose. Licenses have a place in the commercialization of intellectual property and chattels that benefit from intellectual property. If the primary purpose of the license is not to extend the intellectual property owner's rights beyond those granted in public legislation, but rather to serve a more traditional right under private contract law, then the license should be enforced. One purpose of contracts is to encourage parties to share information, and the benefits to society of this sharing outweigh the rights removed from individuals by these contracts, in some scenarios. Private legislation is needed to balance public legislation, particularly in industries that are not adequately covered by existing statutes.

Parties may enter into licenses because they are mutually beneficial. Where the terms are bargained for, not unexpected, and augment but do not circumvent public legislation, they should be enforced. Contracts promote efficiency and the public good by allowing parties to make promises that have legal effect and therefore provide stability and continuity. As described above, many licenses help parties avoid the accountability forced on them by public legislation. However, many licenses are entered into because public legislation does not adequately protect intellectual property owners' rights. The latter licenses ought to be enforced, while the former need to be closely scrutinized.

An emerging area of licenses being used to augment the rights of the intellectual property owner is in the world of art. An artist has a certain view of her art and a strong proprietary interest in what happens to it. In some instances, an artist's view of what changes her work may differ from the court's view. For instance, in the 1990s, the artist Annie Lee sold notecards and lithographs of her copyrighted work.[169] One consumer of these

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168 In 1997, Representative Rick Boucher introduced the Digital Era Copyright Enhancement Act, proposing that such private legislation be unenforceable:

> Section 301(a) of title 17, United States Code, is amended by inserting the following at the end thereof:
>
> When a work is distributed to the public subject to non-negotiable license terms, such terms shall not be enforceable under the common law or statutes of any state to the extent that they:
>
> (1) limit the reproduction, adaptation, distribution, performance, or display, by means of transmission or otherwise, of material that is uncopyrightable under section 102(b) or otherwise; or
>
> (2) abrogate or restrict the limitations on exclusive rights specified in sections 107 through 114 and sections 117 and 118 of this title.

H.R. 3048, 105th Cong. (1997).

169 Lee v. A.R.T. Co., 125 F.3d 580, 580 (7th Cir. 1997).

products, A.R.T. Company, mounted the artist's works on tiles, laminated the tiles, and then sold them to consumers to hang in their houses, even in their bathrooms.[170] Lee sued, contending that the tiles were derivative works,[171] and that only she, as the owner of the artworks' copyright, had the right to create (or to authorize) derivative works.[172] The court did not disagree with Lee, but instead found that the tiles were insufficiently transformative to qualify as a derivative work.[173] The tiles changed the expression of the original protected idea, but not to such an extent as to qualify as a derivative work.[174] Lee's sale of her artwork exhausted her rights in it, allowing A.R.T. Company to use it however they saw fit, as long as that use was not so transformative as to qualify as a derivative work.[175] To maintain the expression of her copyrighted ideas in a way consistent with her vision, then, Lee would have to license, and not sell, the expressions of her ideas. In situations such as this, the artist's rights are better protected under private legislation than through the rights granted to a purchaser through public legislation, and as a result contract terms specifying what rights transfer with artwork is becoming common.[176] One well-known art lawyer, Joshua Kaufman, explained this trend:

> As an artist or a publisher, let us assume you want to prevent third parties from creating unauthorized derivative works from your artworks. True, there are a number of cases which provide that unlicensed canvas transfers--making tiles, cutouts, mini-prints, etc. of original works--infringe on the rights of the copyright holders. However, there isn't a large body of

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170 *Id.*

171 17 U.S.C. § 101 (1999) ("A 'derivative work' is a work based upon one or more preexisting works, such as a translation, musical arrangement, dramatization, fictionalization, motion picture version, sound recording, art reproduction, abridgment, condensation, or any other form in which a work may be recast, transformed, or adapted. A work consisting of editorial revisions, annotations, elaborations, or other modifications which, as a whole, represent an original work of authorship, is a 'derivative work'").

172 *Id.* § 106(2).

173 *Lee*, 125 F.3d at 582.

174 *Id.* The *Lee* decision created a circuit split with the Ninth Circuit. *See* Munoz v. Albuquerque A.R.T. Co., 38 F.3d 1218 (9th Cir. 1994); Mirage Editions, Inc. v. Albuquerque A.R.T. Co., 856 F.2d 1341 (9th Cir. 1988).

175 *Lee*, 125 F.3d at 581 (citations omitted) ("Now one might suppose that this is an open and shut case under the doctrine of first sale, codified at 17 U.S.C. § 109(a). A.R.T. bought the work legitimately, mounted it on a tile, and resold what it had purchased. Because the artist could capture the value of her art's contribution to the finished product as part of the price for the original transaction, the economic rationale for protecting an adaptation as "derivative" is absent. An alteration that includes (or consumes) a complete copy of the original lacks economic significance. One work changes hands multiple times, exactly what § 109(a) permits, so it may lack legal significance too.").

176 For instance, the iTunes license specifically states that the licensee "agree[s] not to modify, rent, lease, loan, sell, distribute, or create derivative works based on the Service, in any manner." iTunes Terms of Service, *supra* note 16.

> law in the area . . . . By licensing, instead of selling your art, you will not be at the mercy of a judge who does not understand copyright law or the art business. Instead, when you license art, you set the terms and conditions that define the license, and you establish terms that will specifically prohibit the use of your artwork in any way except as you intend. A print is to be a print only; it is not to be made into a canvas transfer. A calendar, book or catalog are to be used as calendars, books or catalogs, not packaged as some cheap and offensive product. A license can prohibit the person who acquires the physical work from creating canvas transfers, decoupages, tiles, mini-prints and the like. Since you never give up ownership, you retain the right to control all of its uses.[177]

Field-of-use restrictions that limit the use of an item to only one field or medium (e.g., notecards must remain notecards) are commonly found (and enforced) in licenses of goods that benefit from patent law.[178] Such terms allow patented technology to be used for a particular purpose.[179] Field-of-use terms could allow the copyright owner to restrict the ways in which licensed products could be used and thereby provide protection in the artist's vision of the expression of her protected ideas. Using private legislation to protect interests not adequately covered by public legislation should be allowed. It augments, and does not circumvent, public legislation.

But a justification for a license is not enough; all licenses must be examined carefully because one legitimate purpose behind a license does not mean that the license's primary purpose is legitimate. A license clause that prevents redistribution may be included to augment protection of the information contained in the licensed work, or it may be included to augment profitability of the licensed work.[180] A licensor may argue that the terms of the license ensure quality control over the licensed chattel, when, in fact, use of the chattel under normal conditions would not result in its deteriora-

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177 Joshua Kaufman, *Stop selling art: license it: take a hint from the software industry and license, instead of sell, your art*, ART BUS. NEWS, Mar. 2003, *available at* http://www.findarticles.com/p/articles/mi_m0HMU/is_3_30/ai_98695113.

178 Exploring the ramifications of expanding field-of-use restrictions to copyright law is a topic for another article. The Supreme Court approved of the enforceability of non-price restrictions in licenses in Cont'l T.V. v. GTE Sylvania, 433 U.S. 36 (1977).

179 U.S. Dep't of Justice & Fed. Trade Comm'n, Antitrust Guidelines for the Licensing of Intellectual Property, 5 (1995), *available at* http:// www.usdoj.gov/atr/public/guidelines/0558.pdf ("Field-of-use, territorial, and other limitations on intellectual property licenses may serve procompetitive ends by allowing the licensor to exploit its property as efficiently and effectively as possible. These various forms of exclusivity can be used to give a licensee an incentive to invest in the commercialization and distribution of products embodying the licensed intellectual property and to develop additional applications for the licensed property. The restrictions may do so, for example, by protecting the licensee against free-riding on the licensee's investments by other licensees or by the licensor. They may also increase the licensor's incentive to license, for example, by protecting the licensor from competition in the licensor's own technology in a market niche that it prefers to keep to itself. These benefits of licensing restrictions apply to patent, copyright, and trade secret licenses, and to know-how agreements.").

180 *See supra* note 107 and accompanying text.

tion.[181] A license clause may delineate the parties' agreement, or it may restrict the publicly-legislated rights of the party to whom the chattel was transferred.

In order to maintain a balance between the rights of intellectual property owners and the rights of users, some private legislation is necessary. Concerns arise, however, when such legislation is used to augment owners' rights while eroding users' rights. Intellectual property owners are setting the norms for licenses of products that benefit from intellectual property, and the costs to the potential users have not been fully considered in this realm.

CONCLUSION

> [T]he movement at the state level toward resolving questions as to the enforceability of non-negotiated contracts coupled with legally-protected technological measures that give right holders the technological capability of imposing contractual provisions unilaterally, increases the possibility that right holders, rather than Congress, will determine the landscape of consumer privileges in the future.[182]

When should the private right to enter into a contract be limited in scope by the public interest in promotion of intellectual property? A balance must be struck between allowing intellectual property owners to augment their rights for the purpose of circumventing public legislation and allowing them the freedom to protect their interests through the use of private legislation.[183] When such protection serves a legitimate purpose not

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[181] One reason Monsanto contends that its license should be enforceable is that it enables Monsanto to exercise quality control over the seed covered by its technology. Even the courts doubted this logic:

> As Monsanto's expert testified, "[t]he loss of quality control may result in reduced yields, improper seed segregation and lower quality crops, causing a reduction in the value of Monsanto's brand" to purchasing farmers. We are skeptical of the magnitude of harm to Monsanto's ROUNDUP READY® brand that would flow from violations of the licensing agreement. Damage to a brand occurs when a consumer, here the farmer, receives a substandard product believing that the product is genuine. The farmer who saves and replants seeds, however, is well aware that he is not using the seeds in accordance with the terms required by Monsanto, and he is able to attribute any alleged reduction in quality of the second- or third-generation seeds to his own decision to replant rather than to Monsanto's initial product. Without denying that some minimal harm to the ROUNDUP READY® brand may result from a decision to save and replant seed, we do not believe that this harm [is significant].

Monsanto Co. v. McFarling, 363 F.3d 1336, 1351 (Fed. Cir. 2004).

[182] U.S. COPYRIGHT OFFICE, A REPORT OF THE REGISTER OF COPYRIGHTS OFFICE PURSUANT TO § 104 OF THE DIGITAL MILLENNIUM COPYRIGHT ACT xxxi (2001), *available at* http://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf.

[183] One classic limit on the breadth of the freedom to contract has come from antitrust law. A contract is not enforceable if it unduly restrains trade. There is another article yet to be written which will address more fully the extent to which a license can limit the use of the product before the terms

contrary to public legislation, then private legislation of intellectual property rights should be enforced. Much of the support behind the intellectual property system rests on the idea that it protects the public's interest. But the system as it exists today regulates the sale of intellectual property and not the licensing of it. Without thoughtful extension of the principles of intellectual property into the domain of licenses, the balance between the rights of the intellectual property owner and the public interest in intellectual property shifts away from the public interest.

By licensing chattels rather than selling them, intellectual property owners can circumvent public legislation and expand the protection of intellectual property far beyond the scope envisioned by federal and state governments. The balance between the rights of intellectual property owners and the rights of intellectual property users is tipping in favor of the owners, as those drafting the private legislation are setting the new norms for protection of intellectual property. Beyond the narrow issues currently considered in license enforcement cases, this broader trend deserves the public's attention.

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become an unreasonable restraint on trade. If the licensor can provide a legitimate purpose or justification for the terms of the license, then the license is likely to be enforceable. Terms have been found reasonable that provide for a limited-use license because the quality of the product will otherwise degenerate (an argument that has been made for art and genetically modified seed). Unreasonable terms may be those that eliminate the purpose of buying the chattel in the first place or require the purchase of another product.