

The First Sale Doctrine Under U.S. Copyright Law

FAQs

If a copyrighted movie, book, song, computer program or other copyrighted work is *made and purchased in the United States*, the purchaser has the right to transfer or otherwise dispose of his or her copy of the work under what is known as the “First Sale Doctrine” -- which is codified in section 109(a) of the Copyright Act. The underlying policy of this doctrine is rather straightforward and simple but, various groups are taking advantage of some ambiguities in the language in the copyright statute to muddy the waters and make it seem like copyright owners are trying to expand their rights. That is not the case. In an effort to cut through the hyperbole and hype and to educate people on how the first sale doctrine works in practice, SIIA has put together this FAQ document.

Relevant Provisions

Section 106 of the Copyright Act:

Exclusive rights in copyrighted works

Subject to sections 107 through 122, the owner of copyright under this title has the exclusive rights to do and to authorize any of the following:

(1) to reproduce the copyrighted work in copies or phonorecords;

(2) to prepare derivative works based upon the copyrighted work;

(3) 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;

Section 109(a) of the Copyright Act:

Limitations on exclusive rights: Effect of transfer of particular copy or phonorecord

(a) 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.

Section 602 of the Copyright Act:

Infringing importation or exportation of copies or phonorecords

(a) Infringing Importation or Exportation.—

(1) Importation.—Importation into the United States, without the authority of the owner of copyright under this title, of copies or phonorecords of a work that have been acquired outside the United States is an infringement of the exclusive right to distribute copies or phonorecords under section 106, actionable under section 501.

(2) Importation or exportation of infringing items.—Importation into the United States or exportation from the United States, without the authority of the owner of copyright under this title, of copies or phonorecords, the making of which either constituted an infringement of copyright, or

which would have constituted an infringement of copyright if this title had been applicable, is an infringement of the exclusive right to distribute copies or phonorecords under section 106, actionable under sections 501 and 506.

(3) Exceptions.—This subsection does not apply to—

(A) importation or exportation of copies or phonorecords under the authority or for the use of the Government of the United States or of any State or political subdivision of a State, but not including copies or phonorecords for use in schools, or copies of any audiovisual work imported for purposes other than archival use;

(B) importation or exportation, for the private use of the importer or exporter and not for distribution, by any person with respect to no more than one copy or phonorecord of any one work at any one time, or by any person arriving from outside the United States or departing from the United States with respect to copies or phonorecords forming part of such person's personal baggage; or

(C) importation by or for an organization operated for scholarly, educational, or religious purposes and not for private gain, with respect to no more than one copy of an audiovisual work solely for its archival purposes, and no more than five copies or phonorecords of any other work for its library lending or archival purposes, unless the importation of such copies or phonorecords is part of an activity consisting of systematic reproduction or distribution, engaged in by such organization in violation of the provisions of section 108(g)(2).

(b) Import Prohibition.—In a case where the making of the copies or phonorecords would have constituted an infringement of copyright if this title had been applicable, their importation is prohibited. In a case where the copies or phonorecords were lawfully made, the United States Customs and Border Protection Service has no authority to prevent their importation. In either case, the Secretary of the Treasury is authorized to prescribe, by regulation, a procedure under which any person claiming an interest in the copyright in a particular work may, upon payment of a specified fee, be entitled to notification by the United States Customs and Border Protection Service of the importation of articles that appear to be copies or phonorecords of the work.

FAQs

Does The First Sale Defense Apply To Works That Are Licensed?

No. The doctrine is called the “the first *sale* doctrine” for a reason. Under the Copyright Act, the first sale doctrine applies only to the “owner of a particular copy.” To qualify as an owner, ownership of the copy must be transferred by some means, for example, through a sale or as a gift. The first sale defense does not apply where the goods are licensed, because a license does not transfer ownership rights in the copy.

Take software as an example. Software generally is not sold, it is licensed. Someone who purchases a software license is not the “owner of a particular copy,” they are an “owner of a license to use a copy” of the software. Thus, the first sale defense does not apply. Because most electronic content and some traditional content (such as test materials) is also obtained through a license, the first sale doctrine would likewise not apply to that content because the user does not own a copy of the work, he only has access to it through the license. As a result, it is the terms of the software or content license that will control whether the software or content can be

transferred and not the first sale defense or any other provision in the copyright law. Accordingly, licensees should consult the license agreement to determine whether the licensed copy may be re-distributed.

Why Does The Software Industry License Software And How Does This Practice Benefit Consumers?

The software industry has long relied upon licenses for the mass market distribution and use of its products. Licenses provide the substantial legal framework for the industry. There are many reasons for this, including the typically ongoing nature of the relationship between publisher and customer, including support, maintenance, bug fixes, updates, and upgrades. Licenses have been the standard regardless of the media on which software is distributed – whether floppy disc, CD, or even no media at all (i.e., Internet download). And licenses have allowed the software publisher the flexibility to tailor its products to its various customers, adjusting features, benefits, rights, and price according to the needs of each customer base rather than a “one size fits all” model – a model which logically could require a higher price.

Aren't These Software Licenses, Really Just Sales That The Industry Calls Licenses To Avoid the First Sale Defense?

For decades there had been virtually no question about the legal enforceability of software licenses. Many courts accepted the status of the transaction as a “license,” rather than a sale, as obvious on its face. Other courts provided deeper analysis and justification.¹ Hundreds of cases enforced software licenses, and the few that did not turned on deficiencies in facts, not a different legal approach.² Most recently, the U.S. Court of Appeals for the Ninth Circuit handed down a decision in the landmark case of *Vernor v. Autodesk* that should finally put this issue to rest. The court specified the test for determining whether a transaction is a license or a sale for purpose of determining the applicability of the first sale doctrine under section 109 of the Copyright Act. This test provides that “a software user is a licensee rather than an owner of a copy where the copyright owner (1) specifies that the user is granted a license; (2) significantly restricts the user’s ability to transfer the software; and (3) imposes notable use restrictions.” The court also explained that neither the fact that a software company “allows its customers to possess their

¹ See, e.g., *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996) (Easterbrook, J., discussing why the terms of the shrinkwrap license at issue were enforceable); *Wall Data Inc. v. Los Angeles County Sheriff's Dep't*, 447 F.3d 769, 775-76, 785 n.9 (9th Cir. 2006).

² See, e.g., *Novell, Inc. v. Network Trade Center, Inc.*, 25 F.Supp.2d 1218, 1222 (D. Utah 1997) (first sale defense applied to upgraded software in that case because Novell provided the upgrades without any license restrictions, thereby making them sales and subject to the first sale doctrine); *Krause v. Titleserv, Inc.*, 402 F.3d 119, 124 (2d Cir. 2005) (consultant who left engagement with defendant could not assert ownership of source code he wrote for defendant, because defendant had the right to continue using the software at all times and without any limitations, even after the consulting/development engagement expired). The one known exception is *Softman Products Co. v. Adobe Systems Inc.*, 171 F. Supp.2d 1075 (C.D. Cal. 2001). The case was simply wrongly decided, and was not followed by other courts, even within the Ninth Circuit.

copies of the software indefinitely” or that it “does not require recurring license payments” is dispositive in determining whether the first sale doctrine applies. As most mass market software and content licenses will likely satisfy this three-pronged test, those licenses are certain to be upheld by the courts and the goods distributed under these licenses will not be subject to the first sale doctrine.

If Someone Legally Downloads A Copyrighted Work Online, Can They Transfer Their Copy To Someone Else Under The First Sale Doctrine?

Generally the answer is no. Usually copyrighted works that are downloaded are licensed rather than sold. The first sale defense does not apply to licensed copies. Consequently, for licensed copies the terms of the license – not the first sale defense-- will determine whether the copies can be transferred.

Isn't Market Segmentation Bad For Consumers?

The ability to control distribution to different groups of customers is the source of many marketing and business strategies that benefit consumers. For example, discounted software is made available to the education market at a lower price point only because software companies can control the transfer of software to that specific market.

Why Should Copyright Owners Be Able To Control Importation Of A Copy Into The United States After It Has Been Sold Abroad?

There are a variety of rational and widely beneficial reasons for a copyright owner to prevent copies made for sale abroad from entering the United States, to compete with copies made for domestic distribution. By granting copyright owners the ability to control the distribution of their works they are able to control the flow of their works into and out of different regions. The ability to segment markets allows copyright owners to distribute different versions of a work in different regions and at different price points. Such differentiated global pricing often results in a larger global market for a product. The producer's fixed costs, sometimes including first production costs, then have a wider base against which to be recovered, which in turn permits the producer to spread out its costs over a larger market which results in: (i) lower prices in the domestic market to levels that would not otherwise be possible, and (ii) a larger return its investment, which can be re-invested by the copyright owner to create new innovative products and services for use by consumers.

Differentiated pricing also allows U.S. copyright owners to reach markets that they otherwise could not. For instance, if nursing students in Thailand cannot afford a textbook at the price it is being sold for in the United States then the only way to reach that market is to sell those books at a lower price in Thailand. If the copyright owner is unable to prevent those books from being sold elsewhere then those textbooks will be diverted out of Thailand and back into the United States or some other region where the books can be re-sold for a higher price. What this means

is that the Thai nursing students never get their textbooks, the copyright owner is not expanding its market and – even worse – by distributing the books at a lower price point in Thailand the publisher is cannibalizing its own market since the books will be sold to nursing student in the United States who otherwise would have bought the U.S. version of the textbook. The publisher is then faced with a unfortunate choice of either neglecting the global marketplace or raising the price of the U.S. textbooks to account for the shortfall resulting from the Thai textbooks competing with the U.S. textbooks. In both cases the real losers are the nursing students. This is the exact scenario we have in the recent Supreme Court case of *Kirtsaeng v Wiley*.

Market segmentation is not just about using different pricing strategies to sell to different global markets. It also allows copyright owners to distribute different versions of a work in different regions. Many copyright owners make and sell “country-specific” or “region- specific” versions of their products. Some SIIA member companies introduce slight variations in product presentation or quality to conform to the demand in various countries. For example, many textbook publishers find it impractical and uneconomical to provide its “standard” product in third world countries, but can produce a slightly modified, lower-priced version to sell there. Sometimes the product may be exactly the same as the domestic version. Sometimes it may have differences, such as lower quality paper, or black and white illustrations instead of color, or different typesetting. Other examples include region-specific test preparation materials, textbooks, and other copyrighted works, with prices based upon various local and international factors.

Moreover, market segmentation may also be necessary to comply with the legal regimes of foreign countries or to reduce legal risk in such countries. For example, in the publishing industry, privacy and defamation laws can vary substantially from country to country. The software industry faces similar concerns due to data protection and security laws that vary abroad. As a result, publishers may need to change the content or formatting of their works when distributing them in a particular region. If those region-specific copies find their way into the United States, American consumers will be defrauded into buying products that may be inferior or otherwise very different from those intended for U.S. markets.

If The Supreme Court Rules In Favor Of Publishers In The *Kirtsaeng v. Wiley* Case And Copyright Owners Are Permitted To Control The Importation Into The United States Of Copyrighted Works Made Abroad, Won’t U.S. Copyright Owners Move Their Manufacturing Plants Outside The United States In Order To Take Advantage Of The Ruling, Resulting In A Loss Of U.S. Jobs

There is no tangible basis for this suggestion. While a ruling for Wiley would give copyright owners greater control over copyrighted works that they have manufactured abroad, that does not mean they will pack up and move their manufacturing plants abroad in order to avail themselves of this benefit. No SIIA member has moved manufacturing operations abroad in response to the Supreme Court’s holding in *L’anza v Quality King* or affirmance of the Ninth Circuit’s decision in *Costco v. Omega* – two Supreme Court cases which reached the same conclusion supported by Wiley and SIIA. The reason for this is that there are numerous factors that a company considers when deciding where to locate its manufacturing plants. Although copyright may be one of

those factors, it is not dispositive, and almost certainly not even a leading factor. Other factors, such as issues relating to tax, labor and employment costs, proximity to customers and suppliers, availability of subsidies, power and other manufacturing costs, play a much more crucial role in any company's decision as to where to locate its manufacturing plants.

It should also be pointed out that the Copyright Act already has numerous other provisions that benefit foreign copyright ownership. For example, foreign copyright owners can bring copyright infringement suits in a U.S. court without registering their works with the U.S. Copyright Office, but their U.S. counterparts can't get through the courthouse doors without first registering their works. While these provisions may, at best, provide some small incentive for copyright owners to move abroad, the facts are clear that the effects of these provisions – like a ruling in favor of Wiley – would have no real world effect on the location of copyright owners' manufacturing plants of U.S. jobs.

If The Supreme Court Rules That The First Sale Defense Does Not Apply To Foreign-Made Copies, Won't Secondary Markets For Consumer Products Disappear.

No. There are several reasons that a ruling for Wiley by the Supreme Court will not destroy secondary markets. First and foremost, regardless of the Court's decision here, the first sale doctrine will continue to apply to copies made and sold in the United States. Consequently, nothing in the Court's decision should hinder the secondary market for such copies.

Second, the first sale defense is not the only defense available to those who want to sell or otherwise distribute copyrighted goods in a secondary market-- other copyright exceptions are likely to apply to allow such sales. In particular, the fair use exception and the doctrine of implied license will apply in most cases where the value of the product is largely independent of the value of the associated copyrighted work.

Fair use is at its core an equitable rule of reason designed to take into account the facts of each case. The flexible and fact-specific nature of the defense renders it fully capable of taking into account the practical reality that people do not buy consumer products like watches, shampoos and cars because the product may contain some ancillary copyrighted text, design or software embedded into the product. This reality would certainly influence a court's determination of the fourth fair use factor: "the effect of the use upon the potential market for or value of the copyrighted work."

The fair use doctrine requires that a market for a work be "traditional, reasonable, or likely to be developed" when examining and assessing the effect that a secondary use of a copyrighted work may have on the potential market for or value of that work. In the case of most consumer products there is no economic value in the copyrightable design, text or software contained in the product that is severable from the product to which the work is affixed or embedded, and thus no actual or potential market that can be harmed. For example, there is likely no separate licensing market for shampoo labels as the expressive work – the label – has no economic value severable from the product.

Another defense – the defense of implied license -- is also likely to apply in most cases. The implied license defense is most often applied to fill gaps in copyright and other areas of intellectual law as a way to effectuate the intent of the relevant parties in a pseudo-contractual relationship where a strict application of a provision in the law might result in a unreasonable and unintended outcome. For example, the defense is used to allow search engines to copy all the copyrighted material made available on the Internet for purposes of being indexed and searched. In the case of secondary markets, such as the re-sale of a Toyota that contains a copyrighted GPS system or other copyrighted elements, the defense of implied license can be used to allow the car's owner to sell the car to a willing buyer.

Other defenses like copyright misuse or the so-called “suitcase” exception in section 602(a)(3)(B) of the Copyright Act may also apply. In fact, following the Supreme Court four-four decision in the *Costco v. Omega* case which resulted in the Ninth Circuit ruling in favor of Omega to stand (that the first sale defense did not apply), the case was remanded back to the district court which held that Omega's application of a copyrighted work to an uncopyrighted watch for the purpose of controlling importation of the uncopyrighted good constituted copyright misuse.

What If A Copy Of The Work Is Made In The US And Then Shipped Outside US And Then Re-Imported Back Into The United States?

The applicability of the first sale defense hinges upon the whether the copyrighted work was made in the United States or abroad. If the copy of a copyrighted work is made in the United States and subsequently sold the first sale defense applies regardless of where the copy was sold. That point is uncontested. The *Kirtsaeng v Wiley* case, however, deals with a copy that is made and sold abroad and then imported into the United States. The question of whether the first sale defense applies to that copy is what is being considered by the Supreme Court.

This Case Involves The Sale Of Traditional Bound Books. Will The Decision In This Case Affect The Sale Of Other Copyrighted Works, Like Movies, Music And Photos?

Yes. Although the copyrighted works at issue in *Kirtsaeng v Wiley* are books, the ruling in this case will likely apply to all copyrighted works.

This Case Involves The Sale Of Traditional Bound Books. Will The Decision In This Case Affect eBooks And Other Licensed Downloaded Digital Texts?

Generally the answer is no. Usually copyrighted works that are downloaded are licensed rather than sold. The first sale defense does not apply to licensed copies. Consequently, for licensed copies the terms of the license – not the first sale defense-- will determine whether the copies can be transferred.

Will Travelers Who Buy A Copyrighted Work, Like A Book, DVD Or Painting, Abroad For Themselves Or As A Gift And Try To Bring It Into The United States Be Liable For Copyright Infringement For An Illegal Importation?

No. The so-called suitcase exception in section 602(a)(3)(B) allows people to bring copyrighted items into the United States in their baggage without running afoul of the copyright right owners' importation rights.

Would A Ruling By The Supreme Court In Favor Of Wiley Be A Dramatic Shift In The Copyright Law That Expands The Rights of U.S. Copyright Owners?

No. Copyright owners throughout the United States have been operating under the Supreme Court's interpretation of the first sale defense set forth in *Costco v. Omega* and *L'anza v. Quality King*. Under both cases, the rule is that the first sale defense does not apply when the goods are manufactured outside the United States. The position being urged by Wiley – that copyright owners can control the importation into the United States of copyrighted works that are made and sold outside the United States – has been the law. This is not a case of copyright owners trying to expand their control of their copyrighted works, but rather retailers in the United States trying to unravel existing law and are using past anti-copyright sentiment to make it appear as though the copyright community is trying to expand their copyright rights rather than merely keep the status quo.

How Will Consumers Be Affected By A Ruling In Favor Of Wiley?

A ruling by the Supreme Court in favor of Wiley is likely to result in no change in the way copyright owners distribute their works or the way consumers buy and sell them. A ruling for Wiley is a ruling for the status quo.

How Will Consumers Be Affected By A Ruling In Favor Of Kirtsaeng?

A ruling by the Supreme Court in favor of Kirtsaeng would send a tremor through the copyright publishing industries. Ultimately, we do not know what the ramifications for U.S. businesses that rely on copyright will be. However, it is safe to say that it will not be business as usual. A ruling for Kirtsaeng would create a strong disincentive to market different versions and sell copies at different prices in different regions. For example, why would Wiley sell textbooks in Thailand at a lower price when those books can legally find their way into the U.S. market where they cannibalize book sale of those same textbooks in the U.S. market. If Wiley discontinues this practice and markets the books in Thailand at the U.S. price, as it would be logical to do, than it may be more difficult, and perhaps impossible, for them to sell these books in Thailand. Since they are selling fewer books they may need to raise the price of their books in the United States to cover their expenses – expenses that were previously distributed over a larger global distribution market. So Wiley sells fewer books and U.S. consumers end up paying more for

these books. The ultimately losers here are not only publishers but also both foreign and U.S. consumers.