CREATe Working Paper 2014/2 (February 2014)

The Future Implications of the Usedsoft Decision†

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† An earlier version of this paper was presented at the ALAI 2013 conference, organised by CECOLDA in Cartagena, Colombia in September 2013, and will be published in due course in the conference proceedings.

CREATe Working Paper Series DOI: 10.5281/zenodo.8382.

This release was supported by the RCUK funded *Centre for Copyright and New Business Models in the Creative Economy (CREATe)*, AHRC Grant Number AH/K000179/1.

Introduction

Those were the days! Up to a decade ago exhaustion in copyright was strictly limited to the distribution of (multiple) hard copies of copyright works. Anything else was considered to be outside the exhaustion rules. E.g. multiple showings of a movie in movie theatres was seen as the essence of movie copyright and exhaustion had therefore no role to play in that area according to the *Coditel* decision.[1] How wrong were we though when we assumed that the digital revolution that turned so many things upside down in copyright would have no impact in this area.

Admittedly, the decoder cases[2] were potentially only about hard copies. Hard copies in the sense of cards for decoders for satellite broadcasts of football matches could easily be subjected to the exhaustion rules that enforce the free movement of goods provisions of the EU Treaty. But if the decoder cards that had been obtained in Greece could be used in the UK, such use gave access to the broadcasts. The real impetus to accept this and to breach the uncontested logic of the *Coditel* approach may have been in competition law in the decoder cases, but they show clearly that the logic of copyright is not the dominant factor in the digital era.[3] That dominance is on the basis of the EU Treaty given to the rules on free movement and on competition law.

Usedsoft[4] clearly fits in with that evolution. The *Usedsoft v Oracle* case[5] was all about computer software wich Oracle develops and markets. Oracle is the proprietor of the exclusive user rights under copyright law in those programs. It distributes the software at issue in 85% of cases by downloading from the internet. The customer downloads a copy of the software directly to his computer from Oracle's website. The user right for such a program, which is

[1] Case 62/79 *Coditel SA v Ciné Vog Films SA* [1980] ECR 881.
[2] Case C-403/08 *Football Association Premier League Ltd v QC Leisure* and Case C-429/08 *Murphy v Media Protection Services Ltd* [2012] FSR 1, [2012] 1 CMLR 29.
[3] For a fuller analysis, see P. Torremans, *Holyoak and Torremans Intellectual Property Law*, OUP (7th ed, 2013), pp. 344-349.
[4] Case C-128/11 *Usedsoft GmbH v Oracle International Corp.*, [2012] 3 CMLR 44, [2012] ECDR 19 and [2013] RPC 6.
[5] *Ibid.*

granted by a licence agreement, includes the right to store a copy of the program permanently on a server and to allow a certain number of users to access it by downloading it to the main memory of their work-station computers. UsedSoft markets used software licences, including user licences for Oracle computer programs. For that purpose UsedSoft acquires from customers of Oracle such user licences, or parts of them, where the original licences relate to a greater number of users than required by the first acquirer. Usedsoft's practices involve the making of a copy of the computer program, which raises the question of the infringement of the right of reproduction. A further question that arises is whether the right to distribute a copy of the computer program is exhausted. A positive answer to the question may help to justify Usedsoft's business model.

And effectively, in the CJEU's judgment one see the application of exhaustion rules, despite the absence of a sale of hard copies. But the special rules that are contained in the software Directive are, for fairly obvious reasons, rather omnipresent in the decision. Could it therefore be that *Usedsoft* is entirely software specific[6] and that even in that context a small change to existing business practices can overcome the impact of the decision? Or is this only a first example of the exhaustion logic to come and will the Court of Justice of the European Union apply the same logic to other copyright works? On-line distribution of music and licences granting access to on-line databases are then obvious candidates that attract attention. In essence I am asked whether I have a crystal ball and whether I can gaze in it. The straightforward answer is that I do not have a crystal ball. But let me nevertheless try to identify some guiding principles.

ReDigi* and *Usedsoft

[6] In the first two cases that followed the CJEU's decision the German Courts seem to give an affirmative answer to this question. The OLG Frankfurt confined the decision to cases based on the Software Directive (which was treated as *lex specialis* in relation to the Information Society Directive), see OLG Frankfurt, 18th December 2012 -11 U 68/11, [2013] GRUR 279-285. And the LG Bielefeld explicitly refused to apply the *Usedsoft* approach to the on-line distribution of e-books, as the Software Directive did not apply to that case, see LG Bielefeld, 5th March 2013, [2013] GRUR Prax 207 (summary).

One starting point for the search for guiding principles could be the *ReDigi* decision of the US District Court for the Southern District of New York.[7] Rather than with software and the special rules that come with it, at least in the EU, this case was concerned with mainstream copyright works. It dealt with the resale via an on-line market place of digital used music. The District Court rather resoundingly rejects the application of the first sale doctrine as a defence for the copyright infringement flowing from ReDigi's distribution of copyright work as part of the operation of its on-line market place. It may therefore sound logical to derive from that decision that the exhaustion/first sale doctrine has no role to play in relation to the resale of digital downloads of copyright works and is limited to the (re-)sale of hard copies of copyright works. The District Court's reference[8] to the Supreme Court's decisions in *Quality King v L'anza Research*[9] and in *Kirtsaeng v John Wiley*[10] rather strongly points in that direction. There is no obvious reason why the same conclusion could not apply in an EU context too. One could easily point towards the specific software related rules that underpin the whole *Usedsoft* decision. The *ReDigi* logic would then apply to all copyright works, apart from software and the *Usedsoft* exception requires the software specific rules and is therefore strictly limited to software and software copyright.

It strikes me that this is an oversimplification. Irrespective of whether one thinks *ReDigi* was correctly decided, it has very little value in a European context if one is trying to predict the future implications of the *Usedsoft* decision outside the narrow sphere of software and software copyright.

ReDigi is a decision rooted in copyright. And that is not just the Copyright Act, but, almost more importantly, the US Constitution. The starting point and the highest norm is the copyright norm and the critical role it was given by the Constitution. From that perspective ReDigi is committing infringing acts and its activities are not indispensable to fulfil the role laid down in the Constitution.

[7] *Capitol Records, LLC v ReDigi Inc.*, United States District Court for the Southern District of New York, 30th March 2013, No. 12 Civ. 95 (RJS).
[8] *Ibid.*, at page 11.
[9] *Quality King Distribs. Inc. v L'anza Research Int'l Inc* 523 US 135, 152 (1998).
[10] *Kirtsaeng v John Wiley & Sons Inc*, No. 11-697, [2013] WL 1104736, 19th march 2013.

The mere question that remains at that stage is whether there are any exemptions from which ReDigi can benefit. These are then logically interpreted narrowly by the District Court and ReDigi's activities are then found to be covered neither by the fair use exception, nor by the first sale doctrine. This is a copyright decision and the only logic that it follows is the constitutional copyright logic.

Things are fundamentally different at the EU level and the *Usedsoft* decision shows that fundamentally different logic very clearly. The EU Treaty's cornerstone is the single market and as a result the Treaty provisions and free movement (and competition law) dominate and are the unavoidable main principles that apply to all areas, including copyright. In contrast with the US, copyright rules and principles are not the starting point of the whole logic. On the contrary, copyright must justify itself and fit in with the free movement rules. Copyright needs to justify any different treatment via its essential function and the specific subject matter that flows from it and that is required to fulfil the essential function.[11] That essential function necessarily does not harm the single market and the free movement, rather by allowing what is essentially necessary for the creation of copyright works it stimulates the creation of cultural and intellectual goods.

In such a logic that starts from free movement, exhaustion is the norm (rather than a mere exception to copyright infringement). That leads to a wide interpretation, rather than the narrow one in *ReDigi*. We are therefore not merely concerned with the sale of a hard copy of the software, to return to the facts of *Usedsoft*, but also with anything that in terms of economic function and business model comes close to it and can be seen as an alternative, if one applies that to the exhaustion of the distribution right. This is so because any alternative has the same impact in terms of free movement. In the same way in which the District Court prominently asked whether ReDigi's behaviour could contribute to the implementation of the copyright clause in the Constitution, the Court of

[11] Case C-128/11 *Usedsoft GmbH v Oracle International Corp.*, [2012] 3 CMLR 44, [2012] ECDR 19 and [2013] RPC 6, at para. 62, where the Court also refers to older cases such as case C-200/96 *Metronome Music* [1998] ECR I-1953 (para 14) and case C-61/97 *FDV* [1998] ECR I-517 (para. 13).

Justice of the European Union prominently focuses on the impact on the free movement rules and on the single market. The combination of a free download of the software in combination with a permanent licence, for which there is remuneration replaces from that perspective a sale of a hard copy, it is its equivalent, and it can therefore be subjected to the exhaustion rule. The exclusive right and the remuneration remain in place and the essential function and the specific subject matter are guaranteed. Exhaustion guarantees then that only such restrictions on free movement (and resale) are allowed as are necessary to guarantee that essential function and specific subject matter. Only such minimal restrictions on the free movement rules can be justified.

If this is the fundamental logic that underpins the system, there is hardly any doubt that it also applies to e.g. digital music files bought on iTunes or any other provider. The *Usedsoft* solution can then be expanded to any other type of copyright work. There may however be one fundamental reason why that conclusion that worries so many in the copyright industries may after all not be the correct one. It is after all not necessarily the case that the essential function and the specific subject matter of copyright will have been respected and safeguarded when e.g. a digital music file has been bought on iTunes. The court specifically requires that the rightholder must obtain 'a remuneration corresponding to the economic value of the copy of the work of which it is the proprietor'[12]. Only then will the Usedsoft approach lead to the application of the exhaustion rule, as the respect for the essential function and specific subject matter of copyright is the holy grail of the free movement/exhaustion approach. If the remuneration of the author/creator is of such a minimal nature, as seems to be the cases in on-line music distribution, that minimal requirement is not met and the exhaustion rule will not apply as it would damage the essential function and the specific subject matter of copyright.[13]

[12] Case C-128/11 *Usedsoft GmbH v Oracle International Corp.*, [2012] 3 CMLR 44, [2012] ECDR 19 and [2013] RPC 6, at para. 45.
[13] For more details see P. Torremans, *Holyoak and Torremans Intellectual Property Law*, OUP (7th ed, 2013), pp. 339-347.

But maybe there is more to the judgment, including other reasons why *Usedsoft* cannot be expanded to other types of copyright works.

Permanent

A lot has been made of the Court's emphasis on the fact that the users-licensees of the Oracle software had the permanent and indefinite right to use the software. It is indeed easy to see how the decision could be circumvented by the copyright industries if that permanent nature of the licence were to be an essential requirement. The introduction of a mere time limit would bring any future licence outside the *Usedsoft* rule and exhaustion would no longer apply. The Court of Justice of the European Union does indeed refer to 'a right to use that copy for an unlimited period', but this could be a mere factual reference to the licence contract at issue and to the questions asked in that context by the national court. The Court of Justice of the European Union is after all not legislating, it merely answers the questions put to it by the national court and explains EU law against the setting of the facts of the case. And Oracle's licence contract was for an unlimited period. I do therefore not think that it should be seen as an important limitation on the scope and the impact of the *Usedsoft* case. Introducing a simple time limit, i.e. software licences or music downloads for 50 years only, may be too simplistic as a solution.

In a free movement driven logic one is effectively looking for the equivalent in both social and economic terms of the sale of a hard copy of the copyright work. The Court of Justice of the European Union clearly examined the facts of the *Usedsoft* case on that basis and once such an equivalent is found the approach which the Court took in *Usedsoft* will arguably be applied.

The licence will replace the sale of a hard copy of the work, if the user effectively acquires the right to use the work for the economic or social lifespan of the product. And if that is the case the free movement logic calls for the application of the exhaustion rule. The Court refers to a transfer of the right of ownership in

the copy[14], but in the same way in which a sale of a flat can be limited to 99 years and still be a sale, so can at least arguably a software licence that is limited to 50 years still be a sale, at least if during the 50 years the licensee has the full freedom to use the software which an owner would normally have. It suffices in the words of the Court that the rightholder obtains 'a remuneration corresponding to the economic value of the copy of the work of which it is the proprietor'[15]. That would still be the case for the software licence that is limited to 50 years. The fact that there is a single purchase payment for the licence also points in that direction. The copy that is returned after 50 years and its ownership are worthless and the licence fee has covered the complete economic value of the copy. To return to the *ReDigi* facts, the same could be said to be true for a music download that is limited in time, e.g. to 25 years.

This does of course not warrant the conclusion that every single software or music download will now be affected by the rules on exhaustion. There will still be (plenty of) transactions that are not the equivalent to a sale and that are rather to be compared with a rental contract. Annual subscription fees and licences that are shorter than the economic or social life of the product clearly point in that direction. One also thinks of single use licences and licences that merely grant access to a database that is operated by the provider. One should however in the latter example not attach too much importance to the fact that the database is updated from time to time or on an ongoing basis by the provider. Software updates by Oracle were after all resoundingly rejected by the Court of Justice of the European Union in the *Usedsoft* case.[16] It did not detract from the fact that there was an equivalent of a transfer of ownership in the copy of the work. Databases will therefore not escape the application of the *Usedsoft* rule if the whole database is downloaded onto the server or computer of the licensee.

[14] Case C-128/11 *Usedsoft GmbH v Oracle International Corp.*, [2012] 3 CMLR 44, [2012] ECDR 19 and [2013] RPC 6, at para. 42.
[15] *Ibid*., at para. 45.
[16] *Ibid.*, at paras. 64-67.

A copy needs to be made

The problem with downloads as opposed to hard copies of works is that the copy cannot simply be handed over in the context of a re-sale. A (new or additional) copy is necessarily being made as part of the technological process, irrespective of the fact whether the original copy is deleted afterwards.[17] And exhaustion applies to the distribution right, rather than to the right of reproduction. Could the latter therefore be infringed and in this way effectively scupper the extension of the *Usedsoft* approach to other types of copyright works?

It is indeed true that the software Directive[18] provides specifically in article 5(1) that a reproduction that is necessary for the use of the program by the lawful acquirer in accordance with its intended purpose can be made. And the Court of Justice of the European Union equates the second acquirer of the software licence with a lawful acquirer and allows him or her to rely on article 5(1). The copy made in the process is therefore lawful rather than being an infringing one.[19] The absence of an equivalent provision for other types of copyright works could lead one to conclude that the copy that is made remains in these cases an infringing one.

It is submitted that such a conclusion goes way too far. As there was a question specifically directed at the interpretation of article 5(1) the Court answered it and since the provision exists in relation to computer software it is only natural that it is relied upon. But that does not mean that outside the area of computer software the opposite conclusion is unavoidable. The major rule is that free movement is not to be scuppered. That means that the distribution right has to be subjected to the exhaustion rule and that major rule is of such a capital importance that the Court of Justice of the European Union is unlikely to let the

[17] See the detailed discussion under US copyright law in pages 5-7 of the decision in *Capitol Records, LLC v ReDigi Inc.*, United States District Court for the Southern District of New York, 30th March 2013, No. 12 Civ. 95 (RJS).
[18] Directive 2009/24 of the European Parliament and of the Council of 23 April 2009 on the legal protection of computer programs (Codified version) [2009] OJ L 111/16.
[19] Case C-128/11 *Usedsoft GmbH v Oracle International Corp.*, [2012] 3 CMLR 44, [2012] ECDR 19 and [2013] RPC 6, at para. 88.

effect of the exhaustion of the distribution right be undone by an ancillary rule on the exhaustion of the reproduction right, merely because the technical process requires a copy to be made. That reproduction is in this context nothing but ancillary.

That conclusion may sound surprising in a copyright exhaustion context, but the Court of Justice of the European Union already applied it in a trade mark context. The Kruidvat stores were allowed to use the copyright protected packaging of Dior perfumes in advertisements for the perfumes in a situation where there was trade mark exhaustion. In terms of exhaustion the reproduction right in copyright could not undo the effect of the exhaustion of the trade mark rights. Or if one wants to put it that way, the copyright was ancillary to the trade mark and had to follow the exhaustion of the trade mark right: *accessorium sequitur principale*.[20] Applying that logic to the reproduction right in combination with the exhaustion of the distribution right, it is unlikely that the Court of Justice will let the reproduction right undo the exhaustion of the distribution right. Even in the absence of article 5(1) a copy will be allowed to be made, as an alternative approach would fly in the face of the free movement principles.

Conclusion

The future implications of the *Usedsoft* decision remain unclear and one would still need a crystal ball to find out the details. At first glance the decision seems very narrowly linked to the specific provisions of the software Directive, but that may be deceptive. And the references to aspects linked to the facts of the case should also not make one rush to a very restrictive interpretation of the decision. I have tried to look at the case against the background of the broader principles of European law and in particular against the background of the free movement principles. That leads to the conclusion that a broad application of the *Usedsoft*

[20] Case C-337/95 *Parfums Christian Dior SA & Parfums Christian Dior BV v Evora BV* [1998] RPC 166.

approach is rather likely. Exhaustion may e.g. also apply to music downloads and getting out of it may be increasingly difficult.

But there is more to it than this merely technical aspect. There is also the policy aspect. Whether that is from a copyright perspective the most desirable outcome remains also an open question. Answering it here would lead us too far and that was not the aim of the paper either. And it may not be necessary after all. A wide application of the *Usedsoft* approach is after all linked to the essential function and the specific subject matter of copyright being safeguarded. For the exhaustion rule to apply the rightholder must obtain 'a remuneration corresponding to the economic value of the copy of the work of which it is the proprietor'[21]. That will e.g. not be the case in most digital music download scenarios and it is probably this argument, rather than any other, that will restrict the application of the *Usedsoft*/exhaustion approach. There may after all not be that much reason for the copyright industries to despair…

[21] Case C-128/11 *Usedsoft GmbH v Oracle International Corp.*, [2012] 3 CMLR 44, [2012] ECDR 19 and [2013] RPC 6, at para. 45.

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