

**To Be or Not To Be?**  
**Constructing a Digital Exhaustion Doctrine in the EU and US**

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**A thesis submitted to the Tilburg University in partial fulfilment of the  
requirements for the degree Masters in Law and Technology**

**Tilburg University**  
**2013-2014**

## **APPRECIATION**

I would like to thank you my supervisors, Mr Schellekens, Ms Purtova, Mr Dizon and Ms Vantsiouri for your help and patience. I have become a better student under your tutelage.

To my family, I am eternally grateful for your support. Your encouragement helped me pull through.

To my friends, my super awesome study group, you all are amazing.

My darling husband, this journey was easier with you by my side. Thanks for putting up with my student life!

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## CHAPTER 1

### MUCH ADO ABOUT EXHAUSTION

#### 1.1 INTRODUCTION

How much are the music mp3 files and eBooks on your device worth? In New York, the answer is ‘absolutely nothing’. In *Capitol Records LLC v ReDigi Inc.*<sup>1</sup>, the Court held that the resale would infringe copyright because it requires the making of ‘unauthorised’ copies, unless the sale is of the particular piece of hard drive the file was originally downloaded on. The result of this ruling is a ‘double-standard’ partitioning of a lawful owner’s rights with regards to a tangible copy, vis-à-vis a digital one.

The doctrine of exhaustion also known as the first sale doctrine in the US<sup>2</sup> is a limitation to the exclusive right of a rightsholder to disseminate her work. It gives users of protected work the right to resell their lawfully obtained copies of copyright works.<sup>3</sup> It was not created in vacuum. The courts saw a need to limit the rights of the rightsholder with regards to copies of their work which they had parted with.<sup>4</sup> The rationale behind the doctrine does not change simply because the medium of expression has.<sup>5</sup> We live in the digital age where everything is going digital. The preference for digital media over tangible copies is not irrational; they are unarguably more convenient; they are cheap to make, easy to distribute, weigh nothing and can be stored in multiple places at a time.

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<sup>1</sup> No. 12 Civ 95 RJS, 2013 WL 1286134 (SDNY Mar. 30, 2013) <<http://docs.justia.com/cases/federal/district-courts/new-york/nysdce/1:2012cv00095/390216/109/0.pdf?1364843783>> (hereafter ReDigi)

<sup>2</sup> For the purpose of this paper, they will both be referred to as the exhaustion doctrine except where a distinction needs to be drawn between both terms

<sup>3</sup> For EU legislation, see Council Directive 2001/29/EC of 22 May 2001 on the Harmonisation of Certain Aspects of Copyright and Related Rights in the Information Society [2002] OJ L167/10 Art 4(2) (hereafter referred to as Copyright Directive); For US legislation, see 17 USC s 109a

<sup>4</sup> The necessity of the doctrine was recognised as early as 1908 by the US supreme court in the case of *Bobbs–Merrill Co. v Straus*, 210 US 339 (1908) at 351 where the court, formulating the basis of the doctrine, held that allowing a rightsholder to restrict the resale of legally purchased works would amount to an extension of the scope of copyright beyond that provided in the copyright statute.

<sup>5</sup> The rationale behind the creation of the exhaustion doctrine is discussed in the second chapter.

The concept of ownership is metamorphosing in a way that tilts the scale almost completely in favour of the owner/rightsholder. With the evolution of Technological Protection Measures (TPMs) and other such technologies, rightsholders are finding more ways to interfere with users' interaction with the copyright work in order to gain the upper hand. Recent practices involve licensing of content through click-wrap agreements in place of transfer of ownership<sup>6</sup>. The problem with this is that licenses potentially limit the user's interaction with copyright work including the right to transfer. A licence allows the rightsholder to still exercise control over the content. Amazon's deletion of George Orwell's *Animal Farm* from kindle devices of some consumers, who had paid for the book, is a clear example of one of the dangers of this practice.<sup>7</sup> Since the exhaustion doctrine is only applicable where there has been a legal transfer of ownership, licensing allows circumvention of the doctrine<sup>8</sup>. It must be remembered that copyright does not exist solely to benefit the rightsholder. There should be a balance between competing interests on both sides. However, a discussion about the morality of licencing in order to maintain control is beyond the scope of this paper.

In copyright, the content and not the tangible medium of fixation through which such content is expressed is most important because what copyright protects is the content<sup>9</sup>. This is why a rightsholder maintains a copyright interest even after distribution of his copyrighted work or even destruction of same. Every new medium of fixation generates its own set of risks affecting different aspects of copyright. The invention of the printing press brought about the dissemination of ideas through books. Accompanying this was the possibility of large scale

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<sup>6</sup> A click-wrap agreement is a common type of agreement involving electronic media, most of which require the end user to show consent by clicking on an "ok" or "I agree" button. Refusing to do so usually means the user cannot use or purchase the product or service. Wikipedia < <http://en.wikipedia.org/wiki/Clickwrap>> accessed 29/11/2013

<sup>7</sup> Brad Stone 'Amazon Erases Orwell Book From Kindle' *The New York Times* (New York, 17 July 2009) <[http://www.nytimes.com/2009/07/18/technology/companies/18amazon.html?\\_r=0](http://www.nytimes.com/2009/07/18/technology/companies/18amazon.html?_r=0)> accessed 29/11/2013

<sup>8</sup> Legal ownership is one of the prerequisites for the doctrine to take effect. See footnote 3. See also *Vernor v Autodesk* 621 F.3d 1102 (9<sup>th</sup> Cir 2010); cf *Case C-128/11 UsedSoft GmbH v Oracle International Corp* [2012] OJ 2012/C 287/16

<sup>9</sup>See WIPO, *Understanding Copyright and Related Rights*. Available at <[http://www.wipo.int/export/sites/www/freepublications/en/intproperty/909/wipo\\_pub\\_909.pdf](http://www.wipo.int/export/sites/www/freepublications/en/intproperty/909/wipo_pub_909.pdf)> accessed 29/11/2013

duplication which increased piracy. The introduction of VCRs, photocopiers, scanners, compact discs and the likes also at the time of creation, posed a problem for copyright<sup>10</sup>. By adapting to technology, the law allowed the development of a new market for the exploitation of copyright works; the rental market. Digital media is no different from this. Differences in mediums of expression should not automatically mean the death of the exhaustion doctrine. Its underlying idea should not be abandoned. To do that would be exposing the users whom the doctrine was created to protect to the harm it sought to protect them from in the first place.

The aim of this thesis is to show that the purpose of copyright (whatever theory is adopted) will not be defeated by allowing exhaustion for works transferred over the internet.<sup>11</sup> As stated earlier, the rationale for the exhaustion doctrine has not changed and will not change irrespective of the medium used to express the ideas subject of copyright. The doctrine should be applied in a media-neutral fashion, in a way compatible with the chosen medium of expression without upsetting the delicate balance between competing interests. This is what ReDigi sought to do. Even though the methodology was different, the result was the same: only one copy in existence before and after the sale<sup>12</sup>. They transferred only lawfully acquired files, ensuring long after the transfer that the deleted file could not be reinstalled on any of the seller's synced devices.<sup>13</sup> Despite its laudable efforts, ReDigi was found liable for copyright infringement because it was not a sale of the 'particular' copy originally downloaded. The purpose and effect of the law should not be thwarted because of mere technicalities.

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<sup>10</sup> For example, see *Sony Corp. of America v Universal City Studio* 464 U.S. 417 (1984). Sony developed the Betamax tape recorder which allowed users to record TV programs for later viewing. Despite the fact that this involved technology that aided copying, the Court ruled such copying to be fair use and therefore allowed it.

<sup>11</sup> The theories on the purpose of copyright are discussed in the second chapter.

<sup>12</sup> *ibid*

<sup>13</sup> ReDigi (n 1) at 2-3

## 1.2 THESIS STATEMENT

The central research question which this thesis seeks to answer is: “Should a second-hand digital market for copyright works (in particular, music) be allowed?” In an attempt to answer this in the positive, it has been broken down into three sub-questions:

1. What purposes do copyright and the exhaustion doctrine seek to serve in the EU/US respectively?
2. Do the economic as well as public benefits of a digital second-hand market outweigh its inherent risks such as to render it necessary?
3. Is digital exhaustion feasible?

Answers to the above questions will be attempted in three chapters, the first of which will serve the purpose of laying the foundation. The first part of Chapter 2 will discuss the purpose of copyright, focusing on copyright theories in the US and EU jurisdictions.<sup>14</sup> The second part would discuss the doctrine of exhaustion and the first sale doctrine and compare the peculiarities inherent in both.

Chapter 3 addresses the second sub-question. To this end, it first analyses current case law regarding digital exhaustion in the EU and US in light of the rationale behind the creation of the exhaustion doctrine. It also considers arguments for and against the existence of digital exhaustion.

Chapter 4 will answer the final sub-question. Using Lessig’s modalities of regulation<sup>15</sup>, it proposes solutions for the adoption of a digital exhaustion doctrine that strikes a balance between the rights of the rightsholder and that of the user. After a brief examination of the consequence of

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<sup>14</sup> A discussion of the purpose of copyright in its entirety is beyond the scope of this thesis.

<sup>15</sup> Lawrence Lessig, *Code: And other laws of cyberspace*. (Basic Books (AZ), 1999)

a digital exhaustion doctrine, Chapter 5 concludes the thesis by stating the doctrine ought to be expanded to cover online transmissions.

The answers to the aforementioned research question and sub-questions will be the result of doctrinal research across multidisciplinary sources. The argument for the existence of a second hand digital market has different aspects to it. For example, from an economic perspective, the existence of a second hand market does not necessarily translate into trouble for the primary market. Apart from creating a favourable incentive to take up more risk, it frees up resources that can be re-spent in the primary market. A social argument can be raised that a second hand market helps to bridge the divide between the haves and have-nots. A lot of students depend on second hand textbooks because they cannot conveniently afford the original price of such books. Sometimes the book/cd/game may be difficult to access or even out of circulation. In such cases, a second hand market plays an unrivalled role. However, because this is a legal thesis, more focus will be placed on the legal aspects of this argument. It will feature a comparative analysis between the US and EU, particularly their case law and legislative instruments pertaining to copyright and the exhaustion doctrine as well as what the legal system can do to support this proposed market.

The goal of this thesis is to show that the research question ought to be answered in the positive, along with why and how it can be achieved. If the stage, where due to emerging technologies the exhaustion doctrine has more inherent risks than benefits, is ever reached, it should and would be abandoned. We are however still a long way from that.



## CHAPTER 2

### COPYRIGHT AND EXHAUSTION

#### 2.1. INTRODUCTION

As Maria Von Trapp sang in the movie ‘The Sound of Music’, the beginning is a very good place to start. Appreciating the underlying precepts of copyright as well as the exhaustion doctrine is necessary as they influence current and future copyright legislations. Aimed at discussing the purpose of copyright and exhaustion, this chapter is structured in three parts. The first part gives a general introduction to Copyright, discussing the basics such as The types of ‘works’ protected by copyright as well as the exclusive rights granted by copyright.

A more extensive examination of the rationale for its creation is done in the second part. As will be discussed within the chapter, there are different reasons for the existence of Copyright and these reasons spread across jurisdictions. Since this thesis argues that exhaustion ought to be allowed for digitally transmitted works and makes recommendations to that effect, understanding them is of utmost importance as any law made with regards to copyright must be able to stand when tested by the rationale of Copyright.

The third part is the focal point of this chapter. An in-depth analysis of the First Sale doctrine in the US as well as the doctrine of exhaustion in the EU is made. The applicability of the doctrine to online transmissions is treated in the next chapter. This chapter mainly focuses on its history and the role of the Courts in its formulation.

At the end of this chapter, a clear appreciation for the foundation of Copyright as well as the exhaustion doctrine in the EU and US would have been shown. Then shall the groundwork upon which the arguments in the subsequent chapters will be built, have been laid.

## 2.2 THE ABCs OF COPYRIGHT

Copyright is a legal term which refers to the rights of authors of intellectual creations in their literary and artistic works. It grants rightsholders the right to control certain uses of their creations for a defined period of time. Unlike other forms of Intellectual Property, copyright is automatic and needs no formality. An original work is protected as soon as it exists.<sup>1</sup> Art 2 BC gives a non-exhaustive list as to what may be protected by Copyright. In light of technological advances, the list has been expanded to even include computer programs.

Although Copyright laws are generally territorial, the desire for a basic level of convergence of copyright laws among nations led to the creation of multilateral International and Regional Treaties. There are about six multilateral International treaties relating to copyright but the ones most relevant to this thesis are the Berne Convention (BC), Trade-Related Aspects of Intellectual Property Rights (TRIPS) and the WIPO Copyright Treaty (WCT).<sup>2</sup> Signatories to these treaties are required to give effect to their provisions but are not obliged to implement more extensive laws than that required by the Treaties.<sup>3</sup> In the EU, the desire to ensure a uniform protection of works within the Union led to the adoption of the Copyright Directive<sup>4</sup> which ensured harmonisation, although at a minimum level, across the region.

Consequently, across various jurisdictions, there are basic uniform rights accorded to rightsholders. Understanding these rights is important because they determine what can be done

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<sup>1</sup>Art 2(2) BC provides: “It shall, however, be a matter for legislation in the countries of the Union to prescribe that works in general or any specified categories of works shall not be protected unless they have been fixed in some material form”

In the US, notice of copyright is required for all works published prior to 1989. Although registration is no longer a requirement for validity of copyright, a work must be registered prior to instituting an infringement suit. See Merges, Menell and Lemley, *Intellectual Property in the New Technological Age* (5<sup>th</sup> edn, Aspen Publishers 2010) 416 (hereafter Merges)

<sup>2</sup> The BC has 166 Signatories see [http://www.wipo.int/treaties/en/ShowResults.jsp?treaty\\_id=15](http://www.wipo.int/treaties/en/ShowResults.jsp?treaty_id=15) accessed 29/11/2013

As at March 2, 2013, 159 Countries were signatories to the TRIPS. See [http://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/org6\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm) accessed 29/11/2013

The WCT is in force in over 80 Countries including the US and EU. See [http://www.wipo.int/treaties/en/ShowResults.jsp?treaty\\_id=16](http://www.wipo.int/treaties/en/ShowResults.jsp?treaty_id=16) accessed 29/11/2013.

<sup>3</sup>Art 2 BC; Art 1 TRIPS; Art 5 WCT

<sup>4</sup> Council Directive 2001/29/EC Council of 22 May 2001 on the Harmonisation of Certain Aspects of Copyright and Related Rights in the Information Society [2001] OJ L167/10 (Copyright Directive)

and what must be avoided in order to avoid liability for copyright infringement.<sup>5</sup> These rights can be broadly grouped into two: Exclusive/Economic rights and Moral rights. They are discussed below.

### **2.2.1. Exclusive/Economic Rights**

These are rights which entitle the rightsholder to economic (often financial) rewards. They are also termed exclusive because they can, subject to some exceptions, only be exercised by the rightsholder or anyone authorised by her. They include the right to reproduction, distribution, public performance and derivative works.

#### *i) The Right of Reproduction<sup>6</sup>*

This has been referred to as the most fundamental of all rights.<sup>7</sup> Even as far back as the 15<sup>th</sup> century, the right to control and prevent the copying of a work existed.<sup>8</sup> Only a rightsholder can control the reproduction of a protected work, irrespective of whether the reproduced copy is permanent, transient, temporary or incidental to some other use of the work.<sup>9</sup> It also does not matter if the medium upon which it was originally fixed has changed, so long as the contents are replicated.<sup>10</sup> In the US and EU, this right extends to reproduction in part.<sup>11</sup>

#### *ii) The Right of Distribution<sup>12</sup>*

An original or subsequent copy of a protected work can only be distributed by the rightsholder or with her permission. Distribution, in this sense, is the act of putting into circulation copies of a protected work by or with the consent of the rightsholder. This right has been expanded to

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<sup>5</sup> Bently and Sherman, *Intellectual Property Law* (3<sup>rd</sup> edn, Oxford, 2009) 135 (hereafter Bently)

<sup>6</sup> Art 9 B.C.; Art 106 Copyright Act; Art 2 Copyright Directive

<sup>7</sup> Merges (n 1) 519

<sup>8</sup> See Mark Rose, *Authors and Owners: The Invention of Copyright* (Harvard University Press 1993) 9 (hereafter Rose)

<sup>9</sup> Bently (n 5) 138

<sup>10</sup> *ibid* 141

<sup>11</sup> See Art 3 Copyright Directive and s101 Copyright Act

<sup>12</sup> Art 106 Copyright Act; Art 4 Copyright Directive

include the rental and lending of copies of the work.<sup>13</sup> It is important to note that this right applies to each and every copy put into circulation.

*iii) The Right to Public Display or Performance*<sup>14</sup>

This right prevents display or performance to the public without the consent of the rightsholder. Performance in this sense includes reciting, playing, dancing, acting, showing or broadcasting the contents of a protected work through whatever means.<sup>15</sup> To “display” is to show a copy of a work, either directly or by means of a film, slide, television image, or any other device or process or, in the case of a motion picture or other audio-visual work, to show individual images non-sequentially.<sup>16</sup>

In the EU this is referred to as the right of communication to the public.<sup>17</sup> It is to be understood in a broad sense as covering all communication to the public not present at the place where the communication originates.<sup>18</sup> The performance must be carried out in public or be capable of being received by the public in order to infringe.<sup>19</sup> In the EU and US, ‘public’ is generally understood to mean persons outside family and friends.<sup>20</sup> Under this right, it is of no consequence whether or not they are capable of receiving the display in the same place and at the same time or if they do actually receive it.<sup>21</sup>

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<sup>13</sup> Art 11 and 14 TRIPS; S106(3) Copyright Act; Council Directive 2006/115/E of 12 December 2006 on rental right and lending right and on certain rights related to Copyright in the field of Intellectual Property OJ L376/28 (hereafter rental rights directive)

<sup>14</sup> Art 11 BC; s106(4) Copyright Act; Art 3 Copyright Directive

<sup>15</sup> S101 Copyright Act

<sup>16</sup> *ibid*

<sup>17</sup> Recital 23-24 Copyright Directive

<sup>18</sup> Recital 23 and 24 of the Copyright Directive; Case C-306/05 *SGAE v Rafael Hoteles SA* [2006] ECR I-11519, para 36

<sup>19</sup> *Id*; cf s 109(c) Copyright Act which allows the owner of a particular copy to display that copy publicly, not more than one image at a time to viewers present at the place where the copy is located.

<sup>20</sup> S 101 Copyright Act; Joined Cases C-03/08 and C-429/08 *Football Association Premier League Ltd and Others v QC Leisure and Others* [2011] ECR I-9083 (hereafter *Murphy case*), para 197 where the Court held for an infringement of this right, it must be a new set of public not considered by the rightsholder when they authorised the use of the protected work by the communication to the original public

<sup>21</sup> *ibid*.

#### *iv) The Right to create Derivative Works*<sup>22</sup>

A derivative work is a work based upon one or more pre-existing works. These include translations, abridgements, adaptations, or other such modifications of protected works.<sup>23</sup> Only a rightsholder may prepare or authorise the preparation of derivative works. Where a derivative work has sufficient originality in itself, it would be protected by copyright. The protection granted is only for the new materials included and not the pre-existing material.

#### *Limitations to Exclusive Rights*

As stated earlier, exclusive rights are subject to exceptions and limitations. For example, US copyright law allows derogations where they are considered ‘fair use’.<sup>24</sup> Article 5(3) of the Copyright Directive also lists situations where Member States may allow exceptions and limitations (for example, for educational purposes, criticism or reviews and so on).<sup>25</sup> One limitation applicable in both jurisdictions is the exhaustion doctrine. In the US and EU as well as most jurisdictions, the distribution right is limited to the first sale or distribution of a copy of the work. This exception is central to the thesis and will be discussed in more detail later in the chapter.

### **2.2.2. Moral Rights**

Moral rights are rights granted to protect the rightsholders’ noneconomic interests. They include the right to claim authorship of the work and to object to any distortion, mutilation, modification of, or other derogatory action in relation to, the said work, which would be prejudicial to her

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<sup>22</sup> Art 12 BC

<sup>23</sup> 17 USC s 101

<sup>24</sup> What constitutes fair use is generally determined by 4 factors: i) the purpose and character of the use, including whether it is for commercial or non-profit educational purposes, ii) the nature of the work, iii) the amount and substantiality of the portion used in relation to the work as a whole and finally iv) the effect of the use upon the potential market for or the value of the work as a whole. An example is personal use. See S. 107 Copyright Act

<sup>25</sup> However, the exercise of these exceptions must not conflict with a normal exploitation of the work or other subject-matter and do not unreasonably prejudice the legitimate interests of the rightsholder. See Art 5(5)

honour or reputation.<sup>26</sup> In the US and EU, these rights are maintained for the entire term of copyright, even after the death of the rightsholder.<sup>27</sup>

The exclusive and moral rights are common to US and EU copyright laws however, their scope of execution differs in that some are more extensive than the others.<sup>28</sup> This is largely because of what is perceived as the rationale for copyright in the different jurisdictions since the rationales influence the means of protection adopted or proposed.

### **2.3 RATIONALE FOR COPYRIGHT.**

An analysis of the rationale for copyright is important because understanding why these works need protection explains why they are protected the way they are and how they ought to be protected in the digital age. There are three major theories for the justification of Copyright. They are the utilitarian theory, the rewards theory and the natural rights/labour theory.<sup>29</sup>

#### *1) UTILITARIAN THEORY*

This is an incentive-based theory. It posits that Copyright exists for benefit of the public.<sup>30</sup>

Books, music, art and such other works are of great value to the public, existing to enhance public good. Without incentive, there may be a reduction in the production of such works because although creating a work can consume a lot of time and energy, reproducing it usually takes a lot less. By providing a legal means through which creators of cultural and informational works are assured of recouping their investments as well as recap profits proportional to the popularity of their works, the production and dissemination of such work is encouraged.<sup>31</sup>

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<sup>26</sup> Art 6bis BC; s106A Copyright Act; Recital 19 Copyright Directive

<sup>27</sup> Recital 19 Copyright Directive; 17 U.S.C. s106A(d)

<sup>28</sup> For example, in the US, moral rights are statutorily recognised for only works of visual arts. Even then, where the work was created prior to June 1, 1991 it would only be protected if the artist retained a copy. See Merges (n 1) 578

<sup>29</sup> Bently (n 5) 38-39 adds two more categories: neo-classical economics (which justifies the protection of virtually all things 'virtue') and Democratic Argument (which sees copyright as a way of strengthening democratic institutions by promoting public education, self-reliant authorship and robust debate)

<sup>30</sup> Tritton refers to this as the doctrine of Public justification. See Guy Tritton, *Intellectual Property in Europe* (3<sup>rd</sup> edn, Sweet & Maxwell 2008) 638 (hereafter Tritton)

<sup>31</sup> Bently (n 5) 37

This is the predominant theory in the US where the constitution grants Congress the power to “promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries”.<sup>32</sup> This has also been reflected by case law. In *Twentieth Century Music Corp v Aiken*<sup>33</sup>, the court held:

...The immediate effect of our copyright law is to secure a fair return for an "author's" creative labor. But the ultimate aim is, by this incentive, to stimulate artistic creativity for the general public good. "The sole interest of the United States and the primary object in conferring the monopoly," this Court has said, "lie in the general benefits derived by the public from the labors of authors.

This theory has been criticized firstly on the grounds that an incentive is not ultimately necessary to encourage the production of works.<sup>34</sup> Not all authors write for economic gains. Secondly, even if there is a need for incentive, are economic incentives appropriate? The third criticism is based on deciding what incentive is optimal.<sup>35</sup>

## II) REWARD THEORY

The theory is based on the notion that an author ought to be compensated for the time and effort expended in the creation of the work and making same available to the public.<sup>36</sup> In this sense, copyright is the society’s way of saying ‘thank you’. This is not to be confused with the incentive theory. While the incentive theory sees copyright as a means to an end (to encourage production and dissemination of works), the reward theory sees the reward as the end in itself.<sup>37</sup>

This is the predominant theory within the EU where recital 10 of the Copyright Directive states:

“If authors or performers are to continue their creative and artistic work, they have to receive an appropriate reward for the use of their work, as must producers in order to be able to finance this work. The investment required to produce products such as phonograms, films or multimedia products, and services such as "on-demand" services, is considerable. Adequate legal protection of intellectual property rights is necessary in

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<sup>32</sup> Art 1 Sec 8 of the US Constitution; See also *Wheaton v Peters* 33 US (8 Pet.) 591 (1834). For further discussion on this issue, see generally Jane C. Ginsburg ‘A Tale Of Two Copyrights: Literary Property In Revolutionary France And America’ (1990) 64 Tul. L. Rev 991

<sup>33</sup> 422 US 151, 156 (1975)

<sup>34</sup> Bently (n 5) 37; Tritton (n 26) 638 refers to this as the doctrine of private justification

<sup>35</sup> Bently at 38 “what should a copyright owner be able to prevent another person from doing and for how long?”

<sup>36</sup> Bently at 3

<sup>37</sup> Ibid. It should also not be confused with the Lockean theory. This is discussed later.

order to guarantee the availability of such a reward and provide the opportunity for satisfactory returns on this investment.”

This theory has been critiqued on two grounds. First, are the rewards commensurate to what they actually deserve? Not all works deserve the same level of protection. Secondly, why must the reward be an exclusive right? Other rewards with fewer social and economic costs can be granted.<sup>38</sup> It has been argued that a property right would be preferred as the society would be the determinants of who gets rewarded and the size of the reward.<sup>39</sup>

### *III) NATURAL RIGHTS/LABOUR RIGHTS THEORY*

According to proponents of this theory, Copyright exists to protect works because works are a result of intellectual efforts to produce them. They are therefore worthy of protection accorded to personal property. There are two major consequences of this theory. Firstly, a right to attribution must exist: which means that a person must be recognised as the author of her work and not someone else. Secondly, there is a right to integrity which prevents distortions, mutilations, modifications of the work as well as actions prejudicial to the author’s honour or reputation.<sup>40</sup>

There are two accounts of this theory. The first is the Personhood theory which has its origins in the writings of Hegel and Kant.<sup>41</sup> According to them, a ‘work’ is a product of the author’s mental and technical ability and consequently, an expression of an author’s personality. This theory is the underlying idea behind the existence of ‘moral rights’ which originated in France, gradually spreading to other parts of Europe and the world.<sup>42</sup>

The second version is Locke’s Labour theory, based on his idea of man having a property in his own person. When an individual separates materials from their natural state and mixes them with

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<sup>38</sup>Ibid. For example, Nobel Prize in Literature

<sup>39</sup> ibid

<sup>40</sup> See generally, Art 6bis

<sup>41</sup><http://cyber.law.harvard.edu/copyrightforlibrarians/Introduction> accessed 29/11/2013

<sup>42</sup> See generally Ginsburg (no 30); See also Joined cases C-241/91 P and C-242/91 P *RTE and ITP v Commission of the European Communities* [1995] ECR I-00743, para 28 where moral rights were recognised as one of the essential functions of Copyright



his labour and something that is his own, he creates a property to which no one else but himself has a right to.<sup>43</sup> An author thus ought to have a right over creation of her intellectual labour.<sup>44</sup>

Although similar to the rewards theory, both should not be confused. The Lockean theory focuses more on the ‘self’ of the author put into the creation of the work. Thus, a work is protected because of the piece of herself an author has put into the work. Under the rewards theory, the element of ‘self’ is missing. The Lockean theory is also dominant in the US.<sup>45</sup>

The natural rights theories have been criticized on various grounds. While some reject completely the notion of ‘natural rights’, others question its extension to copyright. A third ground is that even if the work is recognised as a work of intellectual labour, why is it protected by more than a right over the manuscript or immediate creation?<sup>46</sup>

### **2.3.1 APPRECIATING THE THEORIES**

As stated earlier, these theories give a clue to the logic behind the differing scope of protection amongst different jurisdictions. For example, a society in favour of the utilitarian theory is more likely to enforce economic rights over the moral theory while one in favour of the reward theory may seek a balance between the economic rights and the moral rights.<sup>47</sup> The natural rights theory would suggest that an author’s right must not be neglected in favour of the interests of the public. A clear example is France, which statutorily recognises moral rights in all works as perpetual, inalienable and transferable upon death.<sup>48</sup>

In reality, while one theory may be more dominant than another within a jurisdiction, no theory is applied in isolation. Copyright regimes are more or less influenced by a hybrid of these theories. Going back to the US example, even though their copyright law is understood as

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<sup>43</sup> Rose (n 8) 5

<sup>44</sup> This version is strongly represented in US literature See Bently (n 5) 36

<sup>45</sup> Merges (n1) 419

<sup>46</sup> Bently (n 5) 36

<sup>47</sup> For example, The CJEU held, in the *RTE case* (ibid n 29), that the protection of moral rights as well as ensuring a reward for the author’s creative effort is the essential function of Copyright.

<sup>48</sup> Art L121-1 Code de la propriété intellectuelle (French Copyright Law)

primarily utilitarian, moral rights are still recognised and protected by its laws. Even the EU which recognises the sanctity of moral rights understands the need for incentives to stimulate creation. The exhaustion doctrine should not be understood as an ‘either/or’ situation but rather should be viewed as a hybrid of different rationales.

## **2.4 THE DOCTRINE OF EXHAUSTION**

Despite the difference in nomenclature, the first sale (US)/exhaustion (EU) doctrine serve the same purpose; limiting the rightsholder’s exclusive right of distribution. A rightsholder cannot control further distribution of a protected work once it has been disseminated by her or with her permission. Even though the terms may be used interchangeably, there are differences in their scope of application. An analysis of their history may help explain these differences.<sup>49</sup>

### **2.4.1 The First Sale Doctrine (US)**

#### ***2.4.1.1 History***

First enunciated in 1908, the foundation of the first sale doctrine dates as far back as 1854. In *Stevens v Royal Gladding*<sup>50</sup>, the U.S. Supreme Court recognised the rightsholder’s right in a work as distinct from her right in the material object work embodying the work. The plaintiff produced and owned the copyright in a map of Rhode Island. In execution of a judgement against him, the copperplate engraving of the map was sold to a third party who printed and sold the maps without the plaintiff’s permission. The defendant purchased and sold these maps. The defendant argued that the copperplate engraving, having been sold to a third party, entitled him to print and sell the maps. The Court disagreed on the grounds that there was no necessary connection between the copyright and the plate as they were “distinct subjects of property, each capable of existing, and being owned and transferred, independent of the other.”<sup>51</sup> The

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<sup>49</sup>The US will be discussed first because they have earlier recorded case law than the EU.

<sup>50</sup>58 US 447 (1855)

<sup>51</sup> ibid 452

implication of this distinction was gradually expanded<sup>52</sup> and eventually led to the express recognition of the first sale doctrine in the case of *Bobbs-Merrill v Strauss*.<sup>53</sup>

In that case, the appellant owned the copyright in a novel “The Castaway”. Below the copyright notice printed in the book, the following notice was inserted:

The price of this book at retail is one dollar net. No dealer is licensed to sell it at a less price, and a sale at a less price will be treated as an infringement of the copyright.

The Bobbs-Merrill Company

The defendants purchased copies of the book to sell at retail from wholesale distributors who had obtained their copies from the plaintiff either directly or through their licensees. At the time of purchase, the defendants knew that it was a protected work and were familiar with the price restriction clause printed within. The defendants however sold copies of the book for 89c per copy without the plaintiff’s consent.

Bobbs-Merrill sued for copyright infringement, alleging that sale at a price lower than the stipulated price of \$1 was a violation of its exclusive right to vend. He alleged that the granting of a sole right to vend by the statute was tantamount to the vesting of the whole field of the right of exclusive sale which entitled him to part with the work, subject to conditions or restrictions on the purchaser or even withhold it completely, if he pleased.<sup>54</sup> Rejecting this argument, the Court held that the right to vend had already been exercised by the first sale of the book in quantities and at a price satisfactory to it. Looking into the legislative intent, the Court went further to say

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<sup>52</sup> *Harrison v Maynard, Merrill & Co* 61 F. 689 (2d Cir. 1894); *Doan v American Book Co* 105 F. 772, 776-77 (7th Cir. 1901)

<sup>53</sup> 210 US 339 (1908)

<sup>54</sup> *Ibid* at 349

extending the right to control future sales would give a right not included in the statute and thus result in an expansion beyond what was intended.<sup>55</sup>

The following year, Congress expressed their approval of the above decision by codifying the first sale doctrine in the 1909 Copyright Act. The doctrine is currently codified in section 109(a) of the 1976 Copyright Act which reads as follows:

Notwithstanding the provisions of section 106 (3), the owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord.

#### **2.4.1.2 Analysis**

The first point to note is that the first sale doctrine is a limitation on the right of distribution only, which is encoded in Section 106(3) of the Act.<sup>56</sup> Secondly, it applies only to the ‘particular’ copy. This means that the doctrine applies only to the exact copy purchased and not a replica. The reason for this is to prevent the doctrine from running afoul of the exclusive right of reproduction. Furthermore, the party seeking to avail herself of the doctrine must be the owner of the copy. Mere possession is not enough. This is why licensees cannot exercise the rights granted by this exception.<sup>57</sup>

Finally, such copy must have been lawfully made. What exactly does ‘lawfully made under this title’ mean? The Supreme Court had to examine the relevance of the place of manufacture and first sale in *Kirstaeng v John Wiley*.<sup>58</sup> In that case, the respondent, a publisher of academic textbooks had authorised its Asian subsidiary to publish, print and sell English textbooks abroad.

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<sup>55</sup> Ibid at 351

<sup>56</sup> Section 109(a)

<sup>57</sup> *Autodesk v Venor* 621 F.3d 1102 (9th Cir. 2010)

<sup>58</sup> 133 S. CT 1351 (2013) (hereafter *Kirstaeng*)

Prior to this, there had been conflicting decisions from the Circuit courts. See *Sebastian International, Inc. v Consumer Contracts Ltd* 847 F.2d 1093 (3d Cir. 1988); cf *BMG Music v Perez* 952 F.2d 318 (1991); *Parfums Givenchy, Inc. v Drug Emporium, Inc.* 38 F.3d 477 (1994)

The sale of foreign (printed in Asia by the subsidiary) editions were geographically restricted to Europe, Africa, Asia and the Middle East. It was obvious that the US Copyright Act was to apply to both the Foreign and American editions.<sup>59</sup> Kirtsaeng purchased copies of foreign editions of Wiley's English textbooks from Thailand where they were sold at a much lower price and sold them in the US for profit. Wiley brought a suit against Kirtsaeng for infringement of their exclusive right to distribute. They argued that Kirtsaeng's first sale defence was not applicable to imported goods. The Supreme Court disagreed. By a 6-3 majority the Court found that the wording of the statute as well as an examination of the legislative's intention in creating that statute did not envisage a geographical restriction for the statute. The result of this is that the geographical scope of the doctrine in the US is international.

It has been suggested that the court's interpretation of the phrase 'lawfully made under this title' means "the first-sale doctrine includes no geographic limitations, so long as the copyrighted work was lawfully made somewhere."<sup>60</sup> Such a conclusion is far-reaching. In reaching its decision, the Court considered a number of factors, one of which was the fact that the American company John Wiley & Co had authorised the book to be published, printed and sold by their Asian subsidiary.<sup>61</sup> Secondly, the court compared copies of the Foreign and American editions. It was clear that the rightsholder intended that US law should govern.<sup>62</sup> All these read together show a work intended by its author to be subject to the US Copyright Act. Thus, a proper interpretation of "lawfully made under this title" would be "made in accordance with" or "made in compliance with" the provisions of the Copyright Act.

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<sup>59</sup> Both editions contained a clause that read "No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means . . . except as permitted under Sections 107 or 108 of the 1976 United States Copyright Act."

<sup>60</sup>See "*Kirtsaeng* and the First-Sale Doctrine's Digital Problem" <<http://www.stanfordlawreview.org/online/kirtsaeng-and-first-sale-doctrines-digital-problem>> accessed 29/11/13

<sup>61</sup> *ibid*

<sup>62</sup>Kirtsaeng (n 59)

### 2.4.2 The Doctrine of Exhaustion (EU)

The Doctrine of exhaustion as it exists in the EU is a court-developed doctrine. A proper examination shows that the main rationale for the doctrine is to balance the rights of the rightsholder with the need to achieve a single internal market within the Union, free from barriers.<sup>63</sup> Once a rightsholder puts his product on the market within the Union and receives his reward, he should not be allowed to prevent further circulation of that product from one member state to another within the Union.<sup>64</sup> This conclusion is easily reached through an analysis of the statutes and existing case law.

The doctrine of exhaustion is statutorily provided for in Article 4(2) of the Copyright Directive. It states as follows:

“The distribution right shall not be exhausted within the Community in respect of the original or copies of the work, except where the first sale or other transfer of ownership in the Community of that object is made by the rightholder or with his consent.”

#### 2.4.2.1 ANALYSIS

Perhaps the most note-worthy aspect of the doctrine, Article 4(2) confines the doctrine of exhaustion within the Union. One of the fundamental objectives of the European Union is to achieve a single internal market.<sup>65</sup> To this end, Article 34 of the TFEU<sup>66</sup> prohibits quantitative restrictions on imports and all measures having equivalent effects.<sup>67</sup> The Court was quick to find unlawful anything that hampered the free movement of goods within the EU. Prior to the creation of the European Union, the doctrine of exhaustion existed in several national legislations of Member States. This meant that there were various levels of fragmentation amongst member

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<sup>63</sup> Tritton (n 26) 639

<sup>64</sup> Id. see Case 119/75 *Terrapin (Overseas) Ltd v Terranova Industrie CA Kapferer & Co* [1976] ECR 1039; Joined cases 55/80 and 57/80 *Musik-Vertrieb Membran v GEMA* [1981] ECR 147

<sup>65</sup> Art 26 and 27 TFEU. see also *Grundig Case* Joined Cases 56 and 58-64 [1966] ECR 299

<sup>66</sup> Formally Art 28 of the EC Treaty

<sup>67</sup> Art 36 (former Art 30 EC Treaty) contains some exceptions. It reads: “The provisions of Articles 34 and 35 shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of... protection of industrial and commercial property. Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States.”

states. What the Court did was to interpret existing legislation in a way that allowed for a community-wide exhaustion. The *Deutsche Grammophon*<sup>68</sup> case was one of the earliest cases in which the Court established the doctrine of exhaustion relating to copyright as a community-wide scheme whose essence was to promote the internal market.

Deutsche Grammophon (DG) produced gramophone records. Its licensees were bound by a price agreement clause placed in an undertaking. Metro obtained a licence through Polydor, one of DG's subsidiaries without a written agreement. Thus it was not bound by the price fixing agreement. Upon discovery, DG sought to get Metro to sign the undertaking which it refused to do. Consequently, DG terminated all commercial relations with Metro. Metro then purchased copies of the gramophone from a third party and sold them at a price lower than the recommended price in Germany. The copies had been made in Germany by DG who then transferred them to Polydor in Paris who through an undertaking distributed them to the third party in another country from whom Metro purchased the copies. DG brought this action against Metro on the grounds that their actions constituted an infringement of their distribution right as guaranteed under German law which were not exhausted because the sale took place abroad and not within Germany. The German Courts referred questions to the CJEU one of which was whether an interpretation of German law that would allow DG rely on its distribution right to prevent the sale in Germany of records it had personally supplied to its French subsidiary (which although independent at law was commercially wholly subordinate to it) was contrary to the provisions of the EEC Treaty prohibiting actions incompatible with the common market. The Court held that Article 36 of the EC Treaty<sup>69</sup> lays down a boundary between the existence of

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<sup>68</sup> Case 78/70 *Deutsche Grammophon Gesellschaft mbH v Metro-SB-Großmärkte GmbH & Co. KG*[1971] ECR 487(hereafter *Deutsche Grammophon*)

<sup>69</sup> Now Art 36 of the TFEU

rights relating to property and the exercise of those rights in a way contrary to the achievement of a common market.<sup>70</sup> According to the Court:

...Although it permits prohibitions or restrictions on the free movement of products, which are justified for the purpose of protecting industrial and commercial property, Article 36 only admits derogations from that freedom to the extent to which they are justified for the purpose of safeguarding rights which constitute the specific subject-matter of such property.<sup>71</sup>

The Court further said:

If a right related to copyright is relied upon to prevent the marketing in a Member State of products distributed by the holder of the right or with his consent on the territory of another Member State on the sole ground that such distribution did not take place on the national territory, such a prohibition, which would legitimize the isolation of national markets, would be repugnant to the essential purpose of the Treaty, which is to unite national markets into a single market.<sup>72</sup>

This was re-iterated in the landmark case of *Centrafarm v Sterling Drug Inc.*<sup>73</sup> Although related to patents, this case is fundamental in understanding the rationale for the doctrine of exhaustion as it exists in the EU. The Court held:

Whereas an obstacle to the free movement of goods of this kind may be justified on the ground of protection of industrial property where such protection is invoked against a product coming from a Member State where it is not patentable and has been manufactured

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<sup>70</sup> Deutsche Grammophon at 496

<sup>71</sup> Para 11 at 500

The 'specific subject matter' deals with reward of an IPR. It is the right to first place the product on the market which serves the purpose of rewarding the owner of such right. See Tritton at 650-51

<sup>72</sup> Para 12 At 500

<sup>73</sup> Case 15/74[1974] E.C.R. 1147



by third parties without the consent of the patentee and in cases where there exist patents, the original proprietors of which are legally and economically independent, a derogation from the principle of the free movement of goods is not, however, justified where the product has been put onto the market in a legal manner, by the patentee himself or with his consent, in the Member State from which it has been imported, in particular in the case of a proprietor of parallel patents.<sup>74</sup>

From the above cases it appears that at the time of its recognition internal market, not the author was core in the evolution of the doctrine at Union level. Allowing Member states to maintain their different scopes of exhaustion would have dampened efforts to develop a strong internal market. The best way to protect the internal market was to create a regional exhaustion doctrine.

The doctrine of exhaustion makes a distinction between the distribution right and other exclusive rights. Article 3(3) explicitly states that the right of communication to the public or making available to the public is not subject to exhaustion. The reason behind this is not far-fetched. The CJEU has recognised the essential function of Copyright as the protection of rightholder's moral rights and as a means of ensuring a reward for the creative effort.<sup>75</sup> In *Coditel v S.A. CinéVog Films*<sup>76</sup>, the Court considered the peculiar nature of public performance. In that case, CinéVog had exclusive distribution rights to a film in Belgium which it showed in cinemas. By contract, the film was not to be transmitted by Television until 40 months after it was first shown in Belgium. Coditel, a Belgian Cable television distribution service, picked up from Germany, signals of the film being transmitted on TV and broadcasted same in Belgium. German Television had the right to show the film. The Court held:

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<sup>74</sup> Ibid paras 10-11 at 1162-3

<sup>75</sup> Joined cases C-241/91 P and C-242/91 P *RTE and ITP v Commission of the European Communities* [1995] ECR I-00743

<sup>76</sup> Case 62/79 [1980] ECR 00881

A cinematographic film belongs to the category of literary and artistic works made available to the public by performances which may be infinitely repeated...

In these circumstances the owner of the copyright in a film and his assigns have a legitimate interest in calculating the fees due in respect of the authorization to exhibit the film on the basis of the actual or probable number of performances and in authorizing a television broadcast of the film only after it has been exhibited in cinemas for a certain period of time.<sup>77</sup>

The doctrine also does not apply to rental rights. In *Warner Bros v Christiansen*,<sup>78</sup> the Court, recognising the difficulty which film makers would encounter in guaranteeing a remuneration reflecting the number of times which the video-cassettes are actually rented out as well as securing a satisfactory share of the rental market for them, rejected the argument for exhaustion of rental rights.<sup>79</sup>

As can be seen from the above, the doctrine and its scope in the EU is largely influenced by the need to promote a strong internal market. Whether or not a rightsholder can consent to international exhaustion is highly doubtful. Quite recently, the Court held that Member States are not permitted to grant any exhaustion other than a Community-wide one.<sup>80</sup> The interests of the rightsholders must be protected but not beyond what is necessary to safeguard their rights.<sup>81</sup> The restrictions placed by the treaty do not automatically translate into restraints on economic activities which protect intellectual property except where that constitutes a means of arbitrary discrimination or disguised restriction on trade between member states.<sup>82</sup>

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<sup>77</sup> Ibid, paras 12-13.

<sup>78</sup> Case 158/86 [1988] ECR2605

<sup>79</sup> See C-61/97 *FDV v Laserdisken* [1998] ECR I-5171. See also Art 1(3) Rental rights Directive

<sup>80</sup> C-479/04 *Laserdisken ApS v Kulturministeriet* [2006] ECR I-8089

<sup>81</sup> *UsedSoft v Oracle* C 287/16, para 62

<sup>82</sup> *Centrafarm* (n 73)

## **2.5 CONCLUSION**

Bearing in mind the different reasons that have been behind the grant of exclusive rights as well as the doctrine of exhaustion in the EU and US, it is easy to understand why their laws are shaped the way they are. The doctrine in the US exists for the benefit of the consumer, preventing restriction on alienation of lawfully acquired property. To this end, the Courts have interpreted the doctrine quite broadly, even going as far as interpreting the law to allow exhaustion on an international scale. The EU laws go in another direction. They are aimed at helping the EU achieve one of its fundamental objectives; a common internal market. Consequently, unlike the broad geographical definition given to the doctrine by the US, the EU has confined the application of the doctrine to within the Union.

So far, it has worked for them. However, technological advances have always sought to push the boundaries of Copyright and this time is no exception. With the emergence of digital media and the ever-growing trend of digital transmission of protected works, the suitability of the exhaustion doctrine as it currently is has been called into question. The next chapter will focus on the interpretation of the doctrine by Courts in light of new technology. Considering the US is consumer oriented, will it favour exhaustion of digitally transmitted media? Since the EU is focused on regional exhaustion, is exhaustion for digitally transmitted media feasible seeing as there are no borders in the digital world? The evolution of cloud computing even makes this more difficult as location in the clouds is quite difficult to pin point. These are the issues to be examined in the forthcoming chapters.

## CHAPTER 3

### Exhaustion and the Online World

#### 3.1 INTRODUCTION

Development of technology has always pushed the boundaries of Copyright. Since the advent of the Internet, the exhaustion doctrine has been dying a slow death which has only become more apparent in recent years following the shift towards digitization. The previous chapter discussed the reason behind the creation of copyright as well as the exhaustion doctrine in the US and EU. This chapter will build on that. The aim is to understand how the doctrine is currently interpreted in view of progressing trends in media dissemination (online distribution in particular) as well as evolving technology. It examines the innovative ideas of two companies; ReDigi (US) and UsedSoft (EU) and the Court's opinion of their business model in light of existing laws. As will be shown afterwards, the existence of a digital exhaustion doctrine is not as clear cut as it sounds.<sup>1</sup> Contrary to the black and white picture often presented, there are a lot of grey areas in between. There are a number of factors that must be considered in this debate. What will be considered as the right answer to the question of whether or not a digital exhaustion doctrine should exist, will depend in the weight of these factors when pitted against each other. The chapter discusses the arguments raised for and against the extension of the exhaustion doctrine to online transmitted works.

The ReDigi case will be discussed first because it is more recent and then after, the UsedSoft case. Both decisions will be compared as a comparison will further highlight the differences in the doctrines and their application on the two jurisdictions. The arguments against digital exhaustion are followed by counter arguments highlighting the roles to be played by the exhaustion doctrine in the online world. The chapter concludes by stating the CJEU got it right

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<sup>1</sup> The term 'digital exhaustion' was coined by Perzanowski and Schultz in their paper 'Digital Exhaustion'. See Aaron Perzanowski and Jason Schultz, 'Digital Exhaustion'(2010) 58 UCLA L. Rev 889 (hereafter Digital exhaustion)

by allowing the existence of digital exhaustion especially as it is still a necessary instrument in balancing the rightsholder's interest with that of the users.

### 3.2 REDIGI'S DILEMMA

Redigi was sued by Capitol Records on the grounds that ReDigi's business infringed their copyright.<sup>2</sup> Redigi, an online company, describes itself as the world's first pre-owned digital market place. To sell music, users must download and install Redigi's 'Music Manager' The Music Manager makes use of a 'verification engine' to confirm the music file is from an eligible source, in this case, either iTunes or the ReDigi market place.<sup>3</sup> Transfer of the file from the user's computer to the cloud locker is done in packets so that data does not exist in two places at the same time.<sup>4</sup> Upon transfer to the cloud storage, ReDigi, using technological measures, ensures that any additional copies of the file are deleted from the user's computer and synced devices. In the end, only one copy of the file exists and that is the copy in the user's cloud space<sup>5</sup>. Once uploaded, the file undergoes a second round of eligibility verification to ensure that it has not been tampered with nor offered for sale by another user. Upon completion of a sale, the seller's access to it is terminated. Even after the transfer, ReDigi employs technological measures to monitor the seller's computer and devices so that he cannot retain previously sold music or music uploaded for sale on his computer or synced devices. Where such a copy is discovered, Redigi sends a notice requesting the file to be deleted. Where such notice is ignored, the user's account may be suspended or even terminated<sup>6</sup>. The cost of music files range from 59 to 79 cents each. The remuneration earned is shared between the seller (20%), the artist<sup>7</sup> (20%) and Redigi (60%).

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<sup>2</sup> *Capitol Records v ReDigi* No. 12 Civ 95 RJS, 2013 WL 1286134 (SDNY Mar. 30, 2013). <<http://law.justia.com/cases/federal/district-courts/new-york/nysdce/1:2012cv00095/390216/109>> accessed 29/11/2013 (hereafter referred to as ReDigi )

<sup>3</sup>ReDigi (n 2) at 2

See Matt Peckham "The Double Standard in the Room: ReDigi and the (Now Illegal) Resale of MP3s" TIME (April 02, 2013) <<http://techland.time.com/2013/04/02/the-double-standard-in-the-room-redigi-and-the-now-illegal-resale-of-mp3s/>> accessed 29/11/2013

<sup>4</sup> ReDigi (n 2) at 2

<sup>5</sup> ibid

<sup>6</sup> ibid

<sup>7</sup> Redigi (n 2) at 3

It is unclear whether there is a prior agreement with the rightsholder as to the placing of the song on the marketplace or as to the percentage.

Capitol Records considered Redigi's business an infringement on their reproduction and distribution rights. The issue was not whether or not the first sale doctrine applies to digital works but whether or not the transfer of such works over the internet is covered by the first sale doctrine.<sup>8</sup> While Redigi argued that uploading to their server (the only copying that occurred) was nothing more than space shifting which was recognised by law and covered by fair use and the first sale doctrine, Capitol records argued that such space shifting was not what the law envisaged and in fact ReDigi's business is prohibited by Copyright law because it 'necessarily involves copying'.

In a bid to resolve the issues before it, the Court had to refer to Section 106 of the Copyright Act<sup>9</sup>. Section 106 entitles a rightsholder to certain exclusive rights, including the right to reproduce the copyright work in copies or phonorecords, to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, and to publicly perform and display certain copyrighted works. According to Section 101 of the Act, "Phonorecords" are the "material objects in which sounds, other than those accompanying a motion picture or other audiovisual work, are fixed by any method now known or later developed, and from which the sounds can be perceived, reproduced, or otherwise communicated, either directly or with the aid

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Although it was alleged by Redigi that artists get a share, Capitol records consistently denied having received any monetary contributions. However, on its website, Redigi has a page where it requires artists to sign up for the Artist Syndication Programme through which artists get paid for secondary sales. <https://www.redigi.com/syndication/> accessed 29/11/2013

<sup>8</sup> See also U.S. Copyright Office, Library of Cong. DMCA Section 104 report 78-79 (2001) <<http://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf>> accessed 29/11/2013 (hereafter Section 104 report) "The application of section 109 to digital content is not a question of whether the provision applies to works in digital form — it does. Physical copies of works in a digital format, such as CDs or DVDs, are subject to section 109 in the same way as physical copies of works in analog form. Likewise, a lawfully made tangible copy of a digitally downloaded work, such as an image file downloaded directly to a floppy disk, is subject to section 109. The question we address here is whether the conduct of transmitting the work digitally, so that another person receives a copy of the work, falls within the scope of the defense." (footnotes omitted)

<sup>9</sup> 17 U.S.C. Copyright Act

of a machine or device.” It goes further to define the term “phonorecords” as including the material object in which the sounds are first fixed.

The court quoting *London-Sire Records, Inc. v John Doe I*<sup>10</sup> held that the act of downloading a digital music file or digital sequence to a hard disk results in the reproduction of a new phonorecord (material object). Furthermore, an electronic transfer fits within the definition of ‘distribution’ of a phonorecord. Since the transfer of a particular piece of material object over the internet is impossible, any transfer of a phonorecord will result in the creation of a new material object at the receiving end. Consequently, any transfer would be a reproduction within the meaning of the Copyright Act irrespective of whether only one or multiple copies exist after the transfer.<sup>11</sup> After finding that Redigi had infringed the reproduction and distribution rights, the next issue was whether or such infringement was covered by fair use or first sale. With regards to the former, the court held that while uploading to and downloading from the web may generally be considered fair use, doing so *incident to sale* as was encouraged by ReDigi fell outside the scope of fair use.<sup>12</sup> The Court further held that since the reproduction was unlawful, it could not be said to be ‘lawfully made’. Consequently, the first sale doctrine did not apply.

If the Court had held Redigi’s uploading and downloading to constitute fair use, would its business be permitted under first sale? An answer in the affirmative is highly doubtful. The Court after dismissing the first sale defence on the ground that the reproduction was unlawful in the first place pointed out that the doctrine applied only to a ‘particular’ copy. The stress on the word ‘particular’ shows that anything other than the original copy disposed of by the rightsholder or her licensee is unlikely to be accepted by the Courts.

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<sup>10</sup> 542 F. Supp. 2d 153 (2008)

<sup>11</sup> ReDigi (n 2) at 6. “Simply put, it is the creation of a *new* material object and not an *additional* material object that defines the reproduction right.”

<sup>12</sup> Quoting *Harper & Row Publishers, Inc. v Nation Enters.*, 471 US 539, 562 (1985), the Court held “The crux of the profit/non-profit distinction is not whether the sole motive of the use is monetary gain but whether the user stands to profit from exploitation of the copyrighted material without paying the customary price.”

One can sense from the underlying tone of the judgement as a whole, reluctance on the part of the Court to hold otherwise. Reference was made to the Section 104 Report<sup>13</sup> where the peculiarities of digital media that made digital first sale unattractive were laid out. The Court found problematic inter alia, the fact that Redigi could potentially hurt the primary market.<sup>14</sup> Ingeniously, the Court stressed that to hold otherwise (ie to allow the resale of a lawfully made and purchased digital music file by its owner through ReDigi) would be overstepping their duties as the duty of the Court is to interpret the law as it is. Contrary to the above, finding for digital first sale should not be seen as an overstep. In several cases the Courts have in the process of interpreting the law initiated new laws. A clear example is the First sale doctrine.

While the Courts in the US clearly want to avoid any decision that could be interpreted as a judicial expansion of the first sale doctrine, the European Courts have done just the opposite. The CJEU was faced with a somewhat similar scenario as ReDigi in the case of *UsedSoft GmbH v Oracle*<sup>15</sup> but came to a different conclusion. The case is discussed below.

### 3.3 USEDSOFT'S VICTORY

Oracle is a software company involved in the development and marketing of computer software. Its customers can download most of its software from the internet. Customers are bound by a licence agreement granting them a non-exclusive, non-transferable right to use the software for an unlimited period upon payment of a one-time fee. Part of the licensing agreement reads:

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<sup>13</sup> Footnote n 8

<sup>14</sup> “The product sold in ReDigi’s secondary market is indistinguishable from that sold in the legitimate primary market save for its lower price. The clear inference is that ReDigi will divert buyers away from that primary market.” Redigi at 11

However, this problem has always been in existence since music files were sold in CD format. Users could make copies before reselling the CDs. Music files stored in CDs are also in digital format, therefore remain unchanged (with regards to quality).

<sup>15</sup> C-128/11 <<http://curia.europa.eu/juris/document/document.jsf?docid=124564&doclang=en>> accessed 29/11/2013 (hereafter *UsedSoft*)



With the payment for services you receive, exclusively for your internal business purposes and for an unlimited period, a non-exclusive, non-transferable user right, free of charge, in respect of everything which Oracle develops and makes available to you on the basis of this agreement.

A maintenance agreement also allows customers to download updates and patches (programs for correcting faults) from Oracle's website. UsedSoft is an online company involved in the resale of used software. They offered used Oracle licences for sale, which they described as 'current' because the maintenance agreement between the original licence holder and Oracle was still in force. Customers could download the software from Oracle's website and activate same with the used licences purchased from UsedSoft. Oracle successfully sought an injunction from the Munich Regional Court restraining UsedSoft from selling their used software. UsedSoft appealed to the German Federal Court which referred a number of questions on the interpretation of the provisions of the Software Directive relating to exhaustion to the CJEU.

The German Courts asked the CJEU to consider whether a rightsholder's right of distribution is exhausted where a lawful acquirer downloads the software from the internet. If the answer was in the affirmative, the court had to consider whether a purchaser of a 'used' licence was a lawful acquirer, entitling him to rely on the exhaustion doctrine where the first acquirer had erased his program or no longer uses it.

The CJEU ruled that for the purpose of Article 4(2), a copyright holder's distribution right can only be exhausted where the transaction between it and its customer must amount to a 'sale of a copy' of the program. The Court defined a sale as an agreement involving the transfer of rights of ownership in an item of tangible or intangible property in return for payment.<sup>16</sup> The payment must be a one-off fee and the transfer must be for an unlimited period. The content of Oracle's

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<sup>16</sup> *UsedSoft*, para 42.

‘user license agreement’ had all the elements of a valid sale.<sup>17</sup> It held that granting a user the right to exploit a copy for an unlimited period in return for a payment of a fee made irrespective of whether it was made available by download or by means of a material medium, constitutes a sale. Furthermore, the exhaustion of the distribution right extends to any corrections or updates made by the copyright holder under a maintenance agreement. Even if the maintenance agreement is for a limited period, the functionalities corrected, altered or added on the basis of such an agreement form an integral part of the copy originally downloaded and which can be used by the customer for an unlimited period even where the acquirer subsequently decides not to renew the maintenance agreement.<sup>18</sup>

Of great relevance to this thesis are two points. First, the court was firm in holding that the wording of the relevant sections of the statutes did not differentiate between mediums but rather looked at the function (the way it worked) to apply the exhaustion doctrine. According to the court, a broad interpretation of Article 4(2) is necessary as to do otherwise would undermine the effectiveness of the rule of exhaustion since suppliers would merely have to call the contract a “licence” rather than a “sale” in order to circumvent it.<sup>19</sup>

*...The on-line transmission method is the functional equivalent of the supply of a material medium. Interpreting Article 4(2) of Directive 2009/24 in the light of the principle of equal treatment confirms that the exhaustion of the distribution right under that provision takes effect after the first sale in the European Union of a copy of a computer program by the copyright holder or with his consent, regardless of whether the sale relates to a tangible or an intangible copy of the program.*<sup>20</sup>

Surprisingly, this appears not quite different from the approach taken by the US Courts in the ReDigi case. In both cases, the Courts distinguished the ‘content’ (what is protected) from the ‘form’ (the material object embodying the protected work). However, the CJEU took a bolder step and applied the doctrine in a media-neutral manner. While the ‘form’ was of utmost

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<sup>17</sup> Ibid, para 45

<sup>18</sup> Ibid, paras 67 and 68

<sup>19</sup> Ibid, para 49

<sup>20</sup> Ibid at para 61 (emphasis mine)

importance to the District Court, it was of little relevance to the CJEU. In fact, the Court stressed that if the application of the exhaustion doctrine were restricted solely to software sold on material mediums, it would allow the copyright holder to control the resale of copies downloaded from the internet and demand further remuneration on the occasion of each sale even though the first sale of the copy had already enabled the rightsholder to obtain an appropriate remuneration.<sup>21</sup> Such a restriction of sale for copies downloaded from the internet would go beyond what is necessary to safeguard the specific subject matter of the intellectual property (ie Copyright) concerned.<sup>22</sup>

Another point of divergence was the consideration of technology. The CJEU held that in order for a resale (whether tangible or intangible) not to infringe, the original acquirer must make his own copy unusable at the time of its resale.<sup>23</sup> It further stated that it would be permissible for the copyright holder to make use of technical protective measures to ensure the original acquirer does not retain copies.<sup>24</sup> The ReDigi Court on the other hand, refused to consider the role technology can play in mitigating the possible effects of a digital exhaustion doctrine.

The UsedSoft decision has been heralded as an acceptance of exhaustion for digitally transmitted works in the EU. Does this mean that if the Redigi Case had been before the CJEU the outcome would have been different? Even though the underlying tone of the judgement suggests that the CJEU may be persuaded to extend the UsedSoft ruling to the Copyright Directive, 2 factors caution against the adoption of an affirmative assumption. Firstly, the case was decided under the Software Directive and not under the Copyright Directive. Despite the fact that they ought to be construed in the same manner, it must be recalled that the Software Directive constitutes a lex

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<sup>21</sup> *UsedSoft*, para 63

<sup>22</sup> The 'specific subject matter' deals with reward of an IPR. It is the right to first place the product on the market which serves the purpose of rewarding the owner of such right. See Guy Tritton, *Intellectual Property in Europe* (3<sup>rd</sup> edn, Sweet & Maxwell 2008) 638 (hereafter Tritton) at 650-51

<sup>23</sup> Thus if an original acquirer should acquire a multiple user license, he cannot divide and resell only parts since the original program would still be installed on his server and can still be used by him. *Ibid*, para 86

<sup>24</sup> *UsedSoft*, para 61

specialis in relation to the Copyright Directive.<sup>25</sup> The implication of this is that the provisions of the Software Directive are not automatically applicable to other copyright-protected works. A counter argument to this can be made to the effect that Software as a ‘work’ is protected by Copyright. Even though the Court made its decision under the Software Directive, it discussed extensively the exhaustion right as relevant in order to limit restrictions on the distribution right to what is necessary to safe guard the specific subject matter of Copyright as a whole. This was also a driving force behind its application of the exhaustion doctrine in a media-neutral manner.<sup>26</sup>

Secondly, it must be remembered that the exhaustion right is only applicable to the distribution right, not the reproduction right. Even though the Court recognised the application of the exhaustion doctrine in *UsedSoft*, it relied on Article 5(1) of the Software Directive which permits lawful acquirers to carry out acts of reproduction which are necessary for the use of the program. Article 5(1) of the Copyright Directive only allows temporal acts of reproductions.<sup>27</sup> The nature of software generally requires an act of reproduction before it can be used, irrespective of whether it is in tangible or intangible form. The Software Directive permits acts of reproduction essential for the use of a computer program by the lawful acquirer. Music or books, for example, on the other hand do not. While some form of reproduction (space-shifting) is generally allowed under fair use, such reproduction is not essential.

Another interesting point worth considering is what happens where in order to sidestep the exhaustion doctrine, rightsholders grant a licence for a long term? Considering the holding of the US Courts in *Vernor v Autodesk*<sup>28</sup> as well as *Eldred et Al v Ashcroft*<sup>29</sup> it would appear correct to

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<sup>25</sup> *UsedSoft*, paras 56 and 60

<sup>26</sup> *UsedSoft*, para 63

<sup>27</sup> Art 5(1) of the Software Directive allows both temporal and permanent acts of reproduction that are necessary for use by the lawful acquirer. Art 5(1) of the Copyright Directive on the other hand allows temporary reproductions under even stricter rules. More on this will be discussed in the next chapter.

<sup>28</sup> *Vernor v Autodesk, Inc.*, 621 F.3d 1102, 1113 (9th Cir. 2010) (No. 09.35969) at 13879 where the Court held that a software user is a licensee where the rightsholder specifies that the user is granted a licence, significantly restricts the user’s ability to transfer same and imposes notable restriction.

assume that even where what is purported to be a licence agreement is for an unlimited term or for a limited term with a long duration (for example, 50 years), the exhaustion doctrine will be rendered useless. The position of the CJEU in such a scenario would be a bit unclear. Considering a sale as defined by the Court must involve a transfer for an unlimited term, it is uncertain whether or not the Court will once again look into the content and context of the agreement to interpret it as a sale where it is obvious that the intent of the rightsholder is to sidestep the exhaustion doctrine.<sup>30</sup>

### **3.4 THE DIGITAL EXHAUSTION ARGUMENT**

Over the years, various arguments have been raised for and against the existence of a digital exhaustion doctrine. The weight given to these arguments are of great importance. They play a great role in spurring action or inaction on the part of the legislature with regards to statutorily expanding the scope of the doctrine or otherwise. Barring the interference of the legislature, the Courts may even be persuaded on the strength of the arguments, to interpret the existing laws as allowing or prohibiting digital exhaustion.

#### **3.4.1 SAYING NO TO DIGITAL EXHAUSTION!**

The reluctance of the Courts and rightholders to adopt digital exhaustion is logical. Digitisation has brought with it, new threats of different proportions compared to those posed by other tangible media. As stated above, the issue is not whether or not the exhaustion doctrine applies to digital works because it already does. The issue is whether the transfer of digital works over the internet should be covered by the exhaustion doctrine. Several factors complicate the application of the doctrine to online transmitted works, acting as restrictions to the creation of a digital

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<sup>29</sup> 537 US 186 (2002) at 187 where the Court held that the word "limited," must not be strictly construed. It should be understood as meaning 'confined within certain bounds, restrained, or circumscribed'.

<sup>30</sup> But it is clear that the Court will not accept an interpretation of existing law that would render ineffective the exhaustion doctrine. See *UsedSoft*, paras 82 and 83.

secondary market. They can be subdivided into three sub-categories: practical, legal and technical factors.<sup>31</sup>

The practical factors are so termed because they have to do with the nature of digital works which increase the likelihood of harm for the rightsholder. Their nature becomes even more relevant in the case of online transmitted works. The embodiment of digital works in physical tangible media (for example, CDs) helps quell some of the risk of harm occasioned to the rightsholder. The physical properties of works embodied in tangible media generally act as a barrier against wide scale infringements. Infringements of such works were often commercial in nature, not carried out by everyday persons. With digitisation, the tides have turned. Infringers are now everyday people, who need not even have financial motives. Digital works can be stored with ease. Any individual can amass a large collection. They generally cost little to duplicate and distribute. Where they are stored in tangible form, the tendency for individuals to be personally involved in large scale reproduction and distribution were slim given the labour and financial costs involved.<sup>32</sup> With the internet, there is no barrier of place and time. Cost barriers are almost none existent. Every consumer is a potential distributor. A file sent from Nigeria can be received in Australia seconds after it was sent. Furthermore, digital works have a seemingly 'everlasting' shelf life compared to analog works. Except they are erased from the material object embodying them or corrupted by a virus, digital works may exist in perpetuity<sup>33</sup>. Unlike analog media, copies can be made from copies without the slightest degradation. Rightsholders depend on the easy susceptibility of tangible media which embody these digital

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<sup>31</sup> The classification is to help create a clearer understanding of the problems. It should be noted that these categories are not clear-cut and sometimes overlap themselves. The classification is based on what may be the solution. For example, the legal and technical factors can be solved by changing the law and existing technology respectively.

<sup>32</sup> Even though technologies have greatly reduced the skill and labour costs involved in duplication, distribution of tangible media still requires physical delivery to the intended recipient.

<sup>33</sup> See Victor F. Calaba, 'Quibbles 'n Bits: Making a Digital First Sale Doctrine Feasible' (2002)9 Mich. Telecomm. Tech. L. Rev 1 at 8 (hereafter referred to as Quibbles)

works to wear and tear to help maintain a balance between the primary and secondary market.<sup>34</sup>

If digital exhaustion is allowed, these practical factors may increase the likelihood of harm occasioned to the rightholder and distort the delicate balance copyright seeks to achieve.<sup>35</sup>

There are two major legal factors. The first is that the exhaustion doctrine is a limitation on the copyright owner's exclusive right of distribution, not the reproduction right.<sup>36</sup> Distribution over the internet generally involves a hybrid of both as the transmission of such work necessitates the creation of a copy. Even though a 'forward and delete' technology is applied, the fact remains that a copy must be made, distinct from the copy residing on the hard drive of the initiating system, thus encroaching on the rightholder's exclusive right of reproduction. Consequently, except in cases where the rightholder expressly permits reproduction incidental to sale, allowing a digital secondary market may expose users to potential infringement liability. The second problem pertains to contract law. Using licence agreements, rightholders enforce restrictions on use, reproduction, transfer and modification of the work. In the end, what consumers think is a transfer of ownership is only a grant of access. This shift from ownership to access proves particularly problematic for the doctrine because the exhaustion right is only available to lawful owners of copies of copyright works. Since a licensee is at best a lawful 'caretaker', not titleholder, the exhaustion right, even if it existed for online transmissions, would not apply to them.<sup>37</sup>

With regards to technical factors, the first thing that comes to mind is the use of Technical Protection measures (TPM) to control the use of, access to, reproduction as well as transfer of

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<sup>34</sup> See Theodore Serra, 'Rebalancing At Resale: Redigi, Royalties, and The Digital Secondary Market' (2013) 93 Boston University Law Rev. 1753 at 1785, comparing digital works embodied in tangible media and those embodied in intangible media; "This distinction impacts not just usability or functionality, but also desirability. At a certain point, would-be buyers on the secondary market may jump to the primary market because a particular pre-owned copy is unusable or simply undesirable."

<sup>35</sup> Quibbles at 8 (n 23).

<sup>36</sup> Section 109 of the Copyright Act; Art 4(2) of the Copyright Directive

<sup>37</sup> It is worthy to note that the criteria for deciding who is a licensee and who is an owner are different in the US and EU. See *Vernor v Autodesk Inc.* 621 F.3d 1102 (2010); cf *UsedSoft GmbH v Oracle Inc.* (*ibid* n 15)

digitized works. For example, prior to 2009, Apple Inc. made use of ‘Fairplay’, a DRM technology it created, to prevent music purchased from its site from being played on unauthorised computers.<sup>38</sup> Although majority of the music offered online today is protected by a more relaxed DRM regime, a large percentage of eBooks and games are still protected by rigid DRM technologies<sup>39</sup>. The legal regime in the EU as well as the US prohibits the circumvention of TPM for commercial purposes.<sup>40</sup> So where rightsholders employ TPM blocking transfer, even if digital exhaustion were to exist, such work cannot be resold in a secondary market as any circumvention may be illegal. Whether or not such acts will be considered legal by the Court is another story.<sup>41</sup> Another issue is ‘forward and delete’ technology debate. As often heralded by its critics, it is not fail proof. A user may maintain copies of the copyright work after distribution and there would be no way of verifying whether or not all copies have indeed been deleted. The CJEU had an interesting reply when this concern was raised before it.<sup>42</sup> while acknowledging the truth in Oracle’s claim that ascertaining whether such a copy has been made unusable may prove difficult, dismissed it on the grounds that the same concern exists in the offline world (with material mediums such as CD-ROM or DVDs).

### **3.4.2 SAYING YES TO DIGITAL EXHAUSTION!**

12 years ago, the US Copyright Office in its Section 104 Report said:

The tangible nature of the copy is not a mere relic of a bygone technology. It is a defining element of the first sale doctrine and critical to its rationale. This is because the first sale doctrine is an outgrowth of the distinction between ownership of intangible intellectual property (the copyright) and ownership of tangible personal property (the copy)... The benefits to further expansion simply do not outweigh the likelihood of increased harm<sup>43</sup>

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<sup>38</sup> Wikipedia <<http://en.wikipedia.org/wiki/FairPlay>> accessed 16/12/2013

<sup>39</sup> Cyrus Farivar “The music industry dropped DRM years ago. So why does it persist on e-books?” (24/12/12) <<http://arstechnica.com/business/2012/12/the-music-industry-dropped-drm-years-ago-so-why-does-it-persist-on-e-books/>> accessed 06/08/2013

<sup>40</sup> See Art 6 and 7 of the Copyright Directive and Software Directive respectively as well as Section 1201 DMCA

<sup>41</sup> A proper assumption of the *UsedSoft* case leads to the conclusion that the CJEU is unlikely to accept such protection measures that aim to undermine the operation of the exhaustion doctrine as such would result in a restriction beyond what is necessary to safeguard the specific subject matter of the intellectual property (copyright) concerned. . See *UsedSoft*, paras 62, 63, and 83

<sup>42</sup> *UsedSoft*, para 79

<sup>43</sup> Section 104 DMCA report at xix



Today, the story is different. The ‘copy’ being different from the ‘copyright’ is being delivered in intangible form. Consumers are having less choice as to what medium the work they desire is embodied in.<sup>44</sup> The benefits of further expansion of the doctrine cannot be ignored.<sup>45</sup> Moreover, there are economic and technological solutions to the likelihood of increased harm which will help ensure the equilibrium is maintained.<sup>46</sup>

The doctrine still has a very important role to play in the digital market. It must be understood that the doctrine was not created in vacuum. As has been examined in the previous chapter, the US Courts created the doctrine to give effect to the long-adhered Common law principle of alienability of lawfully acquired property as such restraint was not why ‘the right to vend’ was created.<sup>47</sup> In the EU, it was created to avoid the partitioning of markets. To achieve this goal, it operates to limit restrictions on the distribution of protected works to ‘what is necessary to safeguard the specific subject-matter of the intellectual property concerned’.<sup>48</sup>

New technology does not alter the pre-existing premise upon which the doctrine is based which is that granting the rightsholder an overbearing exclusive right of distribution must be prevented.<sup>49</sup> The idea behind the doctrine focuses on the ‘transferred property interest’, not the nature (analog or digital) of the interest at stake.<sup>50</sup> Technological change should not necessitate granting a monopoly on the distribution right. Developments in technology will continue to push the boundaries of Copyright. Once in a while, technological change may render certain

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<sup>44</sup> As an example, Katy Perry’s hit single Roar was released and available for download 2 months before the Album was released. See <[http://en.wikipedia.org/wiki/Prism\\_\(Katy\\_Perry\\_album\)](http://en.wikipedia.org/wiki/Prism_(Katy_Perry_album))> accessed 12/11/2013

<sup>45</sup> These benefits are discussed later in the chapter.

<sup>46</sup> These solutions are discussed in the next chapter.

<sup>47</sup> See also *Brilliance Audio, Inc. v Haight Cross Comme ’ns, Inc.*, 474 F.3d 365, 374 (6<sup>th</sup> Cir. 2007) where the court held that “The first sale doctrine ensures that the copyright monopoly does not intrude on the personal property rights of the individual owner, given that the law generally disfavors restraints of trade and restraints on alienation.”

<sup>48</sup> *UsedSoft* (n 15), para 62; Case C-200/96 *Metronome Musik* [1998] ECR I-1953, para 14; Case C-61/97 *FDV v Laserdisken* [1998] ECR I-5171, para 13; Joined cases C-403/08 and C-429/08 *Murphy case*, para 106

<sup>49</sup> *Ibid*; *Bobbs–Merrill Co. v Straus*, 210 US 339 (1908) at 351

<sup>50</sup> See iTunes. How Copyright, Contract, and Technology Shape the Business of Digital Media ñ A Case Study (2004) <<http://cyber.law.harvard.edu/sites/cyber.law.harvard.edu/files/iTunesWhitePaper0604.pdf>> accessed 05/08/2013.

provisions of the law obsolete. This is not one of such times. Consumers should not lose their rights merely because they choose a digital copy over a tangible copy. Limiting its application to the offline world would mean partitioning the market by creating different sets of rights for purchasers of physical copies vis-a-vis those of digital copies. Where technology such as the 'forward and delete', which helps to maintain a balance, albeit a shaky one for now, exists, digital exhaustion should be encouraged. The purpose of exhaustion has not become irrelevant because of technological development.

Another strong argument for the existence of a digital exhaustion doctrine is that its absence would overthrow decades of precedents showing the economic and public benefits of the existence of a secondary market for copyright works. These benefits are relevant and applicable in the digital as well as non-digital world. The most laudable benefit is that of increased access which the doctrine guarantees in various ways. Firstly, it enables access by ensuring affordability.<sup>51</sup> The most obvious way in which it does this is by permitting price differentiation. Protected works can be made available at costs lower than that charged by the rightsholder of her licensee both in the primary and secondary market.<sup>52</sup> Multiple retailers in the primary market may offer different prices for the same product. The secondary market usually offers a price lower than that of the primary market.<sup>53</sup> The existence of competition can be mutually beneficial for the rightsholder and the consumers. The rightsholder through the first sale, gets to be remunerated for his efforts while consumers who cannot afford (or are not willing) to pay the price set by the rightsholder or his licensees are still able to gain access to these works.<sup>54</sup> Furthermore, the competition created by differentiation can be a good thing for innovation. A clear example is Redigi. Even though the Court has now ruled their business model unlawful, the

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<sup>51</sup> See Ruth Anthony Reese, 'The First Sale Doctrine in the Era of Digital Networks' (2003) 44 B.C.L. Rev 577 at 584. (hereafter referred to as Reese)

<sup>52</sup> *ibid* at 585

<sup>53</sup> *ibid* at 586

<sup>54</sup> If the 'forward and delete' technology is applied, it will ensure that the primary market is continually patronised. That way, the rightsholder can always get what she considers to be adequate remuneration for the first sale of the work.

possibility of the existence of such a model led them to the development of their ‘forward and delete’ technology.

It may be argued that the affordability argument is not as strong in the online world as it is offline. History has shown that price differentiation can be sufficiently handled by the rightsholder since some products are available at different prices to different groups of people for different periods of time. However, to leave price differentiation entirely up to the rightsholder can prove to be dangerous. One of the factors that ensure affordability in the secondary market is that the prices are dictated by utility. The consumer, not the rightsholder is the best determiner of utility.<sup>55</sup>

Another point worth noting is that a symbiotic relationship exists between the primary and secondary market. While the secondary market cannot exist without the primary market, the existence of a secondary market encourages expenditure in the primary market.<sup>56</sup> The possibility of recovering some of the cost price back may encourage some consumers to spend more in the primary market. A consumer is more likely to engage in impulsive buying in the primary market where a secondary market exists because of the possibility of the consumer to resell and recoup her expenditure if it turns out to be something she dislikes.<sup>57</sup>

Contrary to popular fears, a digital secondary market will not spell total doom for the primary market. This point is easily illustrated using the music industry as a case study. Purchase of music is primarily dictated by ‘what’s hot and what’s not’ and even that is constantly changing.

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<sup>55</sup> This is because a rightsholder is likely to value his product higher than the utility cost. A secondary market ensures that consumers can pay the actual utility cost and not that assumed by the retailer.

<sup>56</sup> Even though this might be a motivation to spend in the primary market, not all products bought this way eventually make it to the secondary market. For example, some students may be willing to pay more for books in the primary market because they can sell them afterwards in the secondary market. However, they may decide to keep it afterwards or may even be unable to resell because of the release of a newer edition. See J. Chevalier and A. Goolsbee, ‘Are Durable Goods Consumers Forward-Looking? Evidence from College Textbooks’ *The Quarterly Journal of Economics* (2009) 124 (4): 1853

<sup>57</sup> Lawrence J. Glusman, ‘Comment: It’s My Copy, Right? Music Industry Power to Control Growing Resale Markets in Used Digital Audio Recordings’ (1995) *Wis. L. Rev* 709, 716 “The ability to redeem the residual value of an investment has a distinct value to consumers... The fact that a market *does* exist in which to liquidate these investments provides an incentive to invest in the first instance.”

Since circulation in the secondary market will be based on availability of music purchased from the primary market, continuous patronage of the primary market is ensured.<sup>58</sup> Generally, the utility derived from music does not necessarily diminish after each use. Therefore the transfer from the primary to secondary market may not be immediate. Furthermore, a secondary market provides an alternative market to illegal downloads which even have a positive impact on the primary market.<sup>59</sup>

Another way in which a digital exhaustion doctrine helps increase access is by ensuring availability. It creates an avenue for works withdrawn or suppressed by the rightsholder to remain in circulation. If one of the goals of copyright is to benefit the public and in other to ensure this, the work is protected, should copyright then be allowed to restrict access?<sup>60</sup> The exclusive rights granted by copyright are not determined by the rightsholder, neither do they not go away because the work has been withdrawn. The public's access should not be restricted because the author has changed her mind especially as the exclusive rights remain even where the author has changed her mind. This is particularly important because in this digital era, works can be easily withdrawn. Presented with the reality of digitization, its possibility should not be ignored.<sup>61</sup>

Another added benefit of a digital secondary market is that it can increase innovation.<sup>62</sup>

Rightholders in a bid to compete with the secondary market are inspired to differentiate their

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<sup>58</sup> Serra(no 24) at 1777: "As Sarah Abelson has remarked, "CD's don't traditionally show up at a used CD store while they are still on top of the charts; rather it takes years for [them] to enter the secondary arket."

<sup>59</sup> Dan Graziano, 'Study finds illegal downloading doesn't harm music industry' (BGR, March 20 2013) <http://bgr.com/2013/03/20/music-piracy-study-digital-revenues-385611/> accessed 28/11/2013

<sup>60</sup> Art 1 Section 8 US constitution; recital 9 Copyright Directive.

<sup>61</sup> For example, in 2002, Elsevier, which controls the popular science journal Science Direct, removed a paper at the request of its publishers. This sparked a lot of debate and eventually led to significant policy changes. See <http://editorsupdate.elsevier.com/issue5-november2004/policy-changes-article-retraction-and-removal/> accessed 29/11/2013

See also Reese (n 36) at 601 "Although copyright owners may well have legitimate and economically rational reasons for withdrawing a work, many members of the public will also have legitimate interests in continuing access to such works. The first sale doctrine mediates between those competing interests, allowing a copyright owner who has distributed copies to limit access to her work by refusing to produce and distribute any further copies, but offering the public an alternative avenue by which some access to the work is possible."

<sup>62</sup> Aaron Perzanowski and Jason Schultz, 'Digital Exhaustion' (2010)58 UCLA L. Rev 889 at 897 (hereafter Digital exhaustion)

copies from those sold in the secondary market. This is very common in software where updates and add-on features are often made available.<sup>63</sup> It also provides incentives and support for the creation of new business models, such as Redigi.<sup>64</sup> Amazon has already been awarded a patent for an electronic used digital market place.<sup>65</sup>

### 3.5 CONCLUSION

Victor Calaba summed the problem up nicely when he wrote:

“On the one hand lays copyright owners’ concerns about protecting their intellectual property. On the other is the public’s desire to apply traditional first sale privileges to digital works. Overarching both of these positions is a technological landscape presenting piracy concerns never before seen in the history of copyright”<sup>66</sup>

While it can be rightly argued that the subject matter of the Redigi and UsedSoft cases are different, one being downloaded mp3 files and the other being downloadable software, the underlying issues are the same. Although it is easier for the US Courts to leave the issue of digital exhaustion to Congress, it would have been nice to see the Court toe the line of the CJEU by shunning technicalities and applying a broader interpretation of the statute to accommodate developing technologies which help promote the aim of Copyright law in its jurisdiction: balancing the need for public access with the provision of incentives for the creation of protected works.

The UsedSoft case is important because it highlights an important aspect that is often overlooked.

The choice lies in the hands of the rightholder. He may choose to grant a licence, in which case the work can only be exploited by the user, for a limited period or he may dispose of a copy

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<sup>63</sup> *ibid*

<sup>64</sup> *Ibid* at 898 footnote 37 “... the first sale doctrine offers fledgling companies important benefits. First, it provides some additional incentive for content owners to negotiate licenses. Second, it places a ceiling on the price content owners can demand in those negotiations. And third, it provides a failsafe mechanism that enables an innovative firm to move forward even without copyright holder permission.”

<sup>65</sup> Patent No. 8,364,595.

<sup>66</sup> Quibbles (n 23) at 3

through a sale in which case the user may exploit the work for an unlimited term. Where the rightsholder chooses the former, he is entitled to control further distribution as well as demand further remuneration on the occasion of each sale. Where however, he opts for a sale, it ought to be irrelevant that the copy was obtained from the internet.

The doctrine of exhaustion is worth preserving and the courts ought to apply the doctrine in a media-neutral fashion, to ensure its survival. It may be that the Court is not yet convinced by existing arguments that a digital exhaustion doctrine will help further the purpose of copyright. How likely is this to change in the future? It is clear that any discussion on the expansion of the doctrine must first cross the 3 hurdles (the practical, technical and legal factors). Adapting Copyright law to make a digital exhaustion doctrine feasible is an uneasy but conceivable feat. The next chapter proposes steps to facilitate the adoption of a digital exhaustion doctrine while mitigating harm that may be occasioned to the rightsholder.

## CHAPTER 4

### ACHIEVING DIGITAL EXHAUSTION

#### 4.1 INTRODUCTION

As discussed in the previous chapter, a digital exhaustion doctrine is necessary. However, its necessity does not warrant an implementation detrimental to the interests of rightsholders. Copyright law must always strive to maintain a balance between competing interests of the rightsholder and the public at large. As Kupferschmid recognised, “If decided wrongly, the first-sale issue has the potential to swallow up crucial copyright issues and destroy the delicate balance between copyright owners and users of copyrighted material.”<sup>1</sup> The aim of this chapter is to propose possible measures that can be adopted which allow a digital exhaustion right without disturbing the delicate balance.

The fact that copyright protects only original works shows that copyright is intended as a *quid pro quo*: for creating a work worthy of protection, the law provides a framework to ensure the rightsholder can be rewarded. Copyright law exists to strike a balance between competing interests, whether it does a good job of this will always be up for debate. The balance is a delicate one, requiring adjustments on both sides whenever changes or new technology threatens the balance. Any adjustment to existing laws must not upset that balance in such a way that it benefits one party at the expense of another.

Lessig identifies four modalities of regulation.<sup>2</sup> He rightly points out that regarding regulation of cyberspace there are side-constraints other than law, namely; social norms, the market and finally code. Social norms as an instrument of regulation can be effective because of their decentralised nature. Society, through unspoken rules, determines what is acceptable or otherwise. The theory of the market as an instrument of regulation operates through the device of price. Code in this

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<sup>1</sup>Keith Kupferschmid, ‘Lost In Cyberspace: The Digital Demise of The First-Sale Doctrine’ (1997-1998) 16 J. Marshall J. Computer & Info. L. 825, 827

<sup>2</sup> Lawrence Lessig, *Code: And other laws of cyberspace*. (Basic Books (AZ), 1999)

sense refers to protocols, rules implemented in software and hardware which determine how people interact or exist in cyberspace. Any regulation must be understood as the sum of these constraints operating together. Any proposed regulation for a digital exhaustion doctrine is no different. Any feasible proposal must involve the law, the market and code.

## **4.2 CODE**

Whenever the topic of digital exhaustion is raised, rightholders are quick to point out the harm that could be occasioned to rightsholders due to the nature of digital works. In response, technological solutions have been proposed. Underlying all proposals is a one thing; the number of copies must be controlled. Hess<sup>3</sup> suggests the introduction of aging technology to the file. This will allow for the gradual degradation of the file over time. This way, digital copies will mirror physical copies in the sense that they will gradually degrade with each subsequent use. In so doing, they align digital copies with their physical counterparts.<sup>4</sup> In addition, the application of aging technology would take care of the practical problems associated with digital media; to wit, their perpetual shelf life, ease in reproduction and distribution.

The problem with code as a modality of regulation is that there is no means of escape, even for legitimate causes. Hess recognises the pitfalls of this ‘architectural solution’. Firstly, the ‘who, how and when’ questions may be difficult to answer. Who determines how much use can be made before degradation occurs? How will degradation occur? Will it be a gradual process or will its effect be steep? When will it occur? Furthermore, constructing aging parameters can be problematic. What happens when the copying is for private use, such as transfer between devices or even from one folder to another on the same device?

More popular than the ‘aging technology’ is the ‘forward and delete technology’. It requires the installation of software on the device from which the file is to be transferred. Upon completion of the transfer, the software promptly deletes the copy of the file residing on the transferring device.

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<sup>3</sup> Evan Hess, ‘Code-Ifying Copyright: An Architectural Solution To Digitally Expanding The First Sale Doctrine’ (2013) 81 Fordham Law Rev., 1965 <[http://fordhamlawreview.org/assets/pdfs/Vol\\_81/Hess\\_March.pdf](http://fordhamlawreview.org/assets/pdfs/Vol_81/Hess_March.pdf)>

<sup>4</sup> Ibid at 2010



This mirrors what occurs in the offline world to the extent that at any given point in time, only one copy of the file exists, one copy before transfer, one copy after transfer. In 2001, the US congress considered ‘forward and delete’ technology and dismissed it because it was at that time unsure whether such technology existed or whether the market will bear the cost of such technology.<sup>5</sup> 12 years on, as ReDigi has demonstrated, such technology exists and the market can bear the cost of such technology.

Critics of ‘forward and delete’ technology are quick to point out that even though only one copy exists before and after transfer, a reproduction has still taken place. A lawful owner of a book is not allowed to sell a scanned copy of the book merely because she has destroyed the original. However, it should be remembered that the physical and online world are structured differently. By adopting the ‘forward-and-delete’ technology, the transfer becomes a functional equivalent of what obtains in the offline world. Moreover, an advantageous consequence of this doctrine is that it provides a safeguard that does not exist in the physical world. No one checks a seller’s device to ensure that she did not copy a CD prior to resale, even though this can rightly be assumed to be common practice.

#### **4.3 LAW**

There have been calls for legislative expansion of the scope of the doctrine. As a commenter aptly put it, “the public interest and the evolution of the marketplace often are better served by laws that clearly address and define the rules for a new technological environment.”<sup>6</sup>

In the US, those who advocate for an expansion of the first sale doctrine often point to its common law origins to show that what was intended is an exhaustion right much broader than

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<sup>5</sup> DMCA Section 104 report at xix (2001) <<http://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf>> accessed 29/11/2013 (hereafter referred to as Section 104 report)

<sup>6</sup> Report to Congress: Study Examining 17 U.S.C. Sections 109 and 117 Pursuant to Section 104 of the Digital Millennium Copyright Act <[http://www.ntia.doc.gov/report/2001/report-congress-study-examining-17-usc-sections-109-and-117-pursuant-section-104-digital#N\\_24](http://www.ntia.doc.gov/report/2001/report-congress-study-examining-17-usc-sections-109-and-117-pursuant-section-104-digital#N_24)> accessed 29/11/2013

that in the ReDigi case.<sup>7</sup> Prior to its express recognition in the Bobbs Merrill case, the 7th Circuit in *Doan v American Books Co*<sup>8</sup>, allowed reproduction incidental to sale. Doan had purchased used books originally published by American Books Co. Some books were in very poor condition. In order to render them sellable, Doan reproduced new covers identical to the destroyed original covers. Even though the Court considered the cover to be a protected element of the work, it held that such copying was not an infringement as it fell within the ‘right to repair’ that passed along with ownership of the book.<sup>9</sup>

The US Congress has tried without success to expand the scope of the doctrine. In 2003, three Bills were proposed, which if passed would have resulted in an expansion of the first-sale doctrine to digitally transmitted works.<sup>10</sup> Proposed by Republicans and Democrats alike, these Bills were quite extensive, perhaps too extensive in their provisions. Two of the Bills even proposed the adoption of ‘Forward and Delete’ technology, one (Senate Bill 1621) requiring it to be automated, the other (House Bill 1066) overlooking the automated requirement. The latter further stated that where the licensing terms were such that restricted the exercise of the first sale exception, it should be unenforceable.<sup>11</sup>

Based on the ReDigi ruling, it is clear that an amendment of section 109(a) of the Copyright Act to remove the word ‘particular’ is needed to permit digital exhaustion. In ReDigi, the Court stressed that even if the reproduction was considered fair use, it would still not be the ‘particular’

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<sup>7</sup> Perzanowski & Schultz, *Digital exhaustion; Theodore Serra Rebalancing At Resale: Redigi, Royalties, and The Digital Secondary Market*, 93 BU Law Rev. 1753 (2013) <[http://www.bu.edu/bulawreview/files/2013/10/SERRA\\_Resale.pdf](http://www.bu.edu/bulawreview/files/2013/10/SERRA_Resale.pdf)> accessed 29/11/2013 (hereafter Serra)

<sup>8</sup> 105 F. 772, 776-77 (7th Cir. 1901).

<sup>9</sup> In *Kipling v G.P. Putnam’s Sons*, 120 F. 631, 632 (2d Cir. 1903) a publisher purchased individual unbound copies of protected works and subsequently bound them in multivolume sets for resale. The Court decided that the publisher, as the lawful owner of such copies was allowed create and distribute the compilation. See also *Bureau of Nat’l Literature v Sells*, 211 F. 379, 381-82 (W.D. Wash. 1914) where the court held a former employee was permitted to revise and reconstruct copies of his former employer’s work based on a repair right, distinct from a right to resell. However, in *Ginn & Co. v Apollo Publishing* 215 F. 772 (E.D. Pa. 1914), the Court, on facts very similar to Doan held that any material reproduction, even for the purposes of repair, constituted infringement.

<sup>10</sup> House Bill 1066 was before the House of Representatives while Senate Bill 692 and Senate Bill 1621 were before the Senate. See generally, Serra (n 7) at 1782-85

<sup>11</sup> Serra at footnote 168

copy. However, its removal can open up Section 109(a) to a barrage of unwanted and unintended interpretations. In 2000, the library associations suggested that Section 109 be drafted in a media neutral manner thus:

Notwithstanding the provisions of section 106(3), the owner of a particular copy or phonorecord lawfully made under this title, *or the owner of any right of access to the copyrighted work*, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy, phonorecord, *or right of access*<sup>12</sup>

The above text can permit digital exhaustion, albeit in a limited range. As an example, ReDigi's ReDigi 2.0 software would not infringe if the Copyright Act was so worded.<sup>13</sup> This is because as long as the file remains in the cloud, what the owner would have is a 'right of access' which can then be resold.

With regards to the EU, whether the extant provisions of the Copyright Directive need to be altered to allow for exhaustion of online transmissions depends on one's interpretations of its provisions. As with any law, the relevant sections must be read in the context of the legislation as a whole, and not in isolation. Consequently, despite the close similarity between the wordings of Article 4(2) of the Software Directive and Article 4(2) of the Copyright Directive,<sup>14</sup> recitals 28 and 29 of the Copyright Directive cannot be ignored especially as they constitute a limitation of the exhaustion doctrine as provided in Art 4(2) of the same Directive. Recital 28 in particular provides as follows:

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<sup>12</sup> Inquiry Regarding Sections 109 and 117, Reply Comments of the Library Associations <<http://www.arl.org/storage/documents/publications/dmca-section109-comments-05jun00.pdf>> accessed 29/11/2013

<sup>13</sup> Matt Peckham, 'ReDigi CEO Says the Court Just Snatched Away Your Right to Resell What You Legally Own' (TIME 25 April 2013) <<http://techland.time.com/2013/04/25/redigi-ceo-says-the-court-just-snatched-away-your-right-to-resell-what-you-legally-own/>> accessed 29/11/2013

<sup>14</sup> Art 4(2) Software Directive provides "The first sale in the Community of a copy of a program by the rightholder or with his consent shall exhaust the distribution right within the Community of that copy, with the exception of the right to control further rental of the program or a copy thereof."; cf Art 4(2) Copyright Directive

Copyright protection under this Directive includes the exclusive right to control distribution of the work incorporated in a *tangible* article. The first sale in the Community of the original of a work or copies thereof by the rightholder or with his consent exhausts the right to control resale of that object in the Community. This right should not be exhausted in respect of the original or of copies thereof sold by the rightholder or with his consent outside the Community.<sup>15</sup>

It may be argued that a close reading of recital 28 shows that it was never the intention of the Parliament and Council to extend the operation of the doctrine to works transmitted online since although the Directive was drafted for the Information Society, recital 28 which must be read in conjunction with Article 4(2) emphasizes the embodiment of the protected work in a tangible article. Furthermore recital 29 states that “The question of exhaustion does not arise in the case of services and on-line services in particular. This also applies with regard to a material copy of a work or other subject-matter made by a user of such a service with the consent of the rightholder.” Since recital 28 relates ‘only’ to works embodied in tangible articles, works embodied in intangible articles such as works in digital format must be construed under recital 29. Such an interpretation would necessarily mean online transmissions are to be regarded as services and consequently, not subject to exhaustion. Is such an interpretation accurate?

Such a strict interpretation would be erroneous. Firstly, the directive is silent in defining what constitutes distribution. The relevant part of recital 28 states “Copyright protection under this Directive includes the exclusive right to control distribution of the work incorporated in a tangible article”. If such a strict interpretation is used, it would also mean there is no exclusive right to distribute intangible copies.

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<sup>15</sup> Emphasis mine

The UsedSoft case is of extreme importance because it gives a clue as to the inclination of the Court on the issue of digital exhaustion. In that case, the CJEU stated:

...the objective of the principle of the exhaustion of the right of distribution of works protected by copyright is, in order to avoid partitioning of markets, to limit restrictions of the distribution of those works to *what is necessary* to safeguard the specific subject-matter of the intellectual property concerned.<sup>16</sup>

Holding that the concepts used in both the Copyright Directive and the Software Directive must in principle have the same meaning,<sup>17</sup> the Court recognised the need for a medium-neutral approach where the on-line transmission method is the functional equivalent of the supply of a material medium.<sup>18</sup> The Court was unequivocal in stating that the principle of equal treatment requires that the exhaustion of the distribution right takes effect after the first sale in the European Union of a copy of a computer program by the copyright holder or with his consent, regardless of whether the sale relates to a tangible or an intangible copy of the program. The reasoning and conclusion in this case rings true with regards to other protected works.

However, the fact still remains that the exhaustion doctrine implicates only the distribution right. Unlike the Software Directive, the Copyright Directive only permits acts of reproduction that are temporal in nature.<sup>19</sup> Feiler<sup>20</sup> opines that a strong argument could be made that such acts of reproduction that only serve to enable a different type of use, such as resale need not be part of the exclusive rights of the rightholder especially as in principle, the exhaustion doctrine

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<sup>16</sup> *UsedSoft*, para 62; see also Case C-200/96 *Metronome Musik* [1998] ECR I-1953, para 14; Case C-61/97 *FDV v Laserdisken* [1998] ECR I-5171, para 13; and Joined Cases C-03/08 and C-429/08 *Murphy case* [2011] ECR I-9083, para 106

<sup>17</sup> *UsedSoft*, para 60

<sup>18</sup> *Ibid*, para 61

<sup>19</sup> Article 5(1) copyright directive; cf Art 5(1) Software directive

<sup>20</sup> Lukas Feiler, *Birth of the First-Download Doctrine: The Application of the First-Sale Doctrine to Internet Downloads under EU and U.S. Copyright Law*, Stanford-Vienna TTLF Working Papers No. 17, <[http://www.law.stanford.edu/sites/default/files/publication/378203/doc/slspublic/feiler\\_wp17.pdf](http://www.law.stanford.edu/sites/default/files/publication/378203/doc/slspublic/feiler_wp17.pdf)>accessed 29/11/13

is applicable to digital copies. Taking the position that the ‘forward-and-delete’ technology is an indispensable aspect of digital exhaustion, he gives two reasons for this argument. Firstly, works in digital format are not often embodied in digital mediums intended to be sold along with the work.<sup>21</sup> Transfer of the work would definitely implicate the reproduction right but since the creation of a new copy would necessitate the deletion of the old copy, the reproduction right should not be extended in such a way that it frustrates the application of the doctrine to digital works obtained online. Interestingly, he further posits that the creation of a new copy and subsequent immediate deletion of the old is very similar to the creation of a temporary copy as covered by the temporary reproduction exemption as provided in Art 5(1) of the Copyright Directive. His conclusion is that “article 5(1) should be applied by analogy to acts of reproduction that meet all statutory requirements except that, not the created copy, but the co-existence of the original and the new copy are temporary and transient or incidental.”<sup>22</sup>

Feiler’s argument is quite convincing, upon a proper consideration of Art 5(1) which provides as follows:

1. Temporary acts of reproduction referred to in Article 2, which are transient or incidental [and] an integral and essential part of a technological process and whose sole purpose is to enable:

- (a) a transmission in a network between third parties by an intermediary, or
- (b) a lawful use

of a work or other subject-matter to be made, and which have no independent economic significance, shall be exempted from the reproduction right provided for in Article 2.

The CJEU has explained what it means for copies to be temporal as well as an integral and necessary part of a technological process. In *Infopaq II*, the CJEU said:

...the concept of the integral and essential part of a technological process requires the temporary acts of reproduction to be carried out entirely in the context of the implementation of the technological process and, therefore, not to be carried out, in full or in part, outside such a process. This concept also assumes that the completion of the

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<sup>21</sup> Ibid at 15. As an example, he cites an mp3 file stored on a laptop rather than a CD.

<sup>22</sup> *ibid* at 16

temporary act of reproduction is necessary, in that the technological process concerned could not function correctly and efficiently without that act.<sup>23</sup>

In defining the criteria for determining whether a temporal act of reproduction has independent economic significance, it said:

...the economic advantage derived from their implementation must not be either distinct or separable from the economic advantage derived from the lawful use of the work concerned and it must not generate an additional economic advantage going beyond that derived from that use of the protected work (see, to that effect, *Football Association Premier League and Others*, paragraph 175)<sup>24</sup>

The creation on a new copy of a protected work and subsequent deletion of the old one greatly mirrors the temporal act of reproduction in Article 5(1). Such reproduction is an integral and essential part of the process which allows a user to exercise a right she is otherwise entitled to. A use can be lawful even where the rightsholder does not authorise it.<sup>25</sup> Finally, it has no independent economic significance since it generates no additional economic advantage going beyond that permitted by law.

That being said, it does not mean that any legislative move in both jurisdictions to alter existing law in favour of the exhaustion doctrine for online transmissions will be welcomed with open arms. The failed attempts by the US congress are a clear example. The reason for their failure was probably because they were 1-sided. Amending existing copyright law in such a way that it creates an unencumbered exploitation in favour of one side over another will be difficult to pull off. The balance between competing interests is so delicate that any shift in one direction, no matter how little will require a reciprocal shift in the other direction. This is where 'market' comes in. As is done with software, rightsholders are free to charge an amount commensurate to what may be considered sufficient compensation for the increased risk of harm occasioned to them by digital exhaustion.

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<sup>23</sup> Case C-302/10 *Infopaq International A/S v Danske Dagblades Forening* [2012] OJ 2012/C 73/12 <<http://curia.europa.eu/juris/document/document.jsf?text=&docid=118441&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=665953>>, para 30 accessed 29/11/2013

<sup>24</sup> *Ibid*, para 50

<sup>25</sup> *Ibid*, para 44

#### 4.4 MARKET

Serra<sup>26</sup> suggests the introduction of resale royalties for digital works resold online. For the proposed resale royalties to be effective, they must be monitored and enforced. In order to ensure fairness and transparency, the amount to be paid (as well the collection of the paid sum) should be negotiated and agreed upon by the online platforms and Collective Rights Organisations on behalf of the rightholders.<sup>27</sup> The most efficient way to do this is to restrict resale to recognised online platforms so that only sales through ‘ReDigi-like’<sup>28</sup> platforms would be permitted.

The idea of resale royalties is not a novel one. It originated in the visual-art context in early twentieth-century France.<sup>29</sup> Termed ‘droit de suite’, it granted artists a right to share in the proceeds from subsequent resale of their works.<sup>30</sup> It was largely based on the desire of artists to profit from appreciation in the price of their works as well as recognition of their moral rights.

As attractive as it may be, the idea of a ‘resale royalty’ is fundamentally flawed in that it is contrary to the concept of copyright. While providing the framework to ensure rightholders can receive reward for their works, Copyright does not exist to guarantee income. This is why under copyright law, there is no such thing as the right price. Rightholders are free to put a product first on the market at any given price and this has always been a key factor for the Courts in reaching their decision.<sup>31</sup>

Even if the idea of a resale royalty as proposed by Serra is adopted, it does not answer an important question: when is enough, enough? Considering the aim would be to provide

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<sup>26</sup> See generally, Theodore Serra, ‘Rebalancing At Resale: Redigi, Royalties, and The Digital Secondary Market’ (2013) 93 BU Law Rev. 1753 (hereafter Serra)

<sup>27</sup> At 1791

<sup>28</sup> Serra at 1795

<sup>29</sup> Ibid at 1787

<sup>30</sup> ibid

<sup>31</sup> *Bobbs–Merrill* at 351 “The owner of the copyright in this case did sell copies of the book in quantities and at a price satisfactory to it. It has exercised the right to vend.”

*UsedSoft*, para 45 “The making available by Oracle of a copy of its computer program and the conclusion of a user licence agreement for that copy are thus intended to make the copy usable by the customer, permanently, in return for payment of a fee designed to enable the copyright holder to obtain a remuneration corresponding to the economic value of the copy of the work of which it is the proprietor.”



compensation for the likelihood of increased harm, at what point can a rightholder be said to have received enough compensation? It is ludicrous to assume they ought to receive compensation for the entire period of the copyright especially as no resale royalty right exists in the offline world. It would mean, if Justin Bieber lives to be a hundred years old, he and his heirs will be entitled to a resale royalty for his song ‘One time’ for the next 151 years because consumers want to exercise a right they are otherwise entitled to, over the internet.<sup>32</sup> Using ReDigi’s model as an example, this means 20% for the next 151 years.

Copyrights holders need to understand copyright law for what it is, a regime that allows the procurement of reward, not one that guarantees it.<sup>33</sup> The onus is on rightsholders to create a work worthy of the economic value assigned by them to the work. Furthermore, the existence of a secondary market can among other things, reduce the ‘actual cost’ of a work since consumers can recoup some of their investments on the secondary market.<sup>34</sup>

#### **4.5. CONCLUSION**

A good regulation would be one that adapts the exhaustion doctrine to the online world such that the doctrine maintains its effectiveness without upsetting the delicate balance copyright maintains. Any successful attempt to regulate digital exhaustion must be an amalgamation of the law, market and code. The law ought to clarify the boundaries and scope of a digital exhaustion doctrine, without which Courts will be left groping in the dark. The extant Copyright Act cannot support a digital exhaustion doctrine. S109a must be altered in such a way that allows the resale of a copy provided the original copy was a lawfully owned copy which ceases to be in existence as soon as the transfer is completed. If the UsedSoft case was any indication, the Copyright Directive as it stands, can support a digital exhaustion doctrine. The role of the market is to

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<sup>32</sup> One Time was Beiber’s first single, released in 2009. < [http://en.wikipedia.org/wiki/One\\_Time\\_\(song\)](http://en.wikipedia.org/wiki/One_Time_(song))> accessed 29/11/2013

<sup>33</sup> Perhaps this is where social norm as a means of regulation come in.

<sup>34</sup> Lawrence J. Glusman, ‘Comment: It’s My Copy, Right? Music Industry Power to Control Growing Resale Markets in Used Digital Audio Recordings’ (1995) Wis. L. Rev 709, 716 “The fact that a market does exist in which to liquidate these investments provides an incentive to invest in the first instance”

ensure that rightsholders are satisfactorily compensated so that there is no loss of incentive to create. However, a perpetual resale royalty right is counter-productive. Rather, sale on the second hand market should be restricted to authorised 'ReDigi-like' platforms since that is the only way to ensure only lawfully purchased music is sold as well as monitor and enforce the application of 'forward and delete' technology. Code is essential because it is the most effective means of enforcement. It ensures that the rules of digital exhaustion such as simultaneous deletion are adhered to.

ReDigi's business model should be embraced. Recognising the increased likelihood of harm occasioned to the rightsholder, it has taken necessary precautions to mitigate the harm. By ensuring only lawfully purchased music from iTunes or its marketplace is sold, ReDigi does not support illegal downloads. As was discussed in the previous chapter, it even encourages the patronisation of legal markets. Furthermore, its' simultaneous deletion technology guarantees that the purpose of the reproduction right, which is to control the number of copies in circulation, is not frustrated. By granting a resale royalty, ReDigi ensures that the artists receive satisfactory returns for their investments, even beyond that which they are entitled to in the offline world. As has been shown, a digital exhaustion doctrine is indeed achievable and should be encouraged. Adhering to the aforementioned proposals will ensure its execution does not occasion harm to the rightsholders but will rather help further the purpose of copyright.

## CHAPTER 5

### CONCLUSION

Discussions on the extension of the exhaustion doctrine to online transmitted works did not start today. As far back as 2001, these discussions had generated so much attention that the implication of such extension had to be evaluated by the US Congress. At the time, the result of such evaluation was that the Copyright regime regarding digital exhaustion did not need to be changed. 12 years on, the story is different. Even the extant Register of Copyrights in the US, Maria Pallente, has suggested it is time for a review of the question of digital exhaustion.<sup>1</sup>

Any argument for digital exhaustion must show that the expansion of the doctrine to online transmitted works necessarily furthers the policies behind the creation of doctrine and can be implemented without causing more loss to the rightsholder. As has been discussed in this thesis, a digital exhaustion right furthers the policies behind the creation of the Doctrine. In the US, it was created prevent restraint on alienation of lawfully acquired property. The focus remains on the ‘transferred property interest’, not the nature (digital or analogue) nor the medium embodying the ‘interest’ at stake. Consumers should still be allowed to exercise rights that they are otherwise entitled to where there is a lawful transfer of ownership. The purpose of the Doctrine is to prevent a partitioning of the market within the EU. Allowing a digital exhaustion doctrine will prevent the partitioning of markets with regards to consumers of a tangible article vis-à-vis consumers of intangible articles especially where they serve the same functional purpose. The benefits to be derived from such an extension are numerous, not only will there be improved affordability, availability and access, a digital exhaustion doctrine can also improve innovation.

Opponents to an extension of the exhaustion doctrine are quick to point out the physical characteristics of digital works that will cause an increase in the likelihood of harm occasioned to

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<sup>1</sup> Maria Pallante, *The Next Great Copyright Act* <[http://www.copyright.gov/docs/next\\_great\\_copyright\\_act.pdf](http://www.copyright.gov/docs/next_great_copyright_act.pdf)> at 331-332

the rightsholders should such an extension be allowed. Digital works can be easily stored in multiple places, copied, or transferred without any form of degradation. They fear that an extension could encourage acts that potentially hurt the rightholder's market. On the contrary, statistics show that the availability of cheap alternatives to illegal downloads have caused a decrease in illegal downloads.<sup>2</sup>

Using ReDigi's business model as a starting point, it is apparent that the existence of a secondary market will not hurt the primary market. On the contrary, it will encourage initial purchase from a legal source since only files from a verifiable lawful source will be accepted. Furthermore, the application of simultaneous deletion technology will help ensure the continuous symbiotic relationship between the primary and secondary market. The concerns regarding the application of a 'forward and delete' technology have been overtaken by events. ReDigi has proved that such technology is available, easy to use and inexpensive for the consumer.<sup>3</sup> To combat the 'piracy' fears which may be increased, only regulated platforms such as ReDigi should be permitted to do such sales. Other platforms which may want to adopt this mode of business must show they have an effective simultaneous deletion technology (such as the one operated by ReDigi) at their disposal, the use of which must be extensive and automated.

It is desirable that the law clearly defines the rules for a digital technological environment. The laws applicable offline will have to adapt in order to the online world.<sup>4</sup> To this end, it is desirable

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<sup>2</sup> See the NPD group report, which cites the increase of usage of music streaming services as a factor as a reason for illegal downloads.

The NPD Group, 'Music File Sharing Declined Significantly in 2012' (*NPD Group*, 26 February 2012) <<https://www.npd.com/wps/portal/npd/us/news/press-releases/the-mpd-group-music-file-sharing-declined-significantly-in-2012/>> accessed 16/12/2013

<sup>3</sup> Music sold on ReDigi's marketplace was sold at a price cheaper than the primary market. Therefore the conclusion that the consumers bear the costs does not apply.

<sup>4</sup> See Koops, B.J. & Prins, J.E.J., 'Internationalization and ICT Law: The Position of the UK, Germany, France and the United States' (2000) 16 (5) *The Computer Law and Security Report*, 311. <<http://arno.uvt.nl/show.cgi?fid=5718>> accessed 17/12/2013 where they discuss that the 'why' behind a rule in the offline world should first be examined before a rule (embracing the 'why') which takes into consideration the peculiarities of the online world is constructed. This will ensure that the application of the rule to the online world is not ineffective.

that the US congress examines once again the issue of digital exhaustion. Since the issue with digital exhaustion in the US lies with the word ‘particular’ as contained in Section 109(a) of the Copyright Act, it would be interesting to see what the opinion of the Court would be regarding ReDigi’s new software ‘ReDigi 2.0’ which allows a user to download a file purchased from iTunes directly to her ReDigi cloud locker. Since transfers in ReDigi’s clouds are done by merely changing the file pointers, any transfer of such a file will not implicate the exclusive right of reproduction since it would be a ‘transfer’ of the ‘particular’ copy purchased.

Within the EU, the CJEU is yet to address the issue of digital exhaustion with regards to works protected under the Copyright Directive. Even though the Software Directive is seen as an indication of the inclination of the Court, only an express ruling made under the Copyright Directive can confirm this. As shown in Chapter 4, an analysis of recital 28 and 29 do not preclude the application of the exhaustion doctrine to online transmitted works. Whether the Courts will want to do this is another question. It must be remembered that Article 4(2) of the Copyright Directive not only restricts the exhaustion doctrine to works placed first within the community, it further restricts the effect of the exhaustion doctrine to within the community. Considering the ‘international’ element of the internet as well as the recent development of cloud-computing, it would be interesting to see if an extension of the doctrine to online transmitted works would require ‘ReDigi-like’ companies to maintain servers within the Union as well as restrict transfers to only within the Union.

Rightsholders should understand that copyright law does not exist to guarantee income. The distribution right is a ‘single shot pistol and not a machine gun’.<sup>5</sup> Copyright holders should be denied the right to further control copies of a work after first sale at a price satisfactory to it irrespective of whether it is a tangible or intangible copy. Where rightsholders wish to further

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<sup>5</sup> Andre Lucas, ‘International exhaustion’ in Bently L., Suthersanen U., & Torremans, P. (eds), *Global Copyright: three hundred years since the Statute of Anne, from 1709 to cyberspace* (Edward Elgar Publishing. 2010) at 306

control copies of their work, they should choose to licence out their work. Concerning the necessary marriage between the reproduction and distribution right with regards to digital exhaustion, the law already permits reproductions such as that necessitated by ReDigi's technology.<sup>6</sup> In light of the purpose and benefits of a (digital) exhaustion doctrine, there is no need to disallow such reproduction on the grounds that it is incidental to sale. Moreover, the on-line transmission method is the functional equivalent of the supply of a material medium. Copyright law exists to maintain the delicate balance between competing interests. A business model such as that proffered by ReDigi goes a step further in maintaining that balance.

Whenever the Courts are faced with this question of digital exhaustion, it is the author's wish that they remember the implications of another ReDigi-like decision: partitioning of markets with regards to consumers of a tangible article vis-à-vis consumers of intangible articles in a time where consumers are having lesser choices as to the medium embodying their chosen works.

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<sup>6</sup> For example, storage of music files in a cloud locker is permitted under fair use.

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