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US 9th Circuit: Promotional CDs Not Subject to Restrictions on Sale (and Its Canadian Relevance)

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In *UMG Recordings, Inc. v Troy Augusto*, the US Court of Appeals for the Ninth Circuit confirmed that promotional CDs which are distributed by record companies are not subject to restrictions on their sale (hat tip: Barry Werbin). As the court noted, many record companies distribute music CDs to various individuals or organizations (such as music critics and radio stations) in an attempt to develop marketing buzz. The CDs are often marked with phrases such as "Promotional Use Only - Not for Sale", or even bear printed statements such as:

"This CD is the property of the record company and is licensed to the intended recipient for personal use only. Acceptance of this CD shall constitute an agreement to comply with the terms of the license. Resale or transfer of possession is not allowed and may be punishable under federal and state laws."

Universal Music Group was chagrined to find that Mr. Augusto was obtaining promotional CDs and selling them on eBay - and sued Augusto for copyright infringement (on the basis that Augusto had infringed on UMG's exclusive right to distribute the CDs). Augusto, in defence, raised the US "first sale" doctrine (found in Section 109(a) of the US Copyright Act, which states that "the owner of a particular copy or phonorecord ... is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord" (Section 109(b) nonetheless prohibits the "rental, lease, or lending" of the CD). UMG argued that there had never been a "sale" of the CDs, only a license on particular terms - terms which were breached by Augusto's subsequent sales on eBay.

The Ninth Circuit Court of Appeals held that no license had been created: there did not need to be a "sale" of the CD in order to trigger the "first sale" doctrine, only a transfer of title - and title had been transferred by the fact that the CDs were mailed out without any prior agreement (or even discussion) with the recipient as to how the CDs were to be handled. Simply printing words on the CDs was not sufficient to create a license or to otherwise restrict the ability of the recipient to deal with the CDs. The court also held that, in the alternative, Augusto was able to rely on the provisions of the *Unordered Merchandise Act*, which results in the CDs effectively being treated as "gifts" and confers on recipients the right to dispose of the merchandise as they see fit.

(Although not much attention was paid to the matter, the Ninth Circuit distinguished software licenses mostly on the basis that software owners are able to "control" what software users/licensees are able to do with their software - and there seems to be an implicit recognition that software users need to affirmatively "accept" a software license and that the software itself can impose restrictions on what users are able to do with the software (such as the use of copy controls).

However, while that analysis might work for "click-wrap" licenses, it is unclear whether it would work for "shrink-wrap" licenses.)

Canadian copyright law does not enjoy the benefit of a codified "first sale" doctrine, though there is some limited recognition of the concept of "exhaustion", which would be functionally equivalent (see previous Signal discussion about the "first sale" doctrine). Pascale Chapdelaine, in an IPilogue post we previously highlighted, offers some detailed thoughts about Canadian recognition of a first sale doctrine:

The doctrine of first sale finds its roots in the English common law rule against restraints on alienation of property. In effect, it modulates two competing property interests in the copyrighted work, e.g. the intangible exclusive rights of the copyright holder in the copyrighted work and the property rights in the tangible embodiment of this work by the purchaser. One limits the rights of the other and *vice versa* (although very asymmetrically, as the exclusive rights conferred by copyright impose greater limitations on copy ownership than the reverse). First sale is also consistent with the normative values of freedom and autonomy that underlie property including chattels, as well as the instrumental goals of copyright to encourage the creation and dissemination of copyrighted works, when viewed from a broader perspective that also encompasses users of copyrighted works.

Pascale notes that **Bill C-32 (*The Copyright Modernization Act*)** incorporates references to the first sale/exhaustion doctrine. Bill C-32 would, if passed in its current form, appear to result in Canadian law being consistent with the decision in *UMG v Augusto*. Clauses 4, 9 and 11 of Bill C-32 create what is colloquially referred to as a "making available" right - similar to the exclusive right to distribute a work created by Section 106(3) of the US Copyright Act. Clause 4 of Bill C-32 would add a new subclause (j) to Section 3(1) of the *Copyright Act* (Canada), which would result in the section reading as follows [emphasis added]:

3.(1) For the purposes of this Act, “copyright”, in relation to a work, means the sole right to produce or reproduce the work or any substantial part thereof in any material form whatever, to perform the work or any substantial part thereof in public or, if the work is unpublished, to publish the work or any substantial part thereof, and includes the sole right...

(j) in the case of a work that is **in the form of a tangible object**, to sell or otherwise transfer **ownership of the tangible object**, **as long as that ownership has never previously been transferred** in or outside Canada **with the authorization of the copyright owner**,

Clause 11 of Bill C-32 would modify Section 18 of the *Copyright Act* (Canada) by adding a new Section 1.1 reading as follows:

(1.1) ... a **sound recording maker’s copyright** in the sound recording also i**ncludes the sole right** to do the following acts in relation to the sound recording or any substantial part of it and to authorize any of those acts: ...

(b) if it is **in the form of a tangible object**, to sell or otherwise **transfer ownership of the tangible object**, **as long as that ownership has never previously been transferred** in or outside Canada **with the authorization of the owner** of the copyright in the sound recording.

That would have the effect of making the decision of a Canadian court faced with facts similar to those in *Augusto* almost certainly the same as the Ninth Circuit's decision (at least with respect to copyright issues - I'll leave commentary on whether Canada has anything similar to the *Unordered Merchandise Act* to someone else). The new Section 3(1)(j) and 18(1.1) would give record companies the exclusive right to transfer ownership of the tangible object on which a sound recording was embodied - in other words, the physical CD. But, they would enjoy that right only if ownership had never previously been transferred with the authorization of the record company. Note that the language does not require a "sale" - only a "transfer of ownership". Thus, just as the Ninth Circuit held, a Canadian court would likely determine that ownership of the CD had been transferred when the record company mailed out the promo CDs, and that the recipient of the CD, and anyone to whom they transferred the CD, would be free in turn to sell or transfer the CD.

Of course, the analysis in the preceding two paragraphs depends on Bill C-32 being passed with the relevant language intact. In the absence of Bill C-32 being passed, Canadian copyright owners do not enjoy an express "making available" right, so Canadian record companies would appear to be in an even less enviable position than their US counterparts when trying to prevent unauthorized sales of promotional CDs. The possible arguments they could raise would be limited to a copyright infringement action due to a breach of a license term, or a straightforward breach of contract case; without having done any research on the matter, I'm not sure I can see why Canadian courts would be any more receptive to such arguments than the Ninth Circuit was. Possibly, if the album or single in question had not yet been made publicly available for sale, the record companies could argue that the work on the CD was "unpublished" and that selling a promotional CD was an infringement of their right to "publish" the work - but surely that would be a very time-limited prospect. Presumably, then, the brisk trade in promo CDs on online auction sites and in used record stores will continue unimpeded on both sides of the border.
