Meet the unavoidable - the challenges of digital second-hand marketplaces to the doctrine of exhaustion

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1. A century-old doctrine

The doctrine of exhaustion, or the first sale doctrine, is one of the most fundamental principles of copyright law. Under this doctrine, the right holder must accept that copies, or the originals of copyrighted works, and other subject matter lawfully placed into circulation by or with the authorization of the right holder, through sale or in any other form of transfer of ownership, are subsequently distributed by the lawful owner of those copies or originals, if the right holder received proper remuneration for the initial distribution.

Anglo-Saxon academia and case law have often stressed that the doctrine stems from the common law's refusal to permit restraints on the alienation of chattels,[1] but the earliest direct reference to *Erschöpfungslehre* in copyright law is found in Joseph Kohler's monograph published in 1880.[2]

Regardless of the precise origins of the doctrine, both the US Supreme Court and the Supreme Court of the German Reich confirmed the validity of this concept, at similar times and in cases with comparable fact patterns.[3] The *Königs Kursbuch*[4] and the *Bobbs-Merrill*[5] cases both concerned the resale of books which were originally put into circulation by their respective publishers at a fixed price, yet subsequently, in some instances, were resold at a lower price. Both rulings were based on the premise that a right holder that had received fair remuneration for the first sale had no right to control further resale of the given copies. This is known as *Belohnungstheorie* (EN: reward theory) in the German legal system and as reward theory in Anglo-Saxon jurisprudence.

Following the above two rulings from 1906 and 1908, respectively, the doctrine has been developed for many decades exclusively on a national level. The exact content of the doctrine varied in light of countries' divergent socio-economic backgrounds and their differing policy considerations. Most developed countries with large economic potential, strong domestic markets and the capacity to export cultural goods (such as the United States or Germany) were interested in national exhaustion. In contrast, countries that relied heavily on the importation of cultural goods as well as being developing and small market countries in general, such as the Netherlands, Switzerland, Japan, Australia and New Zealand, were interested in international exhaustion. As a third option, regional protection of copyright law has been developed through CJEU case law. Indeed, several rulings, particularly on the free movement of goods and services, have played a pivotal role in the evolution of copyright law within the EU.[6] This approach was later codified via the EU copyright directives.

For a long time, international interest in further development of the doctrine was absent, as this would inevitably have required surrender of domestic solutions. The TRIPS Agreement, adopted in 1994, was the first international agreement on intellectual property that touched upon the copyright aspects of exhaustion. Nevertheless, as the contracting parties failed to

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[1] *Supap Kirtsaeng v. John Wiley & Sons, Inc*., 133 *S.Ct.* 1351 (2013) 1363.

[2] Joseph Kohler, *Das Authorrecht - Eine zivilistische Abhandlung* (Verlag von Gustav Fischer 1880) 139.

[3] The foundations of the doctrine were first set by court decisions in the United States, commencing from the mid-1880s. See *Clemens v. Estes*, 22 *Fed. Rep*. 899 (1885).

[4] RG 10.06.1906 (Rep. I. 5/06).

[5] *Bobbs-Merrill Company v. Isidor Straus and Nathan Straus*, 210 *U.S.* 339 (1908).

[6] The earliest preliminary ruling of the ECJ in this matter was Case 78/70 *Deutsche Grammophon Gesellschaft mbH v. Metro-SB-Großmärkte GmbH & Co. KG* [1971] ECR 487.

reach a compromise on an independent right of distribution,[7] the TRIPS Agreement introduced no new substantive obligations on the doctrine of exhaustion. Instead, it granted absolute freedom to the signatories on the issue of regulation, "whether enacted by statute, articulated in judicial opinions, or formulated in agency regulations or rules",[8] and whether regulation should have national, regional or international reach. The TRIPS Agreement approached the doctrine from a neutral perspective, stressing that "[f]or the purposes of dispute settlement under this Agreement, subject to the provisions of Articles 3 and 4 nothing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights".[9]

The two WIPO Internet Treaties of 1996 showed a clear progression of the norms of exhaustion. For the first time in international copyright law, these treaties allowed for a general right of distribution. At the same time, signatories of the treaties should comply with specific substantive provisions on exhaustion, whilst remaining free to develop their own regulations in other aspects.[10] The WCT and WPPT allowed signatories to choose whether to introduce domestic, regional or international exhaustion, as well as leaving open the option to leave the issue un-regulated.[11] Additionally, the treaties required that affected copies should be lawfully sold, or ownership over them should otherwise be transferred.[12] The expression "nothing in this Treaty shall affect" makes it clear that no further provisions of the treaty, including the three-step test,[13] create an obstacle for signatories to regulate on exhaustion.[14] In practice, this means that the freedom of lawful acquirers to dispose of property in a copy is absolutely in accordance with the law. Resales do not, per se, conflict with the normal exploitation of works, nor do they unreasonably prejudice the legitimate interests of the author.[15] The Agreed Statement attached to Article 6 of the WCT and Article 8 of the WPPT, makes it clear that "[a]s used in these Articles, the expressions 'copies' and 'original and copies,' being subject to the right of distribution and the right of rental under the said Articles, refer exclusively to fixed copies that can be put into circulation as tangible objects."

A partial and certainly not surprising conclusion might be drawn at this point. The more than a century old history of the doctrine makes it clear that when introduced it was designed to affect tangible copies of protected subject matter. This is well-evidenced by the fact that the statutory endorsement of the doctrine stems from the analogue age. Further, the WIPO Internet Treaties (as well their European implementation norm, the InfoSoc Directive) expressly refer to the tangible nature of copies that might be subject to lawful resale.

Problems associated with the doctrine of exhaustion have, however, grown concurrently with the emergence of digital technologies, in particular with development of the internet. The question as to whether the doctrine of exhaustion is applicable to digital files has become pressing since shortly after protected subject-matter (especially software, audio and audiovisual content, e-books) has been predominantly (or at least significantly) sold online. This dilemma challenges the pre-existing set of economic rights, freedom to provide services, free movement of goods, as well as the traditional business models of the copyright industry.

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[7] Jörg Reinbothe and Silke von Lewinski, *The WIPO Treaties 1996 - The WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty, Commentary and Legal Analysis* (Butterworths Lexis Nexis 2002) 80.

[8] Shubha Ghosh, *The Implementation of Exhaustion Policies - Lessons from National Experiences*, Issue Paper 40 (International Centre for Trade and Sustainable Development 2013) 3–4.

[9] TRIPS Agreement Art. 6.

[10] See Article 6(2) of WCT and Article 8(2) of WPPT.

[11] Reinbothe - von Lewinski (2002) 85.

[12] Ibid. at 86-87.

[13] WCT Article 10; WPPT Article 16.

[14] Reinbothe - von Lewinski (2002) 87.

[15] Silke von Lewinski, *International Copyright Law and Policy* (OUP 2008) 453, para. 17.65.

Courts have faced legal disputes more often following the Millennium, and undoubtedly disputes surrounding the idea of digital exhaustion are far from over.
Following these introductory remarks, the present chapter is separated into two main parts. First, it summarizes the key elements of the *UsedSoft* and the *ReDigi* rulings (Chapter II). Second, it collects the pros and cons regarding possible introduction of a digital exhaustion doctrine. I argue that the traditional positivist approach is a dead end, whereas a constructive realistic approach can convincingly serve as the basis for application of the doctrine in the digital age (Chapter III).

II. UsedSoft and ReDigi

1. The UsedSoft case

UsedSoft was the first major decision to shed light on digital exhaustion. In this case, Oracle sued UsedSoft for reselling used software licenses. 85% of Oracle's clients downloaded the software from the internet. The respective section of Oracle's EULA provided as follows: "[w]ith the payment for services you receive, exclusively for your internal business purposes, for an unlimited period a non-exclusive non-transferable user right free of charge for everything that Oracle develops and makes available to you on the basis of this agreement."[16] Oracle similarly offered so-called volume licenses, under which 25 end-users had the right to use the computer programs. UsedSoft acquired parts of the volume licenses, where the original licensee had not installed the computer program in the available number offered by Oracle. UsedSoft directed its clients to Oracle's website to download the respective program from Oracle's web page. UsedSoft launched an Oracle Special Offer in October 2005. It offered up-to-date software licenses for resale, where the maintenance agreement was also in force. The company testified to the validity of the original purchase of the license key by a notarial certificate. Oracle initiated court proceedings to stop UsedSoft's Special Offer, and the case finally reached the CJEU.[17]
The CJEU provided a bright-line rule on exhaustion of the software distribution right. The Grand Chamber recalled that under Article 4(2) of the Software Directive the right of distribution exhausts if a copy of the computer program is sold within the EEA by or under the authorization of the right holder.[18] Consequently, the issue to decide was whether conclusion of a EULA and download of the computer program from Oracle's website led to a first sale of the program.[19] Since the Software Directive does not refer to Member States' law in terms of sale, the CJEU interpreted this term in an independent and uniform way.[20] The CJEU concluded that "[a]ccording to a commonly accepted definition, a 'sale' is an agreement by which a person, in return for payment, transfers to another person his rights of ownership in an item of tangible or intangible property belonging to him."[21] Further, the CJEU noted that downloading the computer program and concluding the EULA form an indivisible whole. Downloading a copy of the computer program (the source code) from the data carrier or from the internet to the user's computer and concluding a EULA remain inseparable from the point of view of the acquirer. Moreover, Oracle's EULA allowed for permanent use of the software in exchange for payment of a fee that corresponded to the

[16] Case C-128/11 *UsedSoft GmbH v Oracle International Corp.*, ECLI:EU:C:2012:407, para. 23.
[17] On the facts of the case *see* ibid. at paras 20-26.
[18] Ibid. at para. 36.
[19] Ibid. at para. 38.
[20] Ibid. at paras 39–41.
[21] Ibid. at para. 42.

economic value of the computer program. As a result, the principle of exhaustion could not be evaded merely by renaming the contract a license.[22]

The CJEU rejected the claim by Oracle and of the Commission that offering a computer program for download on a website represents making that program available to the public, as long as the contract leads to a sale, as in this case the right of distribution applies.[23] The CJEU also discussed whether the doctrine of exhaustion applies to intangible copies of computer programs, or only to physical/tangible copies. The CJEU noted that the Software Directive refers to the first sale of a computer program without specifying the form of the copy sold. Therefore, the doctrine of exhaustion covers the sale of both tangible and intangible copies of computer programs, including works that were downloaded from the internet.[24] Here, the CJEU argued that the Software Directive operates as a *lex specialis*. Therefore, interpretation of Article 4(2) should be independent of international and other EU norms.[25]

The CJEU used two policy arguments. First, it claimed that "[t]he on-line transmission method is the functional equivalent of the supply of a material medium".[26] Second, limiting the doctrine of exhaustion to copies sold on a tangible medium "would allow the copyright holder to control the resale of copies downloaded from the internet and to demand further remuneration on the occasion of each new sale, even though the first sale of the copy had already enabled the right holder to obtain an appropriate remuneration."[27]

The CJEU accepted Oracle's argument on the partial resale of volume licenses. The judges held that volume licenses are sold as a block by Oracle. An original purchaser who wants to get rid of parts of that must deactivate the remaining copies of the computer program as well. Finally, the CJEU provided a joint answer to the first and third questions. It concluded that the second (and any later) purchaser of the license key should be deemed a lawful acquirer, who has the right to refer to the doctrine of exhaustion, as a limitation on the right of distribution. Nevertheless, a reseller of a computer program must make the original copy installed on his computer unusable and the right holder is allowed to ensure deactivation by all technical means.[28]

Taking into account all reformatory arguments of the CJEU, the result of the procedure for the preliminary ruling is most appropriately summarized by Sven Schonhofen as "facts plus policy = results = doctrine".[29] Christopher Stothers also noted that "[FAPL and UsedSoft] will become fundamental decisions on the interaction between intellectual property rights and the European single market in the online world, in the same way that Consten and Grundig and Deutsche Grammophon set the current framework in relation to physical goods in the 1960s and 1970s".[30]

2. Capitol Records v. ReDigi

[22] Ibid. at paras 44-49.
[23] Ibid. at paras 50-51.
[24] Ibid. at paras 53-59.
[25] Ibid. at para. 60.
[26] Ibid. at para. 61.
[27] Ibid. at para. 63.
[28] Ibid. at para. 69-71. The preliminary ruling was later confirmed almost in its entirety by the German Federal Supreme Court. See: BGH 17.07.2013 (I ZR 129/08) 264-272.
[29] Sven Schonhofen, 'UsedSoft and its Aftermath: the Resale of Digital Content in the European Union' [2015] Wake Forest Journal of Business and Intellectual Property Law 277.
[30] Christopher Stothers, 'When is Copyright Exhausted by a Software Licence?: UsedSoft v. Oracle' [2012] European Intellectual Property Review 790.

In *ReDigi*, "the world's first and only online marketplace for digital used music"[31] was sued shortly after launching its service in October 2011. ReDigi's original version allowed registered users to upload their legally purchased sound recordings to ReDigi's Cloud Locker via the company's Media Manager program. Media Manager detected the uploader's computer and built a list of eligible files, which were lawfully purchased on iTunes or from another ReDigi user. This feature technically guaranteed that "pirate" copies of music files could not be entered into the system. Simultaneously with the uploading of the file to the Cloud Locker, the content was erased from the source computer. This process was generally termed as "migration" or "atomic transaction" of the file. The other function of Media Manager was to continuously double-check whether users retained any copy of the resold files on their computer's hard drive or on any portable devices synchronized with the computer. If Media Manager detected any file of that kind, users were warned to erase the copies. Users who failed to comply with the warning had their account terminated by the company.

After uploading the files to the Cloud Locker, users had two options: they either accessed their music for personal use or sold them to other users. In the latter situation, the files were stored in the same location in the Cloud Locker. However, the "file pointers" of the content were transferred. Accordingly, the new purchaser could exclusively access the sound recording. Users paid with credits purchased from ReDigi for each resale. ReDigi earned a transaction fee on every sale: it retained 60% of the price, whilst 20% was allocated to the seller and 20% was retained in an escrow fund for the respective artist.[32]

In its partial summary judgment in March 2013, the district court accepted Capitol's claims. Firstly, the district court noted that sound recordings are undeniably protected under US copyright law and Capitol owned copyrights on several recordings that were transferred via ReDigi's system. Secondly, sound recordings are fixed in phonorecords and these constitute material objects in which sounds are fixed and "from which the sounds can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device".[33] Finally, sound recordings are reproduced every time they are fixed in a new material object.

Based on this logic, the district court stuck rigidly to the case law on P2P file-sharing[34], noting that "when a user downloads a digital music file or 'digital sequence' to his 'hard disk,' the file is 'reproduce[d]' on a new phonorecord within the meaning of the Copyright Act."[35] Migration of the file was deemed irrelevant by Judge Sullivan, as moving a file from the user's computer to the ReDigi server was declared to represent reproduction.[36]

The court also noted that the electronic file transfer fell within the meaning of the right of distribution.[37] Thus, ReDigi's users infringed both the right of reproduction and the right of distribution when they used the company's service. The only chance to escape liability was to rely on the fair use or first sale doctrines. ReDigi failed to successfully rely on either defense,[38] yet I believe the fair use analysis of the district court was mistaken. Judge Sullivan found ReDigi directly liable for the reproduction and distribution of Capitol's sound recordings, as it willingly allowed the upload of content to the Cloud Locker.[39] However, it was not ReDigi but users that uploaded, migrated, sold, purchased and finally downloaded files. If ReDigi was liable for these acts in any way, its liability should be based on secondary

[31] Capitol Records, LLC, v. ReDigi Inc., 934 *F.Supp.2d* 640 (2013) 644.
[32] Ibid. at 644–646.
[33] *USCA* §101.
[34] See especially *London-Sire Records, Inc. v. John Doe 1*, 542 *F.Supp.2d* 153 (2008).
[35] Capitol v. ReDigi (2013) 649.
[36] Ibid. at 650.
[37] Ibid. at 651.
[38] Ibid. at 652–654.
[39] Ibid. at 657.

liability doctrines. The fair use doctrine only applies to direct infringements, that is, to acts by users, rather than by ReDigi. Elsewhere, the Second Circuit confirmed that "space-shifting" digital content, that is, reproduction of sound recordings from computers to portable devices and *vice versa*, is fair use.[40] In that situation, it is users rather than service providers that create copies in the cloud.[41]

The district court further said that ReDigi's system was capable of interfering with the legitimate primary markets of the right holders.[42] The Second Circuit could confirm that the doctrine of exhaustion is not bound by the three-step test and that resale of copies of works by lawful acquirers should be accepted, even if it is against the primary economic interest of the right holders. In sum, if the fair use doctrine applies to the upload and download of sound recordings by private users, the main argument of the district court would become pointless.

The district court's reasoning on the first sale doctrine is also contradictory. Judge Sullivan noted that ReDigi users must have produced a new phonorecord on the ReDigi server when they uploaded the files to their Cloud Locker. Consequently, users could not sell that "particular" copy via ReDigi.[43]

There are some concerns that the district court's reasoning on "particular" and "that" copy are correct. Music files sold via iTunes are marked with a Persistent ID number that individually identifies the content. The migration of the file via Media Manager and the Cloud Locker therefore leads to duplication and transfer of an entirely identical file marked with the same ID number. From this perspective, content sold via ReDigi is exactly "that particular copy".

Finally, ReDigi tried to satisfy the court that Capitol's interpretation of the first sale doctrine would provide broader protection to the company than envisaged by Congress. The district court rejected this argument, and stressed that it is up to Congress and not the courts to change the scope of the first sale doctrine.[44]

On 4 April 2016, shortly before the trial for damages was scheduled, the parties settled the remedy portion of the case. The district court endorsed a stipulated final judgment on June 3, 2016, and provided for stipulated damages and injunctive relief.[45] However, since the defendants reserved their right to appeal the summary judgment of the district court, the procedure continued to second instance. As of January 31, 2018, the appeals procedure is still pending.

III. The fate of digital exhaustion

1. Traditional positivism: a dead end

Yves Gaubiac noted as early as 2000 that dematerialization of works and the advancement of online uses make it necessary to appropriately categorize dissemination of digital content via the internet.[46]

Several leading international and regional copyright norms try to rectify this problem. The Agreed Statement to Article 6 of the WCT stressed that copies of protected works might be subject to distribution (and consequently exhaustion) if they are fixed and can be put into circulation as tangible objects. Recitals 28–29 of the InfoSoc Directive expressly exclude from the scope of the doctrine of exhaustion: intangible copies, services (especially on-line

[40] *Recording Industry Association of America v. Diamond Multimedia Systems, Inc.*, 180 *F.3d* 1072 (1999).
[41] *Cartoon Network LP, LLLP, et al. v. CSC Holdings, Inc., et al.*, 536 *F.3d* 121 (2008) 132.
[42] *Capitol v. ReDigi* (2013) 654.
[43] Ibid. at 655 (italics in original).
[44] "It is left to Congress, and not this Court, to deem them outmoded." See ibid. at 655–656.
[45] *Capitol Records, LLC, et al., v. ReDigi, Inc.*, 2017 WL 2131544 (Brief for Plaintiffs-Appellees) 7.
[46] Yves Gaubiac, 'The exhaustion of rights in the analogue and digital environment, Copyright Bulletin' [2002] 10.

services) and tangible copies produced with the help of services and on-line services. Similarly, the E-Commerce Directive categorizes on-line sale of goods as services,[47] and the VAT Directive also declared supply of services as "any transaction which does not constitute a supply of goods",[48] whereas supply of goods means "the transfer of the right to dispose of tangible property as owner".[49]
Nevertheless, many have criticized the ambiguities of the InfoSoc Directive's language. AG Bot found that "the distinction as to whether the sale takes place remotely or otherwise is irrelevant for the purposes of applying that rule."[50] Andreas Wiebe took the view that uncertainties in this field stem from the fact that the doctrine of exhaustion and the goods versus services dichotomy serve different purposes in law.[51] He claimed that the emphasis in respect of goods and services was misplaced in EU copyright law. The WCT/WPPT excluded online sale of copies from the scope of the doctrine of exhaustion, as no physical copy is provided by the seller to the purchaser. EU law generally (and unnecessarily) treated these transmissions as services. However, Wiebe argued that "the assumption that online transmissions always involve a service is flawed".[52] Accordingly, it is not the goods versus services dichotomy that leads to exclusion of the doctrine of exhaustion in cases of electronic supply of content, but rather the fact that the seller is not obtaining control over a physical/tangible copy of the work in question.[53]
The present author takes the view that the goods versus services dichotomy leads to a stalemate for the doctrine of exhaustion, while the *status quo* relating to the doctrine of exhaustion is outdated in that it fails properly to reflect the economic, social and technological realities of our age.

2. Constructive Realism: the Economic, Social and Technological Effects of the Digital Exhaustion Doctrine

The idea of a digital exhaustion doctrine, coupled with the concept of virtual property, perfectly illustrates how twenty-first century copyright law should keep pace with social realities. This is what ReDigi, UsedSoft and other digital second-hand marketplaces noticed when they launched their novel business models.
The following paragraphs will show that a digital exhaustion doctrine is completely realistic: it reflects the technological, social and legal *Zeitgeist*, as well as providing for a more balanced treatment of competing interests between users and right holders.
The digital exhaustion doctrine should also respect the interests of right holders. Digital exhaustion should not make downstream commerce of digital copies easier than the first sale doctrine generally allows for resale of tangible copies. Technological measures, as well as legal guarantees, should be put in place to guarantee protection of right holders.

2.1. Pros and Cons

[47] Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market, recital 18.
[48] Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, Art. 24(1).
[49] Ibid. at Art. 14(1). The ECJ also classified the supply of e-books as electronically supplied services. See Case C-479/13 *European Commission v. French Republic*, ECLI:EU:C:2015:141, para. 36.
[50] Case C-128/11, *Opinion of the Advocate General, Axel W. Bierbach, administrator of UsedSoft GmbH v Oracle International Corp.*, ECLI:EU:C:2012:234, para. 76.
[51] Andreas Wiebe, 'The Principle of Exhaustion in European Copyright Law and the Distinction between Digital Goods and Digital Services' [2009] Gewerblicher Rechtsschutz und Urheberrecht Internationaler Teil 115.
[52] Ibid.
[53] Ibid. at 115–116.

Many commentators routinely proclaim that digital copies represent an equivalent of the originals and that they can be illegally reused over and over again.[54] Therefore, downstream commerce of digital copies would decrease the need for originals and would harm the interests of right holders and intermediaries.[55] This can negatively affect right holders' incentives to innovate.[56]

Similarly, the White Paper 2016 of the Internet Policy Task Force concluded that acceptance of a digital exhaustion doctrine would have a negative effect on the primary markets of right holders; it would exclude the possibility of right holders to develop their own flexible business models and technologies; forward-and-delete technologies could not provide complete protection against potential infringements; and, finally, no convincing evidence exists on the potential advantages of introducing a digital exhaustion doctrine.[57] Equally, the reform proposals of the European Commission on the Digital Single Market were also silent on application of the doctrine of exhaustion to the digital environment.[58]

The reluctance of legislatures and academia to accept the practicality of a digital exhaustion doctrine can be refuted by several counter-arguments.

First, the WCT makes it clear that the three-step test should not affect resales covered by the doctrine of exhaustion. Consequently, the form of sale is not decisive. Indeed, should the form be relevant, right holders would be able to unilaterally exclude others from downstream commerce and would gain an unfair monopolistic advantage in this field.

Second, downstream commerce is *per definitionem* "cheaper" than traditional marketplaces. This has numerous advantages for purchasers who are willing to pay for content, but who are unable to afford higher-priced originals.

Third, resale of digital goods could be useful for the whole economy, as it would lead to reinvestment in the copyright ecosystem.[59] Physical data carriers (e.g., CDs and DVDs) have almost totally vanished from the marketplace and in their place is a constantly growing group of users who have subscribed to paid streaming services. It is still plausible that many consumers would continue purchasing digital copies if they would acquire the right to later resell them, and so they could retrieve some of their investment in the copies. This is aptly demonstrated by Aaron Perzanowski and Chris Jay Hoofnagle's empirical "MediaShop study", which convincingly evidences that end-users are "term optimists", in other words, they "expect a contract to contain more favourable terms than it actually provides".[60] This

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[54] Herbert Zech, 'Vom Buch zur Cloud – Die Verkehrsfähigkeit digitaler Güter' [2013] ZGE / IPJ 394; Ole-Andreas Rognstad, 'Legally Flawed but Politically Sound? Digital Exhaustion of Copyright in Europe after UsedSoft' [2014] Oslo Law Review 17; Marco Figliomeni, 'The Song Remains the Same: Preserving the First Sale Doctrine for a Secondary Market of Digital Music' [2014] Canadian Journal of Law and Technology 232–233; Nils Rauer - Diana Ettig, 'Can e-books and other digital works be resold?' [2015] Journal of Intellectual Property Law & Practice 715–716.

[55] Nakimuli Davis, 'Reselling Digital Music: is there a Digital First Sale Doctrine?' [2009] Loyola of Los Angeles Entertainment Law Review 370–371.

[56] Wolfgang Kerber, 'Exhaustion of Digital Goods: An Economic Perspective' [2016] ZGE / IPJ 161.

[57] The Department of Commerce - Internet Policy Task Force, *White Paper on Remixes, First Sale and Statutory Damages - Copyright Policy, Creativity, and Innovation in the Digital Economy*, January 2016 (http://www.uspto.gov/sites/default/files/documents/copyrightwhitepaper.pdf) 51–66.

[58] *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - Towards a modern, more European copyright framework*, COM(2015) 626 final, Brussels, 9.12.2015.

[59] Theodore Serra, 'Rebalancing at Resale: ReDigi, Royalties, and the Digital Secondary Market' [2013] Boston University Law Review 1777; Sarah Reis, 'Toward a "Digital Transfer Doctrine"? The First Sale Doctrine in the Digital Era' [2015] Northwestern University Law Review 196.

[60] Aaron Perzanowski - Chris Jay Hoofnagle, 'What We Buy When We Buy Now' [2017] University of Pennsylvania Law Review 321.

finding evidences that consumers understand contracts on the acquisition of digital files (clicking on the "Buy Now" button) as a sale of content.[61]

Fourth, the doctrine of exhaustion allows right holders to be remunerated for distribution of their works only once, after the first sale of copies or originals. This logic has been followed in *UsedSoft*[62] and in *Tom Kabinet*.[63] There is no valid reason to limit the functioning of reward theory in the digital domain.

Fifth, the negative effects of downstream commerce might be eased by voluntary remuneration systems. Stretching the limits of the exhaustion doctrine this way represents the good faith of service providers and a more balanced treatment of right holders' economic interests.

Sixth, George Orwell, when talking about introduction of the "cheap" ("sixpenny") Penguin books in the first half of the 20th century, noted that cheap books hurt trade as a whole.[64] The history of the book industry has evidenced that members of this industry can and do survive, even if the price of items decreases. It is more – rather than less – plausible that introduction of a digital exhaustion doctrine would not kill traditional forms in the copyright industry either. Indeed, businesses would respond with new business models.

Finally, Göbel has convincingly argued that the advance of lawful digital secondary markets would lead to an increase in prices of used copies and a decrease in prices of originals,[65] since investing more money in market expansion, advertising, or strengthening company goodwill would undoubtedly raise retailers' expenses. On the other hand, right holders could opt for a price reduction, in order to make original copies more attractive or to use their existing goodwill to entice consumers back.

The second significant aversion of right holders to a digital exhaustion doctrine is that it can lead to rearrangement of market powers, as downstream commerce should necessarily be dominated by new, competing service providers. Not surprisingly, dominant content distributors, such as Amazon or Apple, have taken immediate steps to patent their own forward-and-delete technologies. Amazon also introduced Kindle Unlimited in 2014. Right holders should be cautious, however, as monopolizing the market and preventing new actors from entering the market could potentially breach competition law.[66]

A third classic argument against the digital exhaustion doctrine is based on the premise that digital content can be reproduced infinitely at zero cost and without loss of quality.[67] Any such claim is implicitly based on the assumption that members of society are willing to copy protected materials for free.[68] There is nothing surprising in users reproducing works if they

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[61] Ibid. at 337.

[62] *UsedSoft v. Oracle* (2012) para. 63.

[63] Court of Appeal of Amsterdam, *Nederlands Uitgeversverbond and Groep Algemene Uitgevers v. Tom Kabinet*, 200 154 572/01 SKG NL:GHAMS:2015:66, 20 January 2015, [2015] Computer Law Review International 48.

[64] Milton Friedman, *Price Theory* (4th ed. Transaction Publishers 2008) 349.

[65] Alexander Göbel, 'The principle of exhaustion and the resale of downloaded software – the UsedSoft v. Oracle case [UsedSoft GmbH v. Oracle International Corporation, ECJ (Grand Chamber), Judgment of 3 July 2012, C-128/11]' [2012] European Law Reporter 228-229.

[66] Mario Cistaro, 'The interface between the EU copyright law and the fundamental economic freedoms of trade and competition in the digital single market: from the FAPL case to the decision in UsedSoft' [2016] Queen Mary Journal of Intellectual Property 146–151.

[67] Victor F. Calaba, 'Quibbles 'n Bits: making a Digital First Sale Doctrine Feasible' [2002] Michigan Telecommunications and Technology Law Review 7–9, 29; Ellen Franziska Schulze, 'Resale of digital content such as music, films or eBooks under European law' [2014] EIPR 13; Wolfgang Kerber, 'Exhaustion of Digital Goods: An Economic Perspective' [2016] ZGE / IPJ 161.

[68] Tomasz Targosz, 'Exhaustion in digital products and the 'accidental' impact on the balance of interests in copyright law'. In: Lionel Bently - Uma Suthersanen - Paul Torremans (Ed.), *Global Copyright - Three Hundred Years Since the Statute of Anne, from 1709 to Cyberspace* (Edgar Elgar 2010) 347.

can. Indeed, humans have a deep-rooted desire towards possession of culturally valuable goods – a desire that exists independently of the form of protected content.
However, differences between copying analogue or digital content have largely vanished since the spread of digital technologies. There is no greater danger in reproducing digital goods than analogue ones. Further, digital content also degrades over time, although markedly differently from analogue copies. The evolution of information technology inevitably makes file formats obsolete or files become useless for lack of proper software or hardware.[69] This type of evolution is surprisingly faster than degradation in the quality of tangible copies.
Therefore, the problem does not start here. It is more problematic when the costs of producing the original copies, that is, investment by right holders, cannot be refunded in the chain of commerce. However, this is not the case in a balanced digital exhaustion scenario.
Further, exhaustion covers all future resales of lawfully sold copies of protected subject-matter. No internal limitation applies regarding the exact number of future resales of the same copy. A right holder who fears the prospect of unlimited resales of copies of his works should apply a pricing strategy that reflects that very situation. Furthermore, it is not a prerequisite for applying the doctrine that resold copies should be inferior in quality to the originals. The fact that such inferiority was present in the analogue age should not automatically exclude digital copies from having a quality identical to the originals.

2.2. A Balanced Approach for a Digital Exhaustion Doctrine

In 2001, Joseph Liu argued that the right to transfer a digital copy is a bundle of interests under digital copy ownership.[70] Liu correctly saw that an unlimited right to transfer digital copies would clearly undermine the incentives of right holders.[71] He therefore named two distinct measures that are capable of balancing the different interests at stake. First, without using a precise expression, he noted that a fully automated forward-and-delete technology would be necessary for the functioning of the right to transfer a digital copy. This technology would prevent creation of a new permanent copy and, at the same time, it would guarantee that the original file is deleted simultaneously.[72] Second, this solution could also be backed by a bright-line fair-use ruling.[73]
The present author maintains that a balanced digital exhaustion doctrine can be achieved by a combination of technological measures and legal guarantees.
The first technological measure should be a unique ID number that is inserted in the metadata of each digital file sold lawfully by the original seller. Only digital files tagged with a unique ID number would be eligible for resale. The privilege of tagging files should be reserved to right holders and authorized retailers. This would guarantee that content is sold and acquired only through reliable sources.
The second measure should involve application of a workable forward-and-delete technology that is capable of managing unique ID numbers; to validate that a given file is not an illegal copy of protected subject-matter; to control transfer of files between parties; and to guarantee that no copies are retained by the reseller.
Alternatively, blockchain technology could be used to facilitate conclusion of smart contracts for the sale of digital goods. The most significant advantage of blockchain is that it can record

[69] Aaron Perzanowski - Jason Schultz, *The End of Ownership - Personal Property in the Digital Economy* (The MIT Press 2016) 181.
[70] Joseph P. Liu, 'Owning Digital Copies: Copyright Law and the Incidents of Copy Ownership' [2001] William and Mary Law Review 1349-1360.
[71] Ibid. at 1351 and 1355-1356.
[72] Ibid. at 1353.
[73] Ibid. at 1358-1359.

all data relating to a particular transaction in chronological order and all this data is stored and periodically synchronized on every computer that forms part of the network.[74] Such smart contracts guarantee that all transactions are valid and that former transactions cannot be invalidated.[75]

The combination of a unique ID number and forward-and-delete or blockchain technologies could guarantee that end-users can acquire and resell content that was first lawfully marketed by the right holder or any authorized retailers and that files can be effectively traced in downstream commerce. These could effectively guarantee that copies of works are resold in a visible and controlled way that forecloses unlawful duplication of content.

Workable forward-and-delete technologies are available on the market and numerous service providers sell media with unique ID numbers. Likewise, blockchain is already used, for example, by *OpenBazaar* to resell tangible goods over the internet. No technological obstacles exclude extension of the use of smart contracts to resale of digital files.

If digital second-hand markets are legalized, we could immediately be swamped by millions of digital files. However, is is unimaginable that this would generally destroy original marketplaces. First, it is plausible that only a limited number of works will be offered for sale via these systems, as end-users would most probably upload only their unused files and would keep the rest of their content for future enjoyment. Second, any broadening of the supply side would require lawful acquisition of further original copies by end-users. If no one purchases new files, then there would be nothing to resell either. Third, a significant number of end-users would continue to acquire cultural goods from original dealers rather than from downstream commerce, as these services will be far less viral than well-known brands such as iTunes or Amazon. Fourth, this model would not open the floodgates to unauthorized copies downloaded from illegal services. It would similarly be impossible for end-users to resell content ripped from their lawfully purchased CDs or DVDs, as the files stored on these data carriers have never been assigned a unique ID number. Finally, some might question why any right holder or intermediary would tag content sold by them with a unique ID number, since that would allow for later resale of those files. Doing so would be absolutely logical for at least two reasons. First, this way the unique ID number would work as electronic rights management information. Any attempt to remove or alter the unique ID number would lead to legal remedies under Article 12 of the WCT. Second, nothing prevents right holders/intermediaries from launching their own digital second hand markets. If societal demand exists for a given service (here, resale of used digital files), it is still a better option to remain in the whirlwind, rather than staying out of the business.

If a lawful user intends to sell a copy on digital marketplaces, then the operator of the market should effectively guarantee that the digital file is removed from the seller's computer and any connected devices. The seller is required to erase all permanent copies they created on external data carriers (including, but not limited to external hard drives, memory sticks, mp3 players, mobile phones). If the latter devices are used in offline mode, it is hard to prove the existence of unauthorized copies. Most probably, this situation lasts only for a limited period of time. If the user synchronizes the device with a computer connected to the digital marketplace, the forward-and-delete technology applied by the operator's software should detect the unauthorized copy. In such a case the operator should notify the user to expeditiously remove the given copy. If the end-user fails to comply with the notice, the operator should be entitled to block or at least limit access to the end-user's account.

The digital exhaustion doctrine should be regulated by national or international norms as well. These norms should explicitly refer to the transferability of intangible copies of protected

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[74] Aaron Wright and Primavera De Filippi, 'Decentralized Blockchain Technology and the Rise of Lex Cryptographia' (manuscript, available at SSRN: https://ssrn.com/abstract=2580664) 6–7.

[75] Ibid. at 7.

subject matter; the requirement of lawful acquisition of the given copy; and the obligation of the reseller to erase a copy sold via digital marketplaces.[76]

The above system balances the interests of right holders and end-users in downstream commerce. End-users, like property owners, are allowed to control the fate of the copies they acquire, and their private sphere is not unreasonably intruded on. In contrast, recurring but *ad-hoc* control of synchronized data carriers is a necessary way of protecting the interests of right holders. Similarly, a balanced approach to the digital exhaustion doctrine is cost-effective and restricts an influx of pirated copies to downstream commerce.[77]

[76] Targosz (2010) 351.
[77] Calaba (2002) 26–27.