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"First Sale Under Title 17"

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Good morning Chairman Coble, Ranking Member Nadler, Chairman Goodlatte, Ranking Member Conyers, and Members of the Subcommittee. Thank you very much for the opportunity to testify today regarding the first sale doctrine in U.S. copyright law.

I am a nonresident senior fellow in Governance Studies and the Center for Technology Innovation at the Brookings Institution. I am also a professor at UCLA, where I hold appointments in the Electrical Engineering Department and the Department of Public Policy. The views I am expressing here are my own, and do not necessarily represent those of the Brookings Institution or the University of California. Portions of my testimony today are adapted from an article I published last year in *Competition Policy International Antitrust Chronicle*.[1]

My testimony today can be summarized as follows: First, modification of U.S. copyright law to introduce a broad "digital first sale"[2] doctrine would lead to unintended consequences that would dramatically reduce the ability of content creators to be properly compensated for works sold digitally. If loans, sales, and other dispositions of such digital content could be made instantly, without the authorization of the copyright holder, and among parties who might be separated by thousands of miles, those dispositions would largely replace the market for initial sales.

Second, the question of digital first sale, as important as it has been, is becoming less so with each passing year. As licensing-based models continue to become more common, fewer creative works are distributed using sales that confer ownership over a particular digital copy of the content. And when there is no sale, the first sale doctrine does not apply. Instead, the permissible downstream uses of digital content in a license-based ecosystem are addressed through a combination of contract law and intellectual property law.

Many licenses today are overly complex and restrictive. Content providers should provide consumers with clearer disclosures regarding the permissible and prohibited

[1] John Villasenor, "Rethinking a Digital First Sale Doctrine in a Post-*Kirtsaeng* World: The Case for Caution," *Competition Policy International Antitrust Chronicle*, May 2013, Vol. 2., *available at* http://ssrn.com/abstract=2273022. Used with permission.

[2] As used herein, "digital first sale doctrine" refers to a hypothetically expanded 17 U.S.C. §109 that would allow for resales absent any physical transfer of an accompanying storage medium, without the authoriziation of the copyright holder. In addition, as used herein, "digital" refers to works conveyed to consumers through digital transmission, and not to digital works delivered in tangible form such as a music CD or movie DVD.

uses of licensed content. Once consumers are better informed about license-based offerings, I am optimistic that market pressure will lead content providers to offer licenses that are more flexible, and that in some cases could permit dispositions of digital content analogous to those that have long been available to owners of non-digital content under the existing first sale doctrine.

The First Sale Doctrine in U.S. Copyright Law

Before considering the issues that would be raised by modifying copyright law to introduce a digital first sale doctrine, it is helpful to set the context by briefly discussing the first sale doctrine as it exists today.

Under U.S. copyright law a copyright owner has a bundle of exclusive rights.[3] More specifically, a copyright owner, subject to some exceptions, has an exclusive right to reproduce (or authorize the repoduction of) the copyrighted work and to distribute (or authorize the distribution of) "copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending."[4] There are other exclusive rights conferred by copyright as well, but in discussing digital first sale it is the reproduction right and the distribution right that usually play the most central role.

One of the exceptions mentioned above is the first sale doctrine, which is an exception to the distribution right, and is codified in the Copyright Act of 1976 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.[5]

To see how this operates, consider a person who walks into a bookstore in the United States and purchases a brand new paperback book.[6] Suppose that after she has finished reading the book, she decides to loan it to a friend who lives nearby. Thanks to the first sale doctrine, she is able do this without obtaining permission from the copyright holder. In the language of the doctrine, as the "owner of a

[3] 17 U.S.C. §106.
[4] The reproduction right is codified at 17 U.S.C. §106(1); the distribution right is codified at 17 U.S.C. §106(3).
[5] 17 U.S.C. §109(a). In addition, 17 U.S.C. §109(c), which provides a defense to infringement of the display right in 17 U.S.C. §106(5), is also relevant to the first sale doctrine.
[6] This example assumes, of course, that the book is "lawfully made under this title."

particular copy" of the book, she is "entitled, without the authority of the copyright owner," "to dispose of the possession of that copy"—in this example by loaning it to a friend.

No new copies are created when she loans the book, donates it to a library, or sells it at a garage sale. In each of these transactions, the single copy purchased at the bookstore simply gains a new custodian. As a result, the copyright holder's reproduction right is not implicated. In addition, while loans, donations, and resales are distributions, the first sale doctrine frees the purchaser of the book to engage in these transactions without obtaining the authorization of the copyright holder. Stated another way, the copyright holder's exclusive distribution right with respect to that particular copy[7] of the book was exhausted after the "first sale."

Although the first sale doctrine is a feature of copyright law, it has roots in a broader recognition that markets are generally healthier when owners of goods have a high degree of flexibility in determing if, when, and under what terms they are later placed back into the stream of commerce. The procompetive benefits of avoiding restrictions on that flexibility—or more formally, of avoiding restrictions on alienation—have been understood for centuries.

As early as the 1600s, English jurist Lord Coke described the harms to "trade and traffique, and bargaining and contracting"[8] that could accompany transfers of ownership interests encumbered by alienation constraints. In the United States, in the specific context of copyright, the first sale doctrine was articulated by the Supreme Court the 1908 ruling in *Bobbs-Merrill Co. v. Straus*,[9] which held that a copyright owner's "right to vend" did not include the right "to control all future retail sales." The doctrine was codified in the Copyright Act of 1909[10] and again in the Copyright Act of 1976 as noted above.

First Sale in the Digital Era

In the pre-digital era, the transfer of a copyrighted work from one person to another typically involved the movement of a physical storage medium such as a vinyl

[7] This example assumes that all of the dispositions described are occurring within the United States. The landscape for international exhaustion has become more complex after the 2013 Supreme Court decision in *Kirtsaeng v. John Wiley & Sons. Inc.*, 133 S.Ct. 1351 (2013).
[8] 1 E. Coke, Institutes of the Laws of England § 360, p. 223 (1628), a*vailable at* http://www.constitution.org/18th/coke1st1778/coke1st1778_501-550.pdf.
[9] *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339, 351 (1908).
[10] *See* the Copyright Act of 1909, Pub. L. No. 60-349, 35 Stat. 1075 (repealed 1976).

record, CD, DVD, or paper. By contrast, transfers today over the Internet are electronic.

In its current form, the first sale doctrine does not enable the owner of a lawfully made digital copy of a work to loan, sell, or otherwise dispose of it through a digital file transfer over the Internet without the authorization of the copyright holder. The reason is simple: The first sale doctrine is an exception to the distribution right, not to the reproduction right. A digital transfer of a file from one location to another implicates both rights, because a new copy of the work is created at the destination of the transfer.[11]

The role of the first sale doctrine with respect to digital transfers was at the core of the recent *Capitol Records, LLC v. ReDigi Inc.* litigation in the Southern District of New York. ReDigi, a company that launched an online digital marketplace in 2011 aimed at enabling users to resell lawfully acquired digital music files, had also developed file deletion technologies. In addition to hosting a website to facilitate the resales, ReDigi provided a downloadable "Media Manager" designed to ensure that users did not retain copies of songs they had sold. After Capitol Records filed a copyright infringement complaint[12] against ReDigi in the Southern District of New York, Judge Richard J. Sullivan ruled in 2013 that the creation of a copy of a work through ReDigi's service "infringes Capitol's exclusive right of reproduction."[13] In addition, Judge Sullivan ruled that the "sale of digital music files on ReDigi's website infringes Capitol's exclusive right of distribution."[14]

Notably, with respect to the reproduction right, the ruling did not cite any failure of the ReDigi technology at issue in the case to ensure that a seller's copy is not retained upon a sale as the basis for infringement. Instead, ReDigi was found to infringe because the creation of a new copy of a file on a buyer's computer (or

[11] Notwithstanding extensive jurisprudence to the contrary, various legal theories have been advanced to support an interpretation that resales via digital file transfers are permitted under current copyright law. For example, it is sometimes argued that if the seller's copy is deleted at the moment the buyer's copy is created, there has been no reproduction, and that the distribution that accompanies a file transfer can be accomplished in a manner that is equivalent from a copyright law standpoint to the distribution that accompanies the transfer of a tangible medium containing a copyrighted work to a new owner. However, these theories have not gained a sympathetic reception in the courts.

[12] *See* Complaint, *Capitol Records, LLC v. ReDigi Inc.*, No. 1:12-cv-00095-RJS, (S.D.N.Y. Jan. 6, 2012), ECF No. 1., *available at* http://ia700800.us.archive.org/30/items/gov.uscourts.nysd.390216/gov.uscourts.nysd.390216.1.0.pdf

[13] *Capitol Records, LLC v. ReDigi Inc.*, 934 F. Supp. 2d 640, 651 (S.D.N.Y. 2013).

[14] *Id.*. In finding that Capitol's distribution right was infringed, Judge Sullivan wrote that because "a digital music file sold on ReDigi is not 'lawfully made under this title,'" its distribution by ReDigi was outside the scope of the first sale doctrine. *Id.* at 655.

cloud-based locker) falls outside the scope of §109(a). As Judge Sullivan wrote in the conclusion to his decision, "[t]he Court cannot of its own accord condone the wholesale application of the first sale defense to the digital sphere, particularly when Congress itself has declined to take that step."[15]

Digital First Sale: Considering the Unintended Consequences

Few people would question the vital role that the existing first sale doctrine has played with respect to non-digitally-delivered works. We have the first sale doctrine to thank for libraries, used bookstores, garage sales where we can rummage through used music CDs, and, just in the past few years, the hundreds of "Little Free Libraries"[16] that have sprung up in neighborhoods around the country, and where anyone is free to take or leave a book. The first sale doctrine has been, and continues be, a powerful and positive force in the broader culture.

Against this backdrop, it is natural to consider whether to modify copyright law to create a "digital first sale doctrine" that would accommodate dispositions of copyrighted works over the Internet. This issue first gained attention in the 1990s as Internet distribution of creative works became more common. The Digital Millennium Copyright Act of 1998 contained a provision[17] calling for the U.S. Copyright Office to submit a report to Congress on "the relationship between existing and emergent technology and the operation of sections 109 and 117 of title 17, United States Code." The resulting report,[18] which was delivered in August 2001, devoted nearly 30 pages of discussion to "the first sale doctrine in the digital world," and recommended making "no change to section 109 at this time."[19]

Much more recently, in July 2013, the Department of Commerce Internet Policy Task Force published a report titled "Copyright Policy, Creativity, and Innovation in the Digital Economy."[20] The Task Force discussed digital first sale and conluded that "this is an area that deserves further attention."[21] The Task Force also wrote

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[15] *Id.* at 660.
[16] http://littlefreelibrary.org
[17] Digital Millennium Copyright Act of 1998, Pub. L. No. 105-304, 112 Stat. 2860, 2876, *available at* http://www.gpo.gov/fdsys/pkg/PLAW-105publ304/pdf/PLAW-105publ304.pdf.
[18] U.S. Copyright Office, *DMCA: Section 104 Report (A Report of the Register of Copyrights Pursuant to Section 104 of the Digital Millennium Copyright Act)* (2001) ("2001 DMCA Report"), *available at* http://www.copyright.gov/reports/studies/dmca/dmca_study.html.
[19] 2001 DMCA Report, Executive Summary Section, p. xx.
[20] U.S. Department of Commerce, Internet Policy Task Force, *Copyright Policy, Creativity, and Innovation in the Digital Economy* (Green paper, July 2013), *available at* http://www.uspto.gov/news/publications/copyrightgreenpaper.pdf.
[21] *Id.* at 37.

that the "USPTO, in collaboration with the Copyright Office, will solicit public comments and hold a series of roundtables regarding the relevance and scope of the first sale doctrine in the digital age."[22]

Proponents of a digital first sale doctrine often point out, correctly, that owners today have less flexibility than in the past with respect to dispositions of copyrighted works. Thirty years go, a person who purchased a vinyl record became the owner of that copy of the songs it contained and enjoyed a wealth of choices in their later disposition. Today, a person who purchases (as opposed to licenses) a song over the Internet becomes an owner of a digital copy of that song. But, because the first sale doctrine does not provide an exception to the copyright holder's reproduction right, it does not allow the purchaser to electronically transfer the file to someone else pursuant to a loan or sale.

It is tempting to conclude that there is an easy fix: Create a digital first sale doctrine by modifying 17 U.S.C. §109 to add an exception to the reproduction right. This could enable owners of copies of works delivered over the Internet to engage in dispositions analogous to those that have long been possible with non-digital works. But there is a problem: This change would also be exploited to engage in dispositions that are unique to digital content, opening up a Pandora's box of unintended consequences.

One particularly vexing problem would be very short-duration loans of digital works,[23] potentially facilitated by web-based services that would match listeners and owners whose copies of requested songs were sitting unused on hard drives dispersed throughout the country (or, post-*Kirtsaeng*, the world).

Consider a group of one million music fans, each of whom wishes to listen to a certain 3-minute song exactly once a week at a randomly chosen day and time. How many copies of the work would need to be available in the pool of lenders to ensure that multiple simultaneous requests could be satisfied? In the strictest mathematical sense, to account for the infinitesimal chance that all million people might choose to listen to the song at the same time, one million copies would be needed. But the statistical odds of that occurring are so low as to be effectively zero. In practice, the majority of loan requests could be handled with access to an inventory of only a few hundred copies of the song. If this approach were carried to its maximally efficient extreme, a recording artist could only sell a number of copies of a song equal to the

[22] *Id.*
[23] The 2001 DMCA Report discussed this general scenario, though without any numerical examples. See 2001 DMCA Report, at 83.

maximum number of people listening to it at any one time. This would dramatically reduce the market for digital music sales.

Suggestions that no one would go to these sorts of extremes to facilitate content access using schemes like this aren't particularly convincing. After all, one need only look at Aereo's approach to using the Internet to connect consumers with over-the-air television broadcasts to see the lengths to which businesses will go to take advantage of perceived loopholes in copyright law.[24] New loopholes created by a digital first sale doctrine would be exploited to the fullest.

Another well-recognized aspect of digital works is that the concept of "used" loses its meaning. On average, used printed books, CDs, and DVDs are less valuable than their brand new counterparts. By contrast, a digital representation of a work can be transferred over the Internet thousands of times and remain literally bit-for-bit identical to the version originally delivered pursuant to a first sale. Markets where works offered for resale are indistinguishable from new works will behave very differently from markets where that distinction is clear.

Content creators who raise these sorts of issues in digital first sale discussions are often waved off with criticisms that they "just don't get" digital, and are trying to deny inevitable technological progress. But the first sale doctrine has historically worked in part *because* physical copies of works degrade with use, because they cannot be traded instantly and temporarily among parties separated by thousands of miles, and because it is impossible to loan a paperback book to a friend while simultaneously keeping it on your own bookshelf.

Due to the inevitable unintended consequences that would result, modification of U.S. copyright law to introduce a broad digital first sale doctrine would be a mistake. And I am not aware of any statutory language that could be used to craft a *narrow* digital first sale doctrine that would somehow avoid these unintended consequences while also being practical and workable.

[24] As many people with an interest in copyright issues know, Aereo provides a service involving thousands of very small antennas, each assigned to an individual user who uses the Internet to access the signal received at his or her antenna. The Supreme Court heard arguments in *American Broadcasting Companies, Inc., et al. v. Aereo, Inc.* in April 2014, and a ruling is expected in June.

The Shift to a Licensing-Dominated Ecosystem

More fundamentally, the issue of digital first sale, while important, is becoming less so as license-based content distribution becomes increasingly common.[25] Fewer and fewer digital works are provided pursuant to sales that confer ownership of a copy of a work. Due to this shift, consumers of digital content are now increasingly likely to be licensees as opposed to owners. And the first sale doctrine, which applies to "the owner of a particular copy of a work," does not apply to licensees.[26] For licensees, permissible uses of content are governed by a combination of intellectual property law and contract law.[27]

Today's consumers have access to a remarkable and quickly growing range of license-based content offerings. Some classes of offerings, such as Internet-based music streaming and movie streaming services, do not tend to lead to customer confusion regarding ownership. There is little chance that consumers using these services could reasonably conclude that they are receiving an ownership interest in the temporary copies of works streamed to their devices.

However, consumers who shop at content provider web sites featuring opportunities to "buy" a digital verson of a song, movie, or book can reasonably expect that when the transaction is completed, they will own a copy of the work. But in many cases, that is not what occurs. Instead, consumers who "buy" copies of digital works are often subject to terms of use agreements specifying that they are in fact licensees, not owners.

Very few consumers take the time to read these agreements in full. And those who do can find them to be mind-numbingly complex, often containing clauses with

[25] Computer software has been distributed pursuant to licenses for decades. But for music, books, and movies, the shift towards license-based distribution is much more recent.

[26] *See* 17 U.S.C. §109(d): "The privileges prescribed by subsections (a) and (c) do not, unless authorized by the copyright owner, extend to any person who has acquired possession of the copy or phonorecord from the copyright owner, by rental, lease, loan, or otherwise, without acquiring ownership of it." In addition, in 1998 the Supreme Court explicitly noted that 17 U.S.C. §109(a) does not apply to licensees: "[B]ecause the protection afforded by §109(a) is available only to the 'owner' of a lawfully made copy (or someone authorized by the owner), the first sale doctrine would not provide a defense to a §602(a) action against any nonowner such as a bailee, a licensee, a consignee, or one whose possession of the copy was unlawful." *Quality King Distributors, Inc. v. L'anza Research Int'l, Inc.*, 523 U.S. 135, 146–47 (1998).

[27] The issue of when terms constitute contracts is complex, and can depend, for example, on whether the user has taken an action such as clicking an "I agree" button. See, e.g., Ed Baylay, *The Clicks That Bind: Ways Users "Agree" to Online Terms of Service*, ELECTRONIC FRONTIER FOUNDATION, Nov. 16, 2009, https://www.eff.org/wp/clicks-bind-ways-users-agree-online-terms-service.

ambiguous wording susceptible to conflicting interpretations even among attorneys who specialize in contract law.

I am not sympathetic to the argument that the onus is on consumers to resolve these ambiguities as a pre-condition to obtaining new digital content. I believe that content providers have at least an ethical obligation—and quite possibly a legal obligation under consumer protection laws—to clearly structure offerings so that consumers are informed about restrictions accompanying their purchases of digital copies of copyrighted works. When consumers are weighing offers enabling them to "buy" content that they in fact will not own, that information should be clearly and explicitly conveyed before the transaction is completed. When consumers are considering acquiring content that they will be prohibited from loaning, selling, giving as a gift, or bequeathing to an heir, that information should be presented in easy-to-understand, unequivocal language, before the "purchase" is completed.

While these issues are of vital importance to the creative content ecosystem, they cannot and should not be addressed through changes to copyright law. And they should not be addressed through judicial decisions that might retroactively and improperly reclassify contractually valid license agreements as sales.[28] Instead, they should be addressed by ensuring what in fact should be common sense: that consumers who license copyrighted works have access to clear up-front descriptions regarding the permitted and prohibited uses of the content.

Once that occurs, I am optimistic that market forces will lead to future license-based content offerings giving consumers many more options than those commonly available today. And, in contrast with attempting to address digital content dispositions through a one-size-fits-all statutory approach, allowing the market to experiment with a diversity of solutions is more likely to result in balanced approaches that, among other things, could permit licensees to engage in dispositions of digital content analogous to those that have long been available to owners of tangible copies of works.

[28] However, courts do have an important role in determining when licenses are contractually binding. For example, in a 2011 decision in *UMG Recordings, Inc. v. Augusto* (628 F.3d 1175 (9th Cir. 2011)), the Ninth Circuit found license terms prohibiting resale to be nonbinding because there was no "indication that the recipients agreed to a license." *Id.* at 1182-1183. See also *Vernor v. Autodesk, Inc.*, 621 F.3d 1102 (9th Cir. 2010), cert. denied, 132 S.Ct. 105 (2011), in which the court ruled that a software licensee was indeed bound by terms accepted as a condition of installing the software. More problematically, in Europe in 2012, the Court of Justice of the European Union *did* reclassify an apparently valid license as a sale, ruling in C-128/11, *UsedSoft GmbH v. Oracle Int'l. Corp*., 2012 E.C.R. I-0000 (3 July 2012), that a software licensee holding a perpetual license could resell the license, despite terms prohibiting a transfer. Though *UsedSoft* was not a decision by a U.S. court, it could nonetheless have influence in future U.S. court cases involving analogous fact patterns.

Thank you again for the opportunity to testify on this important topic.

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