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### COPYRIGHTS

#### FIRST-SALE DOCTRINE

The authors advocate the viability of consumer rights under the first-sale doctrine with respect to copies of works sold in digitized formats.

### Of Textbooks and iPods—Two Courts Look at the First-Sale Doctrine



BY SETH D. GREENSTEIN AND DANIEL J. VITELLI

**O**n March 19, the Supreme Court gave new vitality to the “first sale” doctrine, the principle that the owner of a copy of a copyrighted work—a book, sheet music, or a DVD—can lend, gift, or resell it beyond the control of the copyright owner. In *Kirtsaeng v. John Wiley & Sons*,<sup>1</sup> the court held that the doctrine extends to physical copies lawfully manufactured outside the United States. Yet, just two weeks later, a federal district court in New York suggested that the first-sale doctrine may have run its course, and that consumers may have no first sale privileges for digital content,

<sup>1</sup> 106 U.S.P.Q.2d 1001 (2013) (85 PTCJ 695, 3/22/13).

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such as e-books, movies, and MP3 music files, lawfully acquired online.<sup>2</sup>

Ironically, the very convenience of purchasing and reselling digital content may spell the end of the first-sale doctrine. But such a result is unnecessary, and unnecessarily distortive to the consumer economy. Consumers deserve and need the right to transfer their property rights in copyrighted digital goods every bit as much as in physical objects.

The policies underlying the first-sale doctrine remain equally relevant to personally owned copies, whether comprised of atoms and bits. As a fundamental principle, the law should encourage, not impede, the public benefits from the flexibility offered by new digital technology. The first-sale doctrine, rooted in the common law as created by the judiciary,<sup>3</sup> should be expanded by the judiciary to encompass digital first sale.

More than 400 years ago, before the dawn of copyright, Lord Edward Coke decried restraints on alienation of personal property. In the 1800s, the Supreme Court extended this rule against such “equitable servitudes” to patent law.

In the patent context, this rule has survived every technological evolution from coffin lids to computer chips. The court consistently has held that the authorized sale of a patented article exhausts the patentee's right to control downstream uses.

In 1908, the court applied the first-sale principle to copyright law, refusing to enforce a publisher's attempt to control the resale price of a book: “one who has sold

<sup>2</sup> *Capitol Records L.L.C. v. ReDigi Inc.*, 106 U.S.P.Q.2d 1449 (S.D.N.Y. 2013) (85 PTCJ 802, 4/5/13).

<sup>3</sup> “Conceptually, the [first sale] doctrine springs from the common law right to control the disposition of chattels in one's lawful possession.” Julie E. Cohen et al., *Copyright in a Global Information Economy* 369 (2d ed. 2006) (citations omitted).

a copyrighted article, without restriction, has parted with all right to control the sale of it. The purchaser of a book, once sold by authority of the owner of the copyright, may sell it again. . . .”<sup>4</sup>

Over more than a century since, the first-sale doctrine has been ingrained into our cultural life and business practices. Libraries lend books, museums display art, consumers give away, lend, or sell used books, CDs, DVDs, and video games, and retailers sell those new and used educational and entertainment content, all exercising the first sale privilege.

The home video rental industry that reigned from the 1980s until just a few years ago, existed because of the first-sale doctrine (although Congress prohibited rental of sound recordings and software).

In the patent law context, the first-sale doctrine is purely a creation of the judiciary. Following *Bobbs-Merrill*, Congress incorporated the first-sale doctrine into the Copyright Act of 1909 and, as amended, in 1976. Section 41 of the 1909 act protected the right to transfer any copy of a copyrighted work “the possession of which has been lawfully obtained.”

In 1976, Congress closed two potential loopholes in the initial codification of the doctrine. First, it clarified (in Section 109) that the first-sale privilege applied only to the “owner” of a copy and not a lessee or bailee; for example, a movie theater owner that lawfully possessed a motion picture.

Second, Congress clarified that Section 109 would apply only to a copy that was “lawfully made under this title”—that is, Title 17 of the U.S. Code, which incorporates federal copyright law—and not, for example, to a pirated copy that nevertheless had been lawfully obtained under the 1909 act.

However well those five words, “lawfully made under this title,” may have clarified those two concerns, it left the courts with a conundrum that took more than 15 years of Supreme Court jurisprudence to resolve: Does the first-sale doctrine apply to copies made or imported from outside the United States?

This issue first came to the court in 1998, in a case considering whether a copyright owner could thwart the “gray market” re-importation of goods manufactured in the United States that were first sold abroad.<sup>5</sup> In that case, a hair care products manufacturer registered a copyright for a shampoo bottle label, to prevent a domestic discount supplier from purchasing the shampoo at lower prices in foreign markets and reselling it in the U.S. below manufacturer suggested retail prices.

The court analyzed the interaction between the first-sale doctrine and the right to prevent unauthorized importations under Section 602 of the Copyright Act. Finding, through a series of nested provisions, that the first-sale doctrine offered a defense to infringement by importation, the court held lawful the re-importation and resale. But foreshadowing the next cases for the court, a concurring opinion by Justice Ruth Bader Ginsburg noted her position that this outcome applied only to the “round trip” context of the case: a re-importation of copies made in the United States.

<sup>4</sup> *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339, 350 (1908).

<sup>5</sup> *Quality King Distributors Inc. v. L’Anza Research International Inc.*, 523 U.S. 135, 45 U.S.P.Q.2d 1961 (1998) (55 PTCJ 386, 400, 3/12/98).

Some 10 years later, Swiss watch manufacturer Omega S.A., faced with similar arbitrage practices by low-price retailer Costco Wholesale Corp., engraved a one-centimeter-wide image of a globe on the back of its Seamaster watches, and claimed that unauthorized importation of the watches by Costco created liability for infringement of the copyright interest in the logo. The district court granted summary judgment based on the first-sale defense for Costco, but the Ninth Circuit reversed.<sup>6</sup> The words “lawfully made under this title,” in the Ninth Circuit’s view, required manufacture in the United States. The court recognized the absurd implications of its holding, which gave perverse incentives for offshore manufacture and even prevented resale of foreign-made automobiles.

To avoid these anomalies, the court allowed the first-sale doctrine to apply when the copyright owner authorized the importation. In effect, the Ninth Circuit made two contradictory counter-textual interpretations of the first sale statute: reading into Section 109 a requirement that the copies be lawfully made *in the United States* under this title; and reading out the statutory safeguard that the first sale privilege applies even where the owner of the copy acts “without the authority of the copyright owner.”

The Supreme Court granted certiorari in *Costco v. Omega*, but newly seated Justice Elena Kagan recused herself because of her involvement in the case when she had served as the U.S. solicitor general. As a result, the decision was affirmed in 2010 by an equally divided vote. (On remand, the district court held that Omega’s assertion of copyright law in the globe design simply to preclude lower-cost resale constituted copyright misuse.)<sup>7</sup>

The issue arose next before the Second Circuit. A student had financed his education by online sales of authentic foreign versions of college textbooks made by a publishers’ foreign subsidiaries. In a split decision, the Second Circuit majority agreed with the Ninth Circuit that “lawfully made under this title” required domestic manufacture.<sup>8</sup> However, the majority rejected the Ninth Circuit’s safety valve, taking instead the draconian view that foreign manufacture precluded first-sale privileges even for authorized imports.

The Supreme Court granted certiorari and, on March 19, 2013, reversed the Second Circuit. Writing for a six-justice majority, Justice Stephen G. Breyer held that the language of the statute has no express geographical limitation, and the word “under” does not ordinarily mean “where.” As such, the words “under this title” should instead be understood as “in accordance with” or “in compliance with” the Copyright Act.

The majority found this reading consistent with the meaning of the same five-word phrase elsewhere in the statute. In addition, this interpretation comported fully with the history of the 1976 act, which phased out a requirement that had limited importation of copies manu-

<sup>6</sup> *Omega S.A. v. Costco Wholesale Corp.*, 541 F.3d 982, 88 U.S.P.Q.2d 1102 (9th Cir. 2008) (76 PTCJ 658, 9/12/08), *aff’d by an evenly divided court, Costco Wholesale Corp. v. Omega S.A.*, 131 S. Ct. 565, 96 U.S.P.Q.2d 2025 (U.S. 2010) (81 PTCJ 205, 12/17/10).

<sup>7</sup> *Omega, S.A. v. Costco Wholesale Corp.*, CV 04-05443 TJH (C.D. Cal. Nov. 9, 2011) (Order and J.).

<sup>8</sup> *John Wiley & Sons Inc. v. Kirtsaeng*, 654 F.3d 210, 99 U.S.P.Q.2d 1641 (2d Cir. 2011) (82 PTCJ 530, 8/19/11).

factured outside of the United States and Canada—suggesting that Congress intended to equalize treatment of copies manufactured in the United States and abroad. And, the reading fulfilled the “impeccable historic pedigree” of the first-sale doctrine, and its antipathy to restraints on the transfer or resale of personal property.

Finally, Breyer cited the arguments of numerous amici curiae, including associations of libraries, used book dealers, technology companies, consumer-goods retailers, and museums, that there would be practical harms resulting from a geographical restriction.

Libraries no longer could lend foreign books; used book dealers no longer could sell foreign texts as they had done since the time of Franklin and Jefferson; virtually no foreign-made technology product could be sold, given the ubiquity of functions performed by embedded software; museums would need permission to display or accept donations of any foreign work; and retailers, which increasingly offer foreign-made goods, noted that infringement liability could adhere to almost any product with a copyrighted label, package, or instruction insert.

While the Supreme Court decision clearly is a boon for consumers, retailers, and companies that import authentic goods into the United States, publishers, licensors, and authors of copyrighted works raise concerns for their international marketing strategies.<sup>9</sup> Copyright interests, like many product manufacturers, offer the same or lower-quality versions in foreign markets at lower prices that better reflect those countries’ relative economic conditions.

Several years ago, movie producers began selling DVD movies at drastically discounted prices in certain countries as an antidote to piracy—preferring to cannibalize their own profits rather than leave their profits to the cannibals.

Such market segmentation has been part of publishers’ business strategy for decades; indeed, the Supreme Court used it as an example, in dictum, in *Quality King*. Although the *Kirtsaeng* majority acknowledged its reading could interfere with copyright owners’ desire to maximize profits in each of various markets, the court found no basic principle of copyright law especially entitling publishers to price discriminate. And, as cases like *Quality King* and *Costco* suggest, too often copyright owners have attempted to use copyright law not primarily to protect their copyrights but principally as leverage to prevent otherwise-lawful arbitrage.

But while the Supreme Court gave the first-sale doctrine a more expansive reading with respect to physical copies, a court in New York was readying a decision that effectively rejected the doctrine vis-à-vis digital content. *ReDigi* involved a digital service that had attempted to create a market for used, lawfully purchased, digital music.

Its service allowed users to sell digital music files to other users for credits, and to use credits to buy digital music files. A key to *ReDigi*’s service was its efforts to ensure that the user did not retain music that had been sold or uploaded for sale.

<sup>9</sup> See, e.g., Scott Turow, “The Slow Death of the American Author,” *New York Times* (April 7, 2013); <http://www.nytimes.com/2013/04/08/opinion/the-slow-death-of-the-american-author.html>.

Capitol Records sued *ReDigi*, alleging copyright infringement. *ReDigi* argued that its service was protected by the first-sale doctrine and Judge Richard J. Sullivan of the U.S. District Court for the Southern District of New York was asked to decide whether a service that enables users to sell digital music files was protected by the first-sale doctrine.

Judge Sullivan sided with Capitol Records, holding that the sale of digital music files on *ReDigi* had infringed Capitol’s reproduction and distribution rights and that the first-sale doctrine did not protect such conduct.<sup>10</sup> In short, because the process of transferring a digital file copies the file to a new location, the court found that the activity constituted both a reproduction and a distribution under the Copyright Act. The court ruled that the first-sale doctrine did not protect *ReDigi*’s behavior because (1) *ReDigi* had violated Capitol’s reproduction right, and the first-sale doctrine is a defense only against a claim of infringement of the distribution right;<sup>11</sup> and (2) *ReDigi* distributed copies of digital music files that had not been lawfully made. Despite *ReDigi*’s arguments to the contrary, the court found the existing first-sale doctrine unambiguous and readily applicable in the digital context. The court declined the invitation to evolve the first-sale doctrine, stating that such an amendment “is a legislative prerogative that courts are unauthorized and ill suited to attempt.”

Sullivan believed his ruling was dutifully applying the language of the Copyright Act. But is it the right result? To be sure, technology advances faster than bills become laws.

The patchwork of industry-driven legislation constituting the current Copyright Act will never cover all fact patterns presented by pioneering methods to create or distribute works. Yet, the underlying policies of copyright and property rights were intended to apply prospectively.

To serve those enduring policies, the law must be flexible enough to account for developing technologies, lest it stifle innovation. The Supreme Court also has observed that courts are ill-suited to adapt statutorily-created copyright rights to technological change, and that such decisions are better left to Congress.<sup>12</sup>

But the first-sale doctrine is not principally a creature of statute. It was developed by the judiciary, and its 400-year history predates the very concept of copyright law. The adoption of the doctrine into the Copyright Act was intended not to constrain the doctrine from its roots in Supreme Court jurisprudence, but rather to clarify the limits on the rights to “vend” or “distribute” copyrighted works.

Arguably, then, the codification of that doctrine in the first-sale statute need not have constrained the *ReDigi* court from extending the judicial first-sale doctrine into the newer context of digital content.<sup>13</sup>

<sup>10</sup> The court’s opinion did not determine whether *ReDigi* had infringed Capitol’s public performance and display rights.

<sup>11</sup> This also was the conclusion of a congressionally mandated Copyright Office study, DMCA Section 104 Report (2001).

<sup>12</sup> See *Sony Corporation of America v. Universal City Studios Inc.*, 464 U.S. 417, 430-431, 220 U.S.P.Q. 665 (U.S. 1984).

<sup>13</sup> The United States, as amicus curiae, argued as much in *Kirtsaeng*. While agreeing with Wiley that the first-sale doctrine applied only to domestically-produced copies, the United States suggested that the Ninth Circuit’s safety valve—

The first-sale doctrine has served society well, permitting local record shops to sell used albums and friends to swap their favorite books without the threat of litigation.

But media consumption has evolved considerably in recent years, particularly with respect to e-books and music. In the first quarter of 2012, publisher revenue from adult e-books outpaced hardcover sales.<sup>14</sup> The corner record shop is a distant memory; revenues attributable to digital music now exceed revenues attributable to physical music in the United States.<sup>15</sup> To sup-

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allowing the first-sale privilege for authorized imported copies—could be justified as an extension of *Bobbs-Merrill*.

<sup>14</sup> Deirdre Donahue, “E-book sales revenue officially tops revenue from hardcover,” *USA Today* (June 21, 2012); <http://books.usatoday.com/bookbuzz/post/2012-06-21/e-book-sales-revenue-officially-tops-revenue-from-hardcover-/787586/1>.

<sup>15</sup> See Joshua Friedlander, *News and Notes on 2012 RIAA Music Industry Shipment and Revenue Statistics 1*; <http://76.74.24.142/4A176523-8B2C-DA09-EA23-B811189D3A21.pdf> (“Overall, digitally distributed formats comprised 59 percent of the total US market by dollar value in 2012, after crossing the 50 percent threshold for the first time in 2011.”); see also The Nielsen Company & Billboard’s 2012 Music Industry Report; <http://www.businesswire.com/news/home/20130104005149/en/Nielsen-Company-Billboard%E2%80%99s-2012-Music-Industry-Report>.

port the continued growth of the digital market and by extension the content industries, purchasers of digital content should be afforded the same rights and privileges as purchasers of physical copies.

Many consumers would be surprised and, to say the least, displeased to learn that they don’t “own” the content they pay for and download.<sup>16</sup> A draconian interpretation of the first-sale doctrine imposes unnecessary restrictions on digital content, depriving consumers of their rights to efficiently sell or give away their property, and potentially resulting in higher supra-competitive prices.

The same entities that have spent the better part of the last decade combating online piracy should avoid alienating consumers turning to legal digital outlets. It makes far better sense for the courts to give consumers back their right to sell or give away their digital content, without having to sell their iPods and Kindles.

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<sup>16</sup> Although the story was later refuted, the issues raised by reports that Bruce Willis had considered suing Apple for restricting his ability to bequeath his digital music collection to his family are telling. Oscar Raymundo, “Bruce Willis Did Not Sue Apple Over His iTunes Library,” *Rolling Stone* (Sept. 5, 2012, 4:10 p.m.); <http://www.rollingstone.com/culture/blogs/gear-up/bruce-willis-did-not-sue-apple-over-his-itunes-library-20120905>.