

Client Advisory | *September 2010*

Copyright First Sale Doctrine Does Not Apply to Resale of Licensed Software

Generally, when someone purchases a CD containing software, or a DVD containing a video game, they believe they own the item. Such ownership usually includes the right to resell or give away the object when one no longer wants it.



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A ruling in a federal court in the State of Washington last week calls this belief into question, and may severely limit the ability of businesses to purchase and resell used software, video games and other electronic content. *Vernor v. Autodesk, Inc.*, No. 09-35969 (9th Cir. Sept. 10, 2010).

Background

Over a century ago, the U.S. Supreme Court first articulated the “first sale doctrine” in copyright law, under which a copyright owner’s exclusive right to control the ownership or transfer of a lawfully made copy of copyrighted content is exhausted after the owner’s first sale of that copy. In that case, the copyright owner sold books to wholesalers with a printed notice announcing that any retailer who sold the book for less than \$1.00 was engaging in copyright infringement. The Supreme Court refused to enforce the restriction against a retail department store, which had purchased the books from a wholesaler, holding that the copyright owner’s exclusive right to control distribution of the book applied only to the first sale of copies of the book to the wholesaler.

Subsequently, Congress codified the first sale doctrine in the Copyright Act. In its current form, §109(a) of the Copyright Act allows the owner of a particular copy of a copyrighted work to sell or otherwise dispose of his copy without the copyright owner’s authorization.

The application of the first sale doctrine has long been an issue with software, video games and other industries distributing electronic content. For decades, software owners have not sold their product, but

instead distributed their software under licenses, which typically contain restrictions on the use and the transfer of the software. More recently, video games have also been distributed with similar license restrictions.

Individuals or entities that wish to resell the software or games have argued that the “substance of the transaction, rather than the form” should control. Because the typical software or video game transaction is more like the purchase and sale of a product than a license, many argue that the first sale doctrine should apply to software and video games. Courts in different jurisdictions have taken positions on both sides of this argument.

Vernor v. Autodesk

On September 10, 2010 the Federal Court of Appeals for the 9th Circuit upheld the right of software companies to treat these transactions as licenses, not sales. Finding that the software is licensed, the Court held that the customer therefore does not own the particular copy and cannot resell the copy under the first sale doctrine.

The facts of the case are relatively simple: In 2007, Mr. Timothy Vernor bought four authentic, used copies of Autodesk’s AutoCAD software, packaged as part of an office sale from a Seattle architectural firm. When he attempted to sell the software on eBay, Autodesk submitted a notice to eBay and Mr. Vernor that it considered the sale an infringement of its copyright. After Mr. Vernor responded that his auction constituted a legitimate sale, Autodesk (with respect to three auctions) did not respond

further and eBay reinstated the auction. In the fourth auction, eBay suspended Mr. Vernor's eBay account for a month, on the grounds of repeated copyright infringement.

Vernor filed an action in the federal courts in Washington, seeking a declaration that his sales were lawful pursuant to the first sale doctrine. In 2009, the federal court for the Western District of Washington ruled that the sale of authentic used CDs by Mr. Vernor did not infringe Autodesk's rights.

The September 10 decision by the 9th Circuit Court of Appeals vacated the district court's ruling. Significantly, the Court of Appeals looked to the circumstances surrounding the transfer of the software, and held that a software user is a licensee, rather than an owner of a copy, when the copyright owner:

- (1) specifies that the user is granted a license
- (2) significantly restricts the user's ability to transfer the software
- (3) imposes notable use restrictions.

Significance

The decision is significant because most software packages include end

user license agreements, many of which would meet the 9th Circuit's license test. As a result, software publishers are able to restrict the subsequent resale of "used" copies of these products in stores and online venues such as eBay or Craigslist.

The case is a major victory for the software industry and for other industries where the content can be licensed separately from the physical medium in which it is transferred. The 9th Circuit's ruling in this case technically only applies to Alaska, Arizona, California, Hawaii, Idaho, Montana, Nevada, Oregon, and Washington. However, 9th Circuit decisions are usually considered persuasive (especially for copyright cases), and are often followed by courts in other parts of the country.

The decision also has important implications in the video game industry where entire business models have been developed based on the repurchase and resale of used games. These practices now must be considered as a possible infringement based on the Court's analysis.

The Autodesk case is one of several in the federal courts that could have a dramatic effect on the scope of the first sale doctrine in the next few

months. Another case pending in the 9th Circuit deals with whether a music publisher can avoid the first sale doctrine by printing "promotional use only, not for resale" notices on CDs that they routinely give away to radio stations, in order to prevent the resale of these CDs on eBay or through other outlets. The 9th Circuit also has been asked to decide another case which deals with the end user's ability to interact with software and copy the software to a computer (in this case a gaming computer program) in a manner prohibited by license terms that accompany the program.

Furthermore, the United States Supreme Court has been asked to weigh in on the first sale doctrine in a case involving watches being manufactured and sold overseas and then imported and resold in the United States at a discount from the regular US price.

The decisions in these cases could substantially alter the current understanding of the first sale doctrine, and may result in inconsistent rulings. To the extent that the end result is unclear or is unsatisfactory to one or more groups, Congress may be asked to clarify the issue.

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