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WHERE VERNOR V. AUTODESK FITS INTO FIRST SALE DECISIONS

Thomas A. Hackett[1]

Abstract

Many courts have found that software is licensed rather than sold. As a result, software often falls outside the first sale doctrine; however, *Vernor v. Autodesk* found with the minority of courts that software is sold rather than licensed, and granted owners of the purchased software first sale rights. This Article examines four pertinent concerns that flow from *Vernor v. Autodesk*, including: (1) the status of federal copyright law in the context of the first sale doctrine; (2) the judicial split among courts applying the doctrine; (3) where *Vernor v. Autodesk* fits into this split; and (4) the future of the first sale doctrine in software sales. This Article concludes that while *Vernor v. Autodesk* provides a fresh approach to the transfer of software that favors sales and, therefore, the application of first sale doctrine, the practical realities of software downloading will likely lead to the further expansion of the majority rule.

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INTRODUCTION

<1> The first sale doctrine is a narrow exception in the body of

federal copyright law. In general, federal copyright law grants a copyright owner certain exclusive rights, including the right to distribute; however, the right to distribute is limited by the first sale doctrine. The first sale doctrine, codified at 17 U.S.C. § 109, grants a legal purchaser of a copy of software (or other copyrighted material) the right to resell that copy without restriction by the copyright owner. The doctrine began in 1908 when book publishers tried to set a minimum price for the sale of used books, and the Supreme Court held that legal purchasers of books have the right to resell those books at any price.[2] Essentially, a copyright owner has the exclusive right to control the initial purchase of a copy of software, but not subsequent purchases of that copy.

<2>*Vernor v. Autodesk*,[3] a recent case involving the first sale doctrine for computer software, shows that the first sale doctrine is still not entirely settled. Courts remain split on the question of whether software is licensed or sold when considering the initial exchange of computer software. The distinction between licensing and sale is critical because the first sale doctrine does not apply if software is only licensed. For example, when a purchaser of software first uses the software, she will often agree to several terms and conditions of use that may be construed as a license to use the product, rather than outright ownership of the software; however, the converse is also possible, where the user "owns" the software. The majority of courts characterize software agreements as licenses,[4] which precludes application of the first sale doctrine. Nevertheless, *Vernor v. Autodesk* joined the minority of courts and found the software at issue was "sold" and, thus, within the first sale doctrine.

<3>Before analyzing the split in court decisions between licenses and sales, the potential advantages of having a license must be noted from the consumer's perspective. The advantage of sales is clear—the ability to freely resell the software. However, there are also advantages to having a license.[5] Specifically, many software licenses grant the licensee the right to install the software on multiple computers owned by the licensee.[6]

<4>In addition, software makers can engage in price discrimination through licensing, by charging more to business users and less to home users.[7] If software were, for example, sold rather than licensed, software makers could not prevent a person buying a student or home version of a program from using it for business purposes. As a result, software makers would have to charge the same amount to both businesses and private consumers. By selling to both business and home users

at different prices, software makers are able to get more users and sales. In capturing sales from both groups, software makers can potentially offer lower prices to each group while still making the same profit as it would have done if only selling to the one group at a higher price.[8]

<5>Given this context and some of the advantages and disadvantages of licenses versus sales, this Article focuses on the legal landscape and *Vernor v. Autodesk* decision as part of the first sale doctrine's evolution. More specifically, this Article: (1) outlines federal copyright law and the first sale doctrine; (2) examines the split in case law applying the first sale doctrine to computer software; (3) evaluates the *Vernor v. Autodesk* decision and its use of previous Ninth Circuit precedent regarding indefinite possession of a product; and (4) comments on the future of the first sale doctrine given the shift to online distribution of software.

COPYRIGHT LAW: FIRST SALE AND LICENSES

<6>Federal copyright law grants a copyright holder certain exclusive rights, including the right to distribute.[9] These rights ensure financial incentives for the creation of new works. In the absence of the exclusive right to distribute, a person that obtained a version of a copyrighted work would be able to profit from the creator's hard work by simply copying and selling it. Indeed, such a practice would violate the copyright owner's exclusive right to distribute.

<7>Nevertheless, the copyright holder's right to control distribution has limits, and the first sale doctrine is one such exception. The Federal Copyright Act carves out an exception to a copyright owner's exclusive right to distribute to those whom the copyright owner sells copies of the work.[10] The first sale doctrine provides that any person who lawfully obtains ownership of a copy of copyrighted work may resell that copy without permission, and without restriction, from the copyright holder or previous owner of the copy. The first sale doctrine opens the secondary market for legally purchased copies of computer software. The doctrine is an attempt to balance the rights of copyright holders to distribute their works against end-users' ability to sell goods once they no longer wish to use them. The first sale doctrine only allows the owner of a copy of software to sell their *one* copy of the software; the doctrine does not allow him or her to make multiple copies of the software and sell those additional copies.

<8>There are four principle steps in analyzing whether a person qualifies for first sale protection in reselling software: "[first,]

was the copy lawfully produced with authorization of the

copyright owner; [second,] was the particular copy transferred under the copyright owner's authority; [third,] does [the person] qualify as the lawful owner of that copy; and [fourth,] did [the individual] thereupon simply distribute that particular copy?"[11] However, computer software makers often seek to avoid the first sale doctrine by defeating the third step of the inquiry by characterizing the initial distribution of a piece of software as a license, rather than a sale.[12] In other words, an argument against finding a first sale exception is that the end-user of a software product does not "own" the software, but rather that the end user is simply "licensed" to use software—no initial "sale" ever took place.

<9>Notwithstanding, in some retail sales of software, licensees are also granted the ability to make a one-time transfer of the software to a third party. Such is not always the case, however, and some users therefore need first sale protections. In instances where a user employs "not-for-resale" software, educational software, or pre-release software, software makers often times do not grant license transfer rights. In addition, other software makers such as Autodesk and Oracle, which sell more expensive software, also withhold from the licensee the right to transfer the license. It is in these cases, where the licensee is not granted the right to transfer the license, that the first sale doctrine may still be deployed for purported licensees to be characterized as owners, so as to enable the legal transfer of a copy of software. Thus, while the doctrine of first sale is relatively straightforward, a clear judicial line arises where courts have considered the issue of licenses versus sales in various contexts.

THE MAJORITY RULE: SOFTWARE IS LICENSED AND NOT SOLD

<10>The majority of courts hold that software is licensed and not sold.[13] Indeed, so predominant is this view that many courts do not even explore whether software is sold or licensed, or only give it scant discussion, and instead facially accept the proposition that software is licensed. Of the cases that do discuss it, the judicial "gloss" on the distinction can be traced back to *Microsoft Corp. v. Harmony Computers & Electronics, Inc.*,[14] where a district court in New York found "Microsoft only licenses and does not sell its products."[15]

<11>The *Microsoft* District Court considered whether the first sale defense was available to a person selling Microsoft software. In that case, the defendant was selling two items: first, counterfeit software, which is clearly not protected by the

first sale doctrine; and second, actual disks with software that may have had an origin traceable back to Microsoft. As Nimmer noted regarding *Microsoft Corp. v. Harmony Computers & Electronics, Inc.*, "[i]f by 'Products,' the court meant to refer to tangible diskettes, and if by 'licenses,' the intent was to convey that such physical items are merely leased or lent, then that conclusion was correct."[16] However, if the physical items incorporating the software were rightfully and indefinitely in the possession of the "licensee," then a sale occurred and the first sale doctrine should apply.

<12>In spite of the semantic tangle of the case, the question in *Microsoft* remains whether the non-counterfeit disks that were sold remained indefinitely in the possession of the "licensee" because the disks were not software. If such was the case, then the purchaser would have satisfied all the elements for a first sale defense previously described: that Microsoft (1) produced the CDs incorporating the software; (2) authorized the transfer of the CD and did not require its return; (3) the defendant qualified as the owner the software (possibly the second or third owner in distribution chain); and (4) the defendant simply sold the software. This, however, was not the conclusion of the court, which found that the disks and their software were licensed.[17]

<13>In light of the complications found in the *Microsoft* case, many commentators think that the threshold inquiry for determining whether a sale occurred should be the following: does the purchaser retain indefinite possession of the software? However, most courts instead look at other incidents of ownership, such as the ability to transfer the software between computers and users. Courts have found those incidents of ownership to be so severely limited that even with indefinite possession of the software, the purchaser can only be a licensee.[18] Nevertheless, courts should look to the substance of the transaction and not the labels put on the transaction by parties, particularly when a software maker attempts to transform a sale into a license agreement. If a sale occurred, then the "restrictions" are without effect because the first sale doctrine allows for those activities that the software maker attempts to restrict.

<14>A majority of courts deciding the issue of license versus sale cite *Microsoft* or the proposition that software is licensed.[19] *Adobe v. One Stop Micro, Inc.*, for example, considered whether Adobe sold software or licensed software.[20] In that case, the defendant was reselling education copies of Adobe software, which the defendant asserted was protected by the first sale

doctrine. Adobe, however, argued that the first sale defense was unavailable because it licensed and did not sell its software. The court found Adobe's argument persuasive and cited *Microsoft* for the proposition that software makers always license their products, which now enshrines the majority position.[21]

THE MINORITY RULE: SOFTWARE IS SOLD AND NOT LICENSED

<15>In spite of the apparent strength of the majority's position in the context of software transfers, a number of courts have found software to be sold and not licensed. In *SoftMan Products Co. v. Adobe Systems Inc.*, for example, SoftMan purchased bundled copies of Adobe software and then sold each piece individually.[22] The court found that the purchaser, who did not enter into the licensing agreement because he did not open the individual pieces of software, was a purchaser of the software and entitled to first sale protections.[23] The court looked at the totality of the circumstances of the transactions and found that the circumstances supported a sale of the software, and not mere licensing.[24] In *SoftMan*, for a single payment, the purchaser obtained a piece of software that had a "license" that ran for an indefinite amount of time, but nevertheless constituted a sale because of the single payment for the software.[25] As the *SoftMan* Court found the transaction constituted a sale, subsequent sales were protected by the first sale doctrine.

<16>Similarly, in *Novell v. Network Trade Center, Inc.*,[26] the court found software to be sold according to Article 2 of the Uniform Commercial Code and was, therefore, within the first sale doctrine. The *Novell* Court and other similarly positioned courts that follow the analysis for the first sale doctrine are in the minority, while the majority of courts accept what first sale advocates consider a gloss on licensing. The *Vernor* decision, however, may breathe new life into the minority view that software is sold and not licensed.

ENTER A NEW CHALLENGER: VERNOR V. AUTODESK

<17>*Vernor v. Autodesk* clears some of the doctrinally murky waters where software is often found to be licensed rather than sold.[27] In *Vernor*, the software in question—AutoCAD—was first sold by Autodesk to an end-user architectural firm.[28] Several years later, the architectural firm sold the software to an eBay reseller named Timothy Vernor.[29] However, when Vernor then attempted to sell the software on eBay, he was served with

notices by Autodesk that he was violating its copyright.[30] In response, Vernor filled for a declaratory judgment that he had the right to resell the software under the first sale doctrine.[31]

<18>The *Vernor* Court, in determining whether a sale or license existed,[32] disposed of the case via a surprisingly simple analysis reliant upon *United States v. Wise*.[33] In *Wise*, the Ninth Circuit had held that a sale took place when the end-user of the movie film retained indefinite possession of the film, even where an end-user had contractual restrictions on the use of film.[34] Indeed, several of the sales in *Wise* were accompanied by significant restrictions on the use of the film; however, the court still held that the transactions that granted indefinite possession of the films constituted sales rather than licenses.[35] As with *Wise*, the software in *Vernor* was transferred indefinitely and, as such, constituted a sale. Vernor, therefore, qualified for the protection of first sale doctrine.

<19>*Vernor* demonstrates the minority rule in first sale cases and provides a less cumbersome analysis for disposition of first sale issues.[36] *Vernor* uses *Wise* to illustrate the simplicity of the third step in the first sale analysis: if a person retains indefinite possession of software, the person is an owner rather than a licensee. Under *Vernor*, if a person has indefinite possession of software, it is irrelevant whether or not the software maker tries to impose additional restrictions on use.

<20>While *Vernor* is unlikely to change the tide in software first sale cases, proponents of the license theory are likely to be wary of its appeal. Such adherents of the license theory may try to limit *Vernor* to its secondary reseller facts. However, the strength of the *Vernor* opinion is in its straightforward analysis: when a person retains indefinite possession of software, the person is an owner because a sale occurred and, therefore, has the legal right to freely resell that piece of software. As such, Vernor provides a persuasive possibility that may breathe new life into the first sale defense, even if the case does run against the current practice among other courts.

FIRST SALE DOCTRINE IN TOMORROW'S SOFTWARE MARKET

<21>While *Vernor*'s reasoning is compelling, the shift to online-delivered software and other media nevertheless appears to favor licenses.[37] With the rise in online stores and increased Internet bandwidth, the sale and delivery of digital media is shifting online.[38] As such, when a purchase is made online, buyers download the software to their hard drive or some other

media device. A purchaser-turned-reseller of downloaded software would have to sell the original media that contains the software—whether that is the hard drive or other piece of media—to have a prospect of invoking the protections of the first sale doctrine. This difficulty creates a practical barrier to the legal resale of software.

<22>Furthermore, another factor that favors licenses in the new digital media distribution model is the ability to have license terms presented before purchase. Courts are more likely to find a license when the purchaser is first presented with the license terms and required to affirmatively assent to the terms by clicking "I agree."[39] In such situations, the consumer knows the terms before the purchase, rather than after taking the software package home and opening up the box containing the agreement.

<23>The first sale doctrine was first created to allow the free resale of books,[40] but even the resale of some forms of books has become obsolete. As people begin to purchase books through Amazon's Kindle™ and Sony's Reader, they will no longer have the traditional physical copy of the book. Instead, they will have a digital copy on some form of media. This creates the same problems of media resale that arise when downloading software to a computer. To use the first sale doctrine, a Kindle book holder would have to sell their Kindle in addition to the digital book.[41] Regardless, as the practical barriers to using the first sale doctrine increase with new forms of media distribution, the minority rule favoring sales that give first sale protections will likely become ever less relevant. This trend may be true, even in light of new first sale cases such as *Vernor*.

CONCLUSION

<24>*Vernor v. Autodesk* may be a last stand of sorts for the first sale doctrine with software sales as digital media is increasingly sold via downloads. *Vernor* lays out a clear test: when a holder of software has the right to indefinitely possess the software, she is the owner of the software and may resell it. However, the majority of courts still hold software to be licensed, or permissibly restricted in ownership, without the benefit of the first sale doctrine. The simplicity of the *Vernor* rule for assessing software sales, while arguably more straightforward as a doctrinal matter, is still unlikely to turn the tide. This trend is even more likely in the context of computer software, where the first sale doctrine's power is waning in light of the direct

downloading of software to computer hard drives rather than purchase of a "hard copy."

PRACTICE POINTERS

- For the first sale doctrine to apply, a purchaser must sell the physical media onto which the software was originally delivered. This means that software makers who distribute software via downloads will largely avoid the first sale doctrine because selling the media—such as an internal hard drive of a computer or Kindle—would be unpractical.
- For software makers that do distribute software via a physical media, such as a CD, DVD, or USB device, such makers can require the return of the media at the end of period of use to lessen the chances that a court will apply the minority rule by preventing the indefinite possession of the device by a user.

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Footnotes

1. Thomas A. Hackett, University of Washington School of Law, J.D. program Class of 2009. Thank you to Professors Jane Winn and Robert Gomulkiewicz of the University of Washington School of Law for their help in editing this Article.
2. Bobbs-Merrill Co. v. Straus, 210 U.S. 339 (1908).
3. 555 F. Supp. 2d 1164 (W.D. Wash. 2008).
4. *See, e.g.*, DSC Commc'ns Corp. v. Pulse Commc'ns, Inc., 170 F.3d 1354 (Fed. Cir. 1999); S.O.S., Inc. v. Payday, Inc., 886 F.2d 1081 (9th Cir. 1989); Davidson & Assocs. v. Internet Gateway, 334 F. Supp. 2d 1164 (E.D. Mo. 2004), *aff'd*, 422 F.3d 630 (8th Cir. 2005); Adobe Sys. Inc. v. Stargate Software Inc., 216 F. Supp. 2d 1051 (N.D. Cal. 2002); Adobe Sys. Inc. v. One Stop Micro, Inc., 84 F. Supp. 2d 1086 (N.D. Cal. 2000). *See also* MAI Sys. Corp. v. Peak Computer, Inc., 991 F.2d 511 (9th Cir. 1993) (asserting that because plaintiff's software was licensed, the end-users did not qualify as owners); Microsoft Corp. v. Software Wholesale Club, Inc., 129 F. Supp. 2d 995 (S.D. Tex. 2000) (granting summary judgment to plaintiff after

defendant fails to introduce evidence that plaintiff sells its software); Berthold Types Ltd. v. Adobe Sys. Inc., 101 F. Supp. 2d 697 (N.D. Ill. 2000) (finding that a licensing agreement for typefaces was not a "sale" for purposes of the U.C.C. because no title was transferred); Microsoft Corp. v. Harmony Computers & Elecs., Inc., 846 F. Supp. 208 (E.D.N.Y. 1994) (finding first sale doctrine inapplicable because Microsoft only licenses its products). *But see* Krause v. Titleserv, Inc., 402 F.3d 119 (2d Cir. 2005) (finding that a transferee exercised sufficient incidents of ownership over a copy of software to be considered the "owner" for purposes of 17 U.S.C. § 117(a)); Step-Saver Data Sys., Inc. v. Wyse Tech., 939 F.2d 91 (3d Cir. 1991) (treating a software licensing agreement as a sale of goods governed by the U.C.C.); United States v. Wise, 550 F.2d 1180 (9th Cir. 1977) (finding insufficient evidence to prove that certain transactions involving films were licenses rather than sales in a prosecution for copyright infringement); SoftMan Prods. Co. v. Adobe Sys. Inc., 171 F. Supp. 2d 1075 (C.D. Cal. 2001) (looking to the "economic realities" of a transaction to determine that a sale of software had occurred); Novell, Inc. v. Network Trade Ctr., Inc., 25 F. Supp. 2d 1218 (D. Utah 1997) (holding that a transaction in software was in fact a sale governed by the U.C.C.), *vacated in part*, 187 F.R.D. 657 (D. Utah 1999).

5. Robert W. Gomulkiewicz & Mary L. Williamson, *A Brief Defense of Mass Market Software License Agreements*, 22 RUTGERS COMPUTER & TECH. L.J. 335, 355 (1996).

6. *See, e.g.*, Microsoft Corporation, Office 2007 Home and Student License, http://office.microsoft.com/en-us/products/HA102103171033.aspx (last visited May 29, 2009).

7. For various prices charged see Microsoft Corporation, Office 2007 Product and Price Comparison, http://office.microsoft.com/en-us/products/FX101635841033.aspx (last visited May 29, 2009). The main difference for most users between home and business product is price; the functional difference is negligible for basic word processing needs. *See, e.g.*, *id.*

8. Interestingly, licensing is also integral to the open

source movement, which requires subsequent development of licensed open source software to follow the open source principals. Heather Meeker, *Outsource Software Development and Open Source: Coming of Age in the 2000s*, 24 SANTA CLARA COMPUTER & HIGH TECH. L.J. 869, 872-73 (2008).

9. 17 U.S.C. § 106(3) (2006).

10. 17 U.S.C. § 109(a) (2006).

11. 2 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT, § 8.12[B][1][d][i], (Matthew Bender ed., LexisNexis 2009) (1963).

12. 1 RAYMOND T. NIMMER, THE LAW OF COMPUTER TECHNOLOGY § 1:46 (4th ed. 2009); *see also* Microsoft Corp. v. Harmony Computers & Elecs., Inc., 846 F. Supp. 208 (E.D.N.Y. 1994).

13. *See, e.g.*, DSC Commc'ns Corp. v. Pulse Commc'ns, Inc., 170 F.3d 1354 (Fed. Cir. 1999); S.O.S., Inc. v. Payday, Inc., 886 F.2d 1081 (9th Cir. 1989); Davidson & Assocs. v. Internet Gateway, 334 F. Supp. 2d 1164 (E.D. Mo. 2004), *aff'd*, 422 F.3d 630 (8th Cir. 2005); Adobe Sys. Inc. v. Stargate Software Inc., 216 F. Supp. 2d 1051 (N.D. Cal. 2002); Adobe Sys. Inc. v. One Stop Micro, Inc., 84 F. Supp. 2d 1086 (N.D. Cal. 2000).

14. Microsoft Corp. v. Harmony Computers & Elecs., Inc., 846 F. Supp. 208 (E.D.N.Y. 1994).

15. *Id.* at 213.

16. 2 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 8.12[B][1][d][i] (Mathew Bender ed., LexisNexis 2009) (1963).

17. *Microsoft Corp.*, 846 F. Supp. at 213.

18. *See, e.g.*, Adobe Sys. Inc. v. Stargate Software Inc., 216 F. Supp. 2d 1051 (N.D. Cal. 2002).

19. Nimmer points out that this "gloss" on the *Microsoft v. Harmony* ruling effectively "undoes the dictates of Congress by undermining an essential feature of the Copyright Act!" 2 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 8.12[B][1][d][i] (Mathew Bender ed., LexisNexis 2009) (1963). Essentially, the majority of courts follows this approach and allows computer software makers to control the distribution of computer software through licensing. In these

cases, the software license as a contract between the software maker and purchaser trumps first sale doctrine. The first sale doctrine thus becomes the default that can be contracted around. For a discussion of preemption and the first sale doctrine see Raymond T. Nimmer, *Breaking Barriers: The Relation Between Contract and Intellectual Property Law*, 13 Berkeley Tech. L.J. 827 (1998).

20. Adobe v. One Stop Micro, Inc., 84 F. Supp. 2d 1086 (N.D. Cal. 2000).

21. *Id.* at 1092.

22. SoftMan Prods. Co. v. Adobe Sys. Inc., 171 F. Supp. 2d 1075 (C.D. Cal. 2001).

23. *Id.* at 1089.

24. *Id.*

25. *Id.* at 1085.

26. Novell v. Trade Network Ctr., Inc., 25 F. Supp. 2d 1218 (D. Utah 1997), *vacated in part*, 187 F.R.D. 657 (D. Utah 1999).

27. Vernor v. Autodesk, Inc., 555 F. Supp. 2d 1164 (W.D. Wash. 2008).

28. *Id.* at 1166.

29. *Id.* at 1165.

30. *Id.*

31. *Id.*

32. The court also considered whether to apply more recent Ninth Circuit precedent, but ultimately found *Wise* to be controlling. *Id.* at 1169-74.

33. United States v. Wise, 550 F.2d 1180 (9th Cir. 1977).

34. *Id.* at 1192-94.

35. *Id.*

36. *See generally* 2 Melville B. Nimmer & David Nimmer, Nimmer on Copyright § 8.12[B][1][d][i] (Mathew Bender ed., LexisNexis 2009) (1963) (setting forth the analysis for first sale cases).

37. *Id.* at § 8.12[E].

38. *See, e.g.*, John Borland, *iTunes Outsells Traditional Music Stores*, CNET NEWS, Nov. 21, 2005, http://news.cnet.com/iTunes-outsells-traditional-music-stores/2100-1027_3-5965314.html (last visited May 29, 2009).

39. *See, e.g.*, Specht v. Netscape Commc'ns Corp., 306 F.3d 17, 33 (2d Cir. 2002).

40. Bobbs-Merrill Co. v. Straus, 210 U.S. 339 (1908).

41. Matt Buchanan, *Amazon Kindle and Sony Reader Locked Up: Why Your Books Are No Longer Yours*, GIZMODO, Mar. 21, 2008, http://gizmodo.com/369235/amazon-kindle-and-sony-reader-locked-up-why-your-books-are-no-longer-yours (last visited May 29, 2009).