

**Question Q240**

**National Group:** United States of America

**Title:** Exhaustion issues in copyright law

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**Questions**

**I. Current law and practice**

The Groups are invited to answer the following questions under their national laws:

**Right of distribution**

- 1) Does the copyright law of your country recognise the right of distribution within the meaning of Article 6, paragraph (1) of WCT? If so, please cite the provisions which set forth the definition of the right of distribution and recognise such right.

**RESPONSE:** Section 106(3) of the Copyright Act establishes the exclusive right to distribution and grants "the owner of copyright under this title" certain "exclusive rights," including the right "to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease or lending." 17 U.S.C. §106(3).

**Exhaustion of copyright-protected works**

- 2) Does the copyright law of your country recognise the exhaustion of copyright-protected works after the first sale of the work with the authorisation of the author? Is it recognised by statutory law or case law?

**RESPONSE:** Section 109(a) of the Copyright Act of 1976 codified the common law principle of the first sale doctrine. Section 109(a) sets forth the first-sale doctrine as "Notwithstanding the provisions of section 106(3) [the section that grants the owner the exclusive distribution right as set forth in Question 1], the owner of a particular copy or phonorecord lawfully made under this title . . . is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord." 17 U.S.C. §109(a).

The U.S. Supreme Court established the first sale doctrine in *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339 (1908). The first sale doctrine was first codified as Section 27 of the Copyright Act of 1909.

3) How does your law treat exhaustion of copyright-protected works?  
Specifically,

- a) Does exhaustion of rights occur for all kinds of works or is exhaustion limited to certain kinds of works?

RESPONSE: The first sale doctrine makes no distinction as to the type of work. The first sale doctrine, however, does make a distinction as to whether the work is sold or licensed and, plausibly, as to whether the item is a material item or a digital media.

Limitations to the first sale doctrine, however, apply to certain types of works such as rentals of phonorecords and software. The Record Rental Amendment of 1984, codified in 17 U.S.C. §109(b), prohibits an owner of a phonorecord that embodies a sound recording or musical work from renting it to the public for direct or indirect commercial advantage. This exception was designed to prevent music stores from renting records and thereby facilitating home copying. Libraries and educational institutions are exempted from this limitation.

The Copyright Software Rental Amendments Act of 1990 also amended 17 U.S.C. §109(b) to prohibit rentals of computer software for direct or indirect commercial advantage. The exception does not apply to lending of a copy by a nonprofit library for nonprofit purposes, provided the library affixes an appropriate warning.

- b) Which right can be exhausted? Is it (a) the right of distribution, and/or (b) the right of reproduction, and/or (c) the right of lending and/or renting of copies?

RESPONSE: The first sale doctrine affects the right of distribution. The first sale doctrine does not affect the right of reproduction. In other words, the owner of a copy does not have the right to make additional copies of the work. In certain circumstances, lending or renting copies of phonorecords and software is an exemption to the first sale doctrine as described above in Question 3(a).

- c) What are the requirements for exhaustion of rights to occur? What activities by rightholders are required for exhaustion to apply? Are licensees/buyers required to take any positive steps for exhaustion to be applicable?

RESPONSE: The first sale doctrine excludes copyright owners from secondary market control only if they elect to sell or otherwise transfer copies in a manner that allows a transferee to become an owner of a copy, rather than licensing rights or making other similar transfers that do not convey copy ownership. Raymond T. Nimmer, "Copyright First Sale and the Overriding Role of Contract," 51 Santa Clara L. Rev. 1311, 1319 (2011).

The elements of the first sale doctrine includes (1) the copy was lawfully made with the authorization of the copyright owner; (2) ownership of the copy was initially transferred under the copyright owner's authority; (3) the defendant is a lawful owner of the copy in question; (4) the defendant's use implicates the distribution right only; not the reproduction or some other right given to the copyright owner; and (5) the sale or other disposition of the owner's copy is of the owner's "particular" copy. The buyers/licensees are not required to perform any positive steps to perfect exhaustion.

- d) If the rightholder A distributes lawful copies made by A to people including B, B purchases a copy from A and sells it to C, and thereafter A cancels the sales agreement between A and B because of non-payment of the price by B to A, may A assert his/her copyright against C? May C rely on exhaustion of A's rights to the work

(or the right of distribution)? In this connection, which party (A or C) will keep the right of ownership in the tangible copy?

RESPONSE: We know of no case law or statute on point. The mere act of purchasing a material copy or a phonorecord, however, does not infringe any of a copyright owner's enumerated rights under the Copyright Act. In criminal copyright infringement, criminal defendants frequently resist prosecution by claiming that they believed the works they were selling had been the subject of a legitimate first sale. See, Criminal Resource Manual 1854, United States Attorneys' Manual 9-71.001. This scenario may also be subject to state law regarding the sale of goods including, but not limited to, the holder in due course doctrine.

- e) Are there any statutory exceptions to the exhaustion of rights, e.g. transformation of the work by the licensee/buyer prior to re-selling?

RESPONSE: There are no explicit statutory exceptions to the exhaustion of rights under Section 109 of the Copyright Act.

- f) May the exhaustion of rights be waived contractually?

RESPONSE: Although this issue continues to work itself through the courts in several jurisdictions in the United States, the Court of Appeals for the Seventh Circuit has held that the exhaustion of rights from a sale can be waived contractually and are enforceable unless their terms are objectionable on grounds applicable to contracts in general (for example, if they violate a rule of positive law, or if they are unconscionable). See, *ProCD, Inc. v Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996).

- 4) What is the rationale/justification under your law for the exhaustion of rights?

RESPONSE: The legislative history of 17 U.S.C. §109 provides the policies behind the first sale doctrine, namely, "The first sale doctrine was originally adopted by the courts to give effect to the early common law rule against restraints on the alienation of tangible property." S. Rep. No. 162, 98th Cong., 1st Sess. 4 (1983)(regarding The Record Rental Amendment of 1984, now codified in 17 U.S.C. §109(b)).

The legislative history of section 109 of the 1976 Act and of section 27 of the 1909 Act, the first codification of the first sale doctrine, is quite brief. Despite its brevity, it focuses on one important and relevant concept. Repeatedly, the congressional reports refer to the ability of the owner of a material copy to dispose of that copy as he sees fit. H.R. Rep. No. 2222, 60th Cong., 2nd Sess. 19 (1909); H.R. 28192, 60th Cong., 2nd Sess. 26 (1909); H.R. Rep. No. 94-1476, 94th Cong., 2nd Sess. 79 (1976)(regarding the Copyright Acts of 1909 and 1976, respectively). The creation of the first sale doctrine appears to have been motivated as well by competition concerns; specifically, the ability of publishers to use their vending or distribution right to control not only the initial sales of books, but the aftermarket prices for resales. DMCA Section 104 Report (2001) at 86-91.

#### **International exhaustion (specific issue 1)**

- 5) Does your law recognise international exhaustion of copyright? Specifically, if a copyright-protected work stored on a tangible medium (such as CD or DVD) which was lawfully made and distributed outside your jurisdiction is imported into and sold in your jurisdiction, may the holder of the copyright in your jurisdiction assert his/her copyright against such copy?

RESPONSE: In *Kirtsaeng v. John Wiley & Sons, Inc.*, 133 S. Ct. 1351 (2013), the U.S. Supreme Court recognized that lawfully-made copies made outside the United States may be imported into the United States without infringing the copyright owner's copyright. Accordingly, copyright-protected work stored on a tangible medium lawfully made and distributed outside the U.S. may be imported into the U.S. without infringing a copyright owner's distribution right. It has no effect, however, on any other rights the copyright owner might have (e.g., the right to copy or the public performance right.)

- 6) If your law recognises international exhaustion of rights, what is the rationale/justification under your law for such international exhaustion?

RESPONSE: The Supreme Court's determination was largely based on statutory construction of the phrase "lawfully made under this title" in Section 109 of the U.S. Copyright Act. In attempting to resolve conflicting language in the Act, the Supreme Court found that "lawfully made under this title" did not impose a geographic restriction on the creation of a copy.

#### **On-line exhaustion (specific issue 2)**

- 7) Does your law recognise on-line exhaustion or exhaustion in the case of downloaded copies of copyrightable works? Under which conditions are which kind of rights in different kinds of copyright-protected works exhausted?

RESPONSE: Under U.S. law, the first sale doctrine applies only to physical copies, not digital copies.

The controlling statute is §109 of the U.S. Copyright Act. Section 109 states that the defense applies only to "copies" and "phonorecords." The definition of the terms "copy" and "phonorecord" in §101 of the U.S. Copyright Act defines each as "material objects."

The leading court decision on whether the first sale doctrine applies to digital copies is *Capitol Records v. Redigi Inc.*, 934 F. Supp. 2d 640 (SDNY 2013) from the federal district court from the Southern District of New York. In that case, the court concluded that an online service designed to permit owners of digital iTunes ® files to re-sell their music files infringed the copyrights in the works embodied in the music files because:

- a) The transfer of the digital files necessarily involved reproductions of the works and therefore constituted a violation of the copyright owner's exclusive reproduction right, to which the first sale doctrine is not a defense; and
- b) The transfer of files also involved a violation of the copyright owner's exclusive distribution right, to which the first sale can be a defense but in this case was not because the first sale doctrine is limited to
  - i) Lawfully made copies, which these were not; and
  - ii) The owner's particular copy, which this was not.

The court further found that the service did not qualify under the fair use doctrine because:

- a) The use was not transformative and was commercial;
- b) The music works were at the "core of copyright protection;"
- c) The works were copied in their entirety; and
- d) The resulting copies were direct substitutes for the original.

The court stated in its opinion "the first sale defense is limited to material items, like records, that the copyright owner put into the stream of commerce...." It is important to note that under U.S. law, the decisions of a district court are not binding, even on other courts in the same district. In the absence of controlling authority, however, courts often view other district

court opinions (particularly, in a copyright case, New York district court opinions) as persuasive.

Supporting this judicial opinion is a 2001 Report of the U.S. Copyright Office, *Library of Cong., DMCA Section 104 Report (2001)*, which concludes that the FSD does not properly apply to digital goods.

- 8) Are rights exhausted in a perpetual or non-perpetual licence? Are "re-sellers" of digital copies allowed to further re-sell such digital copies under the circumstances described in *UsedSoft v. Oracle*? Can multi-user-licences be split up and sold separately?

RESPONSE: No rights are exhausted unless there is a sale.

- 9) Is a distinction made for each kind of copyright-protected work (computer programs, music files, e-books and videos)?

RESPONSE: As stated above, the first sale doctrine applies only to physical copies and not to digital copies, and only to copies that are sold and not to copies that are licensed. Among physical copies that are sold, there is no distinction among different types of works (computer programs, musical works, books, audiovisual works).

- 10) If your exhaustion regime for digital works differs from that for analogue works, what is the rationale/justification for such difference?

RESPONSE: The reasons for not applying the first sale doctrine to digital works as explained in *Redigi Inc.*, 934 F. Supp. 2d 640, and in the Copyright Office Report, discussed above in Question 7, include:

- a) As a matter of statutory construction, it does not fall within the language of the statute;
- b) There are practical differences in secondary markets for physical copies that create "natural brakes" against creating undue harm to copyright owners which practical barriers do not exist in secondary markets for digital goods; and
- c) A secondary market for digital goods directly competes with the primary market for the copyrighted works.

### **Exhaustion of copyright-protected works in case of recycling and repair of goods (specific issue 3)**

- 11) In the case of recycling or repair of goods which are copyright-protected works, to what extent may one recycle or repair such goods without infringing (1) the right of reproduction, (2) the right of adaptation, the right of arrangement and/or other alteration rights; or (3) the right to integrity?

RESPONSE: (1) With respect to recycling or repair of goods and the right of reproduction, under 17 U.S.C. § 106, the owner of a copyright has the exclusive right to reproduce the copyrighted work in copies or phonorecords or authorize such reproduction. As a general rule, lawful owners of copies may do whatever they wish with their copies as long as they do not create a derivative work. There are a few exceptions. In the repair of computers a party can make an additional copy under certain circumstances related to that repair. U.S.C. §117(c).<sup>1</sup> Outside of that limited context, the intersection of recycling or repairing and the

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<sup>1</sup> 17 U.S.C. § 117(c):

copyright owner's right to reproduction does not appear to have been squarely addressed in the U.S.

Ultimately, the line between "repair" and reproduction has yet to be fully explored in the United States, which means the answer to this question will depend on the facts as determined by the fact finder, which, in the U.S. can be either the court or a jury, if requested by either party to an infringement lawsuit.

(2) With respect to recycling or repair of goods and the right of adaptation, arrangement, and/or alteration, except as noted below, the owners of lawful copies may do whatever they wish with the copies, so long as they do not produce a derivative work.

(3) With respect to recycling or repair of goods and the right to integrity, the "right to integrity" is found in 17 U.S.C. 106A and is limited to works of visual art. That section permits copyright holders to "prevent any intentional distortion, mutilation, or other modification" of their work to the extent such mutilation would be "prejudicial to his or her honor or reputation." Under the same subsection, any intentional or grossly negligent destruction of a work of recognized stature is a violation of that right. To the extent "recycling" is seen as a distortion, mutilation, or modification that would be prejudicial to the author's honor or reputation, it, too, would violate the statute.

## **II. Policy considerations and proposals for improvements of the current law**

12) How should the law treat exhaustion of rights?  
Specifically,

- a) Should exhaustion of rights occur for all kinds of works or should exhaustion be limited to certain kinds of works?

**RESPONSE:** AIPPI-US favors exhaustion in analog or material copies, but does not take a position on digital copies. (see below)

- b) Which right(s) should be exhausted?

**RESPONSE:** The distribution right should be exhausted.

- c) What should be the requirements for exhaustion of rights to occur?

**RESPONSE:** A legitimate sale of the copy.

- d) Should copyright be exhausted even if the first sale of a copy by which exhaustion occurs is cancelled due to non-payment of the sales price or similar circumstance?

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(c) Machine Maintenance or Repair.—Notwithstanding the provisions of section 106, it is not an infringement for the owner or lessee of a machine to make or authorize the making of a copy of a computer program if such copy is made solely by virtue of the activation of a machine that lawfully contains an authorized copy of the computer program, for purposes only of maintenance or repair of that machine, if—

(1) such new copy is used in no other manner and is destroyed immediately after the maintenance or repair is completed; and

(2) with respect to any computer program or part thereof that is not necessary for that machine to be activated, such program or part thereof is not accessed or used other than to make such new copy by virtue of the activation of the machine.

RESPONSE: This question is more appropriately answered under the laws relating to the sale of goods and contract law. As a general rule, any downstream bona fide purchasers for value should be free to alienate any validly purchased copies.

### **International exhaustion (specific issue 1)**

13) Should there be international exhaustion of copyrights?

RESPONSE: No. Copyright owners will only have the incentive to adapt copies and derivative works to local markets if they can be confident that such adapted works will not be exported into other countries whose consumers otherwise would have purchased higher quality and higher priced copies.

Permitting copyright owners to price markets' copies differently (depending on, *inter alia*, the quality of the local copies) provides copyright owners with the incentive to provide such goods to developing nations.

### **On-line exhaustion (specific issue 2)**

14) Should there be on-line exhaustion of downloaded copies? In your view, are downloaded copies fully comparable with copies stored on tangible data media?

RESPONSE: The AIPPI-US Division does not take a position as to whether there should be on-line exhaustion of downloaded copies.

There are many who believe the first sale doctrine for on-line or digital copies should be follow the common law principles of the first sale doctrine codified in the subsequent Copyright Acts. Essentially, this position follows the "You bought it, you own it" rationale. In connection with this position, many believe that all transactions should be categorized as unrestricted sales instead of licenses.

On the other hand, many others believe such a policy of on-line exhaustion of downloaded copies would create substantially more harm to copyright owners than provide any lawful benefit to consumers. Re-sales of downloaded copies are essentially pristine copies and are otherwise indistinguishable from purchases from the copyright owners. The amount of resources used to store copies and make copies is virtually nonexistent. Others argue market forces have addressed the inability to resell online downloads by providing lower prices of copyrighted works to consumers and by providing the means to make and share a limited number of copies. Thus, many of the foundations of the common law first sale doctrine are not applicable to copyrighted downloads.

Many who are against a policy of on-line exhaustion believe the critical right implicated in a first sale doctrine applicable to online download is not the distribution right but the reproduction right. Currently, there are few safeguards in place that prevent a reseller of online downloads from keeping copies (reproductions) of the work for themselves. Once a technology exists to protect copyright owners' reproduction rights, a more focused discussion on the distribution right can be had.

15) If there should be on-line exhaustion, under which conditions should different kinds of rights be exhausted? Should there be any differences between downloading a work and streaming it? Should rights be exhausted in a perpetual or non-perpetual licence? Should "re-sellers" of digital copies be allowed to further re-sell such digital copies? Should multi-user-licences be split up and sold separately?

RESPONSE: The AIPPI-US Division does not take a position as to whether there should be on-line exhaustion of downloaded copies and thus has not developed a consensus on these questions.

16) Should a distinction be made for each type of copyright-protected work (e.g. computer programs, music, books and films)?

RESPONSE: The AIPPI-US Division does not take a position as to whether there should be on-line exhaustion of downloaded copies and thus has not developed a consensus on this question. Those in favor of applying the first sale doctrine generally favor applying the first sale doctrine to all types of works. Those against applying the first sale doctrine to downloads generally oppose applying the first sale doctrine to all types of downloadable copyright protected works.

### **Exhaustion of copyright-protected works in case of recycling or repair of goods (specific issue 3)**

17) To what extent should one be able to recycle or repair goods which are copyrightable works without infringing (1) the right of reproduction, (2) the right of adaptation, arrangement and other alteration rights; and (3) the right to integrity?

RESPONSE: As long as the recycling or repair of a good does not create a derivative work, AIPPI-US does not favor any limits on recycling or repairing goods.

### **III. Proposals for harmonisation**

18) Should exhaustion of rights as set forth in Question 12 above generally be harmonised? Please provide your reasons.

RESPONSE: AIPPI-US favors harmonizing exhaustion of the distribution right in tangible copies. AIPPI-US generally favors harmonization of intellectual property rights. Because AIPPI-US does not favor international exhaustion, however, the practical effect of harmonizing domestic exhaustion laws may be minimal.

19) Should international exhaustion of rights be harmonised or not? Please provide your reasons.

RESPONSE: AIPPI-US favors harmonizing laws that restrict international exhaustion of rights because, as discussed above, it provides the certitude necessary to content providers to adapt their products for local markets.

20) Should on-line exhaustion of rights be harmonised? Please provide your reasons.

RESPONSE: Given the relative ease with which re-sales of downloaded copies of digital works can be transferred around many different jurisdictions, harmonized on-line exhaustion of rights would benefit both copyright owners and consumers to allow for efficient transactions.

21) Should exhaustion of rights in case of recycling and repair of goods be harmonised? Please provide your reasons.



RESONSE: For the reasons set forth in the foregoing questions, the exhaustion of rights in recycled and repaired goods should be harmonized.

With regard to Questions 18 through 21, if you note that harmonisation is desirable, we will assume that harmonisation should be as your proposals for improvements of the current law as described in your answers to Questions 12 through 17. If that is not the case, please explain.