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DOES THE RISE OF PROPERTY RIGHTS THEORY DEFEAT COPYRIGHT'S FIRST SALE DOCTRINE?

Jenny Lynn Sheridan*

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INTRODUCTION

Imagine a book, a DVD, a CD or a video game packaged with a notice stating that the user had the perpetual right to enjoy this book, this film, this music album or this game for their personal use only. Is such a notice legally binding?¹ If the user ignored that notice and sold the item on eBay, would there be repercussions? Although the answer to that specific question is not known yet, the operative word in the preceding clause is “yet.” For, if the “personal use” notice was couched as an “agreement,”—more commonly known in the digital commercial world as an “end user license agreement,”—and if it contained a few more phrases than “personal use only,”—such as clauses specifying restrictions on title—there is now circuit court authority suggesting that publishers, music producers and other content producers effectively may control the secondary markets for commercial distribution.

Anticipating this possibly cataclysmic outcome, the Electronic Frontier Foundation (“EFF”),² a digital rights advocacy group, recently warned that a “dangerous decision” would permit copyright owners to use “a few ‘magic words’ in a license agreement” to deprive consumers of their traditional rights to sell, borrow or donate copyrighted materials.³ This

1. See Nate Anderson, *Universal: You don't own those promotional CDs we gave you*, ARS TECHNICA (Apr. 9, 2008, 10:15 PM), <http://arstechnica.com/tech-policy/news/2008/04/universal-tossing-that-promo-cd-violates-ourrights.ars> (Fred Von Lohmann, copyright attorney, formerly at EFF, stated, “CDs, books, DVDs, and video games *could* be festooned with ‘notices’ that erode a customer’s first sale, fair use, and other rights.”) (emphasis added) (last visited Jan. 21, 2011).

2. See ELECTRONIC FRONTIER FOUNDATION, <http://www.eff.org> (last visited Dec. 13, 2011).

3. Corynne McSherry, “*Magic Words*” Trump User Rights: Ninth Circuit Ruling in *Vernor v. Autodesk*, ELECTRONIC FRONTIER FOUNDATION,

dangerous decision was the Ninth Circuit's opinion, *Vernor v. Autodesk*,⁴ issued on September 10, 2010, which determined that Timothy Vernor infringed Autodesk's software copyright when he attempted to sell a copy of Autodesk software on eBay.⁵ Vernor had purchased an authentic copy of the software from a company who, in turn, had purchased it directly from Autodesk.⁶ The license agreement attached to the software, however, restricted its use to the initial purchaser and prohibited further transfer without Autodesk's express permission.⁷

Prior to *Vernor v. Autodesk*, Ninth Circuit district courts were split on the question of the application of copyright law's first sale doctrine in the context of software licensing transactions.⁸ All three district court decisions involved the same software producer, Adobe, with two decisions favoring Adobe and one against it.⁹ If one includes software decisions on the related copyright doctrines of fair use and essential copying, the upshot is that decisions adjudicating licensing disputes have lined up decisively in favor of the software producers.¹⁰ The implications here are important because while the commercial practice and the court decisions have been confined to software, even the Ninth Circuit acknowledged the broad application of the principles stated in its decision, *Vernor v. Autodesk*, to digital media generally, including DVDs and CDs.¹¹

These trends have not been lost on scholars. Commentators have argued for some time that overreaching software producers have attempted to "contract around" and otherwise eliminate statutory privileges, including first sale that a copyright user should enjoy.¹² In general the courts

(Sept. 13, 2010), <http://www.eff.org/deeplinks/2010/09/magic-words-trump-user-rights-ninth-circuit-ruling>.

4. *Vernor v. Autodesk, Inc. (Vernor II)*, 621 F.3d 1102 (9th Cir. 2010).

5. *See id.* at 1111, 1116.

6. *Id.*

7. *Id.*

8. *See infra* notes 103–08 and accompanying text.

9. *See infra* notes 103–05 and accompanying text.

10. *See infra* notes 73–96 and accompanying text.

11. *See Vernor II*, 621 F.3d at 1115. *Cf.* *UMG Recordings, Inc. v. Augusto*, 628 F.3d 1175 (9th Cir. 2011).

12. *See* Brian W. Carver, *Why License Agreements Do Not Control Copy Ownership: First Sales and Essential Copies*, 25 *BERKELEY TECH. L.J.* 1887, 1890 (2010) (Carver notes that there is a "larger debate concerning whether

have not been persuaded by the commentary, as the courts found these end user license agreements (also called shrink wrap, mass market, referred to herein as EULA or EULAs) enforceable and not preempted by federal copyright law.¹³ Thus, the weight of opinion among scholars has been critical of pro-software decisions whereas the weight of decisions culminating with the recent Ninth Circuit decision has favored the software producer.¹⁴

Why are the courts so unpersuaded by this commentary? Scholars have been distracted by the contract critique and have failed to expose the underlying theoretical dialectic in copyright. This Article attempts to reframe the debate by focusing the discussion on the underlying copyright theories competing in the conflicting decisions. One aim of this discussion is to provide greater coherency to the underlying rationales of the decisions. The normative objective is to propose adjustments to the first sale doctrine of copyright to ameliorate the potential negative effects of the current trend.

The pro-software producer decisions are best justified as a product of the "property rights" paradigm of copyright, grounded in natural rights and economic theory. The "property rights" paradigm supports a very narrow construction of the first sale doctrine or in Professor Goldstein's characterization of the "copyright optimists,"

mass consumer contracts should trump the policies embodied in statutory schemes enacted by Congress . . . [B]oilerplate [end-user license agreements] that purport to restrict rights [that users of copyrighted works] have grown accustomed to . . . and [that] Congress intended they have as part of its larger effort to craft a balanced Copyright Act."); Mark A. Lemley, *Intellectual Property and Shrinkwrap Licenses*, 68 S. CAL. L. REV. 1239, 1239 (1995) (Lemley claimed that "[s]oftware vendors are attempting en masse to 'opt out' of intellectual property law by drafting license provisions that compel their customers to adhere to more restrictive provisions than copyright (and even patent) law would require."); David A. Rice, *Licensing the Use of Computer Program Copies and the Copyright Act First Sale Doctrine*, 30 JURIMETRICS J. 157, 185-86 (1990) ("The antitrust issue, then may reduce to whether it is reasonable to leverage copyright by contract to establish suprastatutory liability . . . [T]he answer seems clear that what is involved is the contractual expansion of a limited statutory monopoly.").

13. See *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996); *Nat'l Car Rental Sys., Inc. v. Computer Assocs. Int'l, Inc.*, 991 F.2d 426 (8th Cir. 1993); *Taquino v. Teledyne Monarch Rubber*, 893 F.2d 1488 (5th Cir. 1990); *Acorn Structures, Inc. v. Swantz*, 846 F.2d 923 (4th Cir. 1988).

14. See *infra* notes 73-96 and accompanying text.

perhaps no first sale doctrine at all.¹⁵ On the other side, the decisions against the software producer found limits on the ability of the copyright holder to control the distribution of its creative works. In this context, “limits” means the ability (or restraint on the ability) of the copyright holder to retain title to its copyrighted work (e.g., DVD or CD) after placing it in the stream of commerce.

The “traditional incentives” school of thought advocates greater access to these creative works and a broad construction of the first sale doctrine.¹⁶ Adherents of this school of thought argue that if the consumer has indefinite possession of the DVD, or other cultural product, and has paid full price (no other payments are due) then this should be characterized as a sale for purposes of copyright’s first sale doctrine. If the court upheld the user’s right to transfer the cultural product (e.g., DVD) then it is placing “limits” on the copyright holder’s (content producers) ability to control distribution of its copyrighted products. The current majority rule, as expressed in the Ninth Circuit’s decision in *Vernor v. Autodesk*, runs contrary to this view and supports the ability of the copyright holder to unilaterally dictate the terms of downstream distribution of its copyrighted works.

This Article proceeds as follows. Part I introduces the analytical framework to illustrate the dialectic tension between the “traditional incentives” strand of utilitarian theory of copyright and the “property rights” paradigm, the product of another strand of utilitarian theory with natural rights philosophy. These competing approaches to the justification of copyright inform and influence the divergent outcomes of the software decisions. This section provides the context for the main argument that the rise of the “property rights” rationale in the judicial doctrine, both implied and expressed, is displacing the “traditional incentives” rationale, as seen in the recent pro-software producer decisions. Where the “traditional incentives” justification for copyright law addresses the balance between the protection afforded to the copyright holder and the public’s access to copyrighted works,

15. See *infra* notes 27–31 and accompanying text. Professor Goldstein introduced the “celestial jukebox,” a metaphor for the ideal “property rights” model of digital dissemination of content. In this model, consumers can purchase content but have no ability to transfer that content to third parties.

16. See *infra* Part I.B.6.

the “property rights” rationale focuses on the benefit to societal welfare derived from maximal control of the works by the copyright holder.

The second section of Part I provides further contextual background to the contemporary software first sale decisions that influenced the courts and commentators. The early judicial and legislative treatment of software contributed to the misplaced emphasis by the courts on flawed contract reasoning and weak statutory construction, rather than a coherent copyright analysis. These areas included: (a) the ongoing debate throughout the 1990s of the efforts of the software industry to create a special statutory scheme in the UCC to establish default rules for software transactions consistent with their interests, including non-alienability of software products; (b) the problem of borrowing from the statutory construction of § 117 on essential copying of software to inform the construction of the term “owner” in § 109’s first sale doctrine; (c) early software decisions that established a pattern of turning to the UCC to interpret EULAs and potential conflicts with copyright; and (d) academic commentary’s misplaced emphasis on the UCC and contract preemption.

Part II argues that the pro-software decisions are more justifiably explained by tracing their heritage to several earlier decisions involving not only software but also other content, film prints and children’s toys. These pre-digital “heritage” decisions represent an important link to the later rise of the “property rights” paradigm of copyright. These decisions evidence an “inherent rights” doctrine of copyright ownership derived from natural rights theory of copyright. The “inherent rights” doctrine of these heritage decisions informs the natural rights branch of the “property rights” paradigm; the other branch being the utilitarian strand of economic theory inspired by the work of Professor Harold Demsetz. By tracing the influence of “inherent rights” doctrine of the heritage decisions on the current “property rights” model, the underlying copyright rationale at work in these contemporary pro-software decisions becomes visible. The “property rights” model provides a more coherent rationale for these contemporary pro-software outcomes, rather than the flawed contract analysis and weak statutory construction expressed in the opinions.

Part III analyzes the line of decisions finding against the software producer in the context of the original principles of the first sale doctrine as enunciated by the Supreme Court in its decision, *Bobbs-Merrill v. Straus*.¹⁷ The rationale of these decisions, both express and implied, supports the “traditional incentives” model of drawing a limit on the power of the copyright holder to retain title to copyrighted works after they have been placed in the stream of commerce. These limits are intended to ensure the benefits of availability and accessibility of creative works to the society at large. The limits are invoked by courts when they resist the characterization by copyright holders of its distribution as something other than a sale when the principles of rightful possession have been met, namely indefinite possession and full price. At the moment, however, this is the minority view of the courts, and arguably has been overruled by precedent of Ninth Circuit in its recent decision in *Vernor v. Autodesk*.

Finally the Article proposes a model of “constructive ownership,” drawn from the “rightful possessor” theory of ownership as articulated by the minority view, which includes the *Bobbs-Merrill* principles of “full dominion” and “satisfactory price.” However, the model adds a third dependent prong for the special case of software. A central tenet of this Article is that judicial doctrine has evolved to accommodate software and in the process it has distorted the important principles of *Bobbs-Merrill* with respect to the first sale doctrine. This model allows for the special case of software if certain conditions are met, namely a continuing license of intellectual property. This model, if adopted by the courts, would limit the Ninth Circuit decision in *Vernor v. Autodesk* to software (assuming it met the conditions of the model) but not apply the decision to other digital media. The theory and rationale of the “traditional incentives” model forms the best fit with the progenitor first sale decision, *Bobbs-Merrill*, and fulfills those promises made over a century ago.

17. *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339 (1908).

I. BACKGROUND

A. *Analytical Framework of Competing Copyright Theories*

As argued in this Article, the unifying theme that lends coherence to the pro-software (content) producer decisions on the one hand and the decisions finding against the software (content) producer on the other hand, lies in an analysis and understanding of the divergent theoretical views for the justification of copyright law. The scholarly debate and the dominant critique of the pro-software decisions focuses on the courts' express reasoning for its outcomes, which have been based on contract analysis and statutory construction.¹⁸ The implied reasoning of the pro-software decisions and the express reasoning of the pre-digital "heritage" first sale decisions favoring content producers are both derivative of the "property rights" paradigm of copyright. The recent decisions finding against the software producer on first sale reveal some express reasoning which relies on the "traditional incentives" model of copyright; however their persuasive authority is diluted, it is argued, by a similar distraction of flawed contract reasoning and misplaced statutory construction. The "property rights" paradigm and the "traditional incentives" model of copyright are explained below.

The U.S. intellectual property regime has traditionally been viewed as justified by a utilitarian view that granting copyright and patent protection for works and inventions promotes social welfare.¹⁹ As Peter Menell claimed in his article, *Intellectual Property: General Theories*, "[t]he utilitarian framework has been particularly central to the development of copyright law in the United States."²⁰

18. See *infra* Part I.B.6.

19. Roberta Rosenthal Kwall, *Inspiration and Innovation: The Intrinsic Dimension of the Artistic Soul*, 81 NOTRE DAME L. REV. 1945, 1980 (2006) ("Utilitarianism is the predominant copyright justification in the United States, as evidenced by the Copyright Clause's affording protection for a limited time as an economic incentive to create.").

20. Peter S. Menell, *Intellectual Property: General Theories*, in 2 ENCYCLOPEDIA OF LAW & ECONOMICS, 129, 130 (Boudewijn Bouckaert & Gerrit de Geest eds., 2000); cf. Jane C. Ginsburg, *A Tale of Two Copyrights: Literary Property in Revolutionary France and America*, 64 TUL. L. REV. 991, 1023 (1990). Professor Ginsburg argues against the conventional conception of a neat divide between the origins of the two systems, namely a utilitarian conception

The consensus breaks down at the definition of social welfare and the precise mechanism, i.e., amount and type of protection, to achieve that optimal social welfare.²¹ A major strand of utilitarian theory, arguably the dominant one in academic circles, posits that the level of protection can increase too far causing deadweight losses from monopoly exploitation.²² Scholarship following this view has referred to the “delicate balance” embodied in copyright law and policy between protecting the rights of the content producers on the one hand, and ensuring the access and availability of the creative works to the public both for improver rights and

for the U.S., and natural rights basis for France. *Id.* at 994–95. Rather the systems were influenced by both bases of copyright justification. *Id.* at 1000, 1012–13. In her conclusion, she noted that “the characteristic modern portrayal of French revolutionary copyright as an unambiguous espousal of an author-centric view of copyright requires substantial amendment,” and that “familiar conceptions of early U.S. copyright also warrant reconsideration.” *Id.* at 1023. If U.S. copyright’s exponents sought to promote the progress of knowledge, they also recognized that the author’s labors are due their own reward.” *Id.* Professor Paul Goldstein similarly argued that natural rights theory has influenced copyright in the U.S. (and England) but he would call it “practical intuition and economic analysis” that have produced the “same prescription that natural rights theory has produced on the Continent.” PAUL GOLDSTEIN, *COPYRIGHT’S HIGHWAY: FROM GUTENBERG TO THE CELESTIAL JUKEBOX* 178–79 (1994). In his classic work on copyright, Professor Benjamin Kaplan’s intimated that the influence of the “natural rights” theory was at work in Judge Learned Hand’s decision in *Sheldon v. Metro-Goldwyn Picture Corp.*, where the plaintiff argued that its play had been infringed by the film producer defendant. BENJAMIN KAPLAN, *AN UNHURRIED VIEW OF COPYRIGHT* 2 (1966). In his criticism of the decision, Kaplan stated, “I reflected that if man has any ‘natural’ rights, not the least must be a right to imitate his fellows, and thus reap where he has not sown. Education after all proceeds from a kind of mimicry, and ‘progress,’ if it is not entirely an illusion, depends on generous indulgence of copying.” *Id.* In his study of the origins of Britain’s Statute of Anne, the first copyright statute, and the model for the first U.S. copyright statute, Professor Mark Rose noted that the Statute of Anne curtailed the efforts of the London booksellers to transform their prior licensing privilege into a perpetual common law right of copyright. MARK ROSE, *AUTHORS AND OWNERS: THE INVENTION OF COPYRIGHT*, 47–48 (Harvard Univ. Press 1993). It did not, as he noted, “settle the theoretical questions behind the notion of literary property.” *Id.*

21. See William Fisher, *Theories of Intellectual Property*, in *NEW ESSAYS IN THE LEGAL AND POLITICAL THEORY OF PROPERTY* 1, 14 (Stephen R. Munzer, ed., Cambridge Univ. Press 2001).

22. See *id.* at 14–15 (Professor William Nordhaus applied classic monopoly economic theory to intellectual property to demonstrate that the monopoly model will price higher and produce less than in a free competition model; thus leading to the creation of a consumer surplus or “deadweight loss” of output unavailable to society.); Menell, *supra* note 20, at 133; William A. Landes & Richard A. Posner, *An Economic Analysis of Copyright Law*, 18 J. LEGAL STUD. 325 (1989) [hereinafter *An Economic Analysis*].

general dissemination of knowledge on the other.²³ This balance has often been referred to as the “protection-access” paradigm.²⁴

In a different direction of scholarship, it has been argued that under a “property rights” theory more protection is justified to respond to the needs and wants of consumers in the marketplace and to encourage investment in the continuing availability of creative works. Professor Fisher cited the work of 1960’s Chicago school economist, Harold Demsetz, for inspiring this school of thought which argued for strong property rights in intellectual property and relied on Coasean theory of bargaining as the most efficient method of allocating and distributing the fruits of the intellectual property regime in society.²⁵ A basic assumption of this

23. Fisher, *supra* note 21, at 2; *An Economic Analysis*, *supra* note 22, at 326.

24. See Glynn S. Lunney, Jr., *Reexamining Copyright's Incentives-Access Paradigm*, 49 VAND. L. REV., 483, 492 (1996). Within the “balance” group there have been variations depending on value norms around definition of societal value, and level of concern about the access side of the paradigm. The economic theory model as espoused by Landes & Posner has been associated with a “strong rights” model because they have argued for “indefinite copyright.” See Neil W. Netanel, *Why Has Copyright Expanded? Analysis and Critique*, in 6 NEW DIRECTIONS IN COPYRIGHT LAW 3, 20 (Fiona Macmillan ed., Edward Elgar Publ’g 2007). In discussing these variations in his article, *Theories of Intellectual Property*, William Fisher, included Landes & Posner squarely in the incentives theory approach of intellectual property. See Fisher, *supra* note 21, at 4. Landes & Posner did not advocate absolute property rights for copyright holders. Their “indefinite copyright” would consist of renewable short terms that they believed would have the effect of a) promoting greater investment in protected works and b) enlarging the public domain. See William M. Landes & Richard A. Posner, *Indefinitely Renewable Copyright*, 70 U. CHI. L. REV. 471, 517–18 (2003) [hereinafter *Indefinitely Renewable Copyright*]. More important to this discussion, they acknowledged that a balance must be struck between incentives and access to creative works, and have stated that “[s]triking the correct balance between access and incentives is the central problem in copyright law.” See *An Economic Analysis*, *supra* note 22, at 326. In their analysis of maximal societal welfare they have argued for a broad construal of fair use and a narrow construal of “substantial similarity” standard for copyright infringement. See Robin Elizabeth Herr, *Is the Sui Generis Right a Failed Experiment?* 66 (DJØF Publ’g 2008). Another viewpoint on the question of “balance,” there are those scholars that William Fisher grouped (including himself) who fall in the category of social and institutional planning. See Fisher, *supra* note 21, at 6–8. A distinctive feature of this group particularly in comparison to Landes & Posner is the belief that societal welfare should be defined broader than in purely economic terms, e.g. creative expression, civic participation. The unifying theme of both viewpoints is that they acknowledge and support some limits on the copyright holder’s power and control over its creative works for the benefit of the societal welfare.

25. See Fisher, *supra* note 21, at 15; Menell, *supra* note 20, at 133.

theory was that the copyright holder is best situated to control the allocation of its creative works.²⁶ Another distinctive feature of this model is the mechanism of price discrimination as a critical tool for the copyright holder (asset owner) to maximize the efficient allocation of its creative works. For example, a software producer may choose to discriminate in pricing its product, depending on the type of user (e.g., a non-commercial “home” user pays a lower price than a commercial “business” user). The theory holds that this mechanism maximizes both optimal use of the product in society and profit to the asset owner.

To illustrate Demsetz’s influence on legal theory, Professor Fisher quoted from Paul Goldstein’s invocation in his treatise, *Copyright’s Highway: From Gutenberg to the Celestial Jukebox*:

The logic of **property rights** dictates their extension into every corner in which people derive enjoyment and value from literary and artistic works. To stop short of these ends would deprive producers of the signals of consumer preference that trigger and direct their investments.²⁷

Although Professor Goldstein did not openly claim to be a “property rights” theorist who has abandoned or discredited the incentives theory camp, his sentiments seemed pretty clearly aligned with those he referred to as “copyright optimists.” In the first chapter of his book entitled, *The Metaphysics of Copyright*, Professor Goldstein described “copyright optimists” as those “who assert . . . natural justice, entitling authors to every last penny that other people will pay to obtain copies of their works [T]hey view copyright’s cup of entitlement as always half full, only waiting to be filled still further.”²⁸ A few pages later he succinctly noted that the “copyright optimists” rely on the “larger truth” of “natural rights” to support their view of the extension of copyright into every corner.²⁹ Later in the book where Professor Demsetz’s work on property rights approach to intellectual property was introduced, Professor Goldstein concluded that such a view was consistent with not only “the

26. See Netanel, *supra* note 24, at 18.

27. Fisher, *supra* note 21, at 15 (emphasis added); GOLDSTEIN, *supra* note 20, at 178–79.

28. GOLDSTEIN, *supra* note 20, at 15.

29. *Id.* at 17.

same prescription that natural rights theory has produced on the Continent” but also with “two hundred years of practical intuition and economic analysis in England and the United States.”³⁰ If there was any doubt regarding his sentiments they were dispelled by the penultimate sentence of his treatise:

The main challenge will be to keep this trajectory clear of the buffets of protectionism and true to copyright’s historic logic that the best prescription for connecting authors to their audiences is to extend rights into every corner where consumers derive value from literary and artistic works.³¹

The absence of any discussion of monopoly inefficiencies leads the reader to the conclusion that Professor Goldstein (again for himself or on behalf of the “copyright optimists”) rejected the incentive theory’s assumptions. Consistent with the property rights approach, he adhered to the belief that, similar to the assumptions in real property, the property owner (landowner or copyright holder) knows best how to allocate uses of property.³² There was also an implicit assumption in the “copyright optimists” argument that the boundaries of this property were clear and little concern about reliance of copyright systems on creations of others.³³

Professor Goldstein’s central metaphor of his treatise, the celestial jukebox, proves all allocation to society is solved by the technological wonders of the digital dissemination model. The “celestial jukebox” celebrated in Professor Goldstein’s treatise embraced the economic theory underlying the “property rights” paradigm, namely that price discrimination by the property owner will result in the optimal creation and allocation of the creative works. The common denominator of the “property rights” group is the combination of the property motif and the markets mechanism.³⁴ Similar to real property

30. *Id.* at 179.

31. *Id.* at 236.

32. See Netanel, *supra* note 24, at 18.

33. Cf. Netanel, *supra* note 24, at 24 (discusses the influences on the “copyright as a natural right” rationale, including the 18th and 19th century Romantic ideal of the author as unique, a genius, “eschewing any imitation or reliance upon the work of others.”).

34. See Netanel, *supra* note 24, at 18. Professor Netanel provided a lucid discussion of the “copyright is property” rationale and its view that copyright “is primarily a mechanism for facilitating markets in existing expression” and can best serve that goal “when copyright owners have full proprietary control over

(arguably more than chattel), the concept of control over the property is vested in the landowner or copyright holder as the one best situated to make the determination regarding allocation and use of its resource.³⁵ In addition the “property rights” paradigm, as illustrated by Professor Goldstein, also draws on natural rights philosophy for further justification of the maximal control of the asset by the copyright owner.

In his article, *Why Has Copyright Expanded?*, Professor Netanel remarked that the influence of the “copyright is private property” group had increased with the support of the copyright industry.³⁶ He traced their philosophical heritage to 18th century William Blackstone who argued for “perpetual exclusive rights” for author’s literary compositions.³⁷ Professor Netanel claimed that this view conflicted with the main thrust of U.S. jurisprudence, citing many Supreme Court references to copyright as a “statutory monopoly” or “limited monopoly privilege.”³⁸

their works.” *Id.* As he explained, concentrating control of exclusive proprietary rights in a single owner facilitates the licensing and marketing strategies for the original work and any derivative works. *Id.*

35. See Netanel, *supra* note 24, at 18. Professor Netanel lumped the work of Landes & Posner with the “copyright is property” group; however, I argue, like Professor Fisher, that Landes & Posner’s viewpoint may exist on the conservative side of the “delicate balance” spectrum but they do subscribe to that view rather than the “property rights” view as discussed *supra*.

36. See Netanel, *supra* note 24, at 12.

37. See Netanel, *supra* note 24, at 21–22. Professor Netanel discusses the “copyright as property” viewpoint separately from the “copyright as a natural right.” *Id.* at 18, 21. William Blackstone was an early advocate of natural rights jurisprudence. It is worth noting that Blackstone developed his natural rights approach to copyright as a private attorney on behalf of his clients, private London booksellers. Blackstone’s clients were attempting to establish a permanent common law right in literary property in the mid-18th century England in reaction to the passage of the Statute of Anne. See ROSE, *supra* note 20, at 75, 77–78, 88–89. I analyze the “copyright as property” viewpoint as relying on “natural rights” theory for further support to its economic theory argument. This view is also supported by Professor Goldstein’s treatise, *Copyright Highway*, which clearly combined a natural rights justification with a markets based, property rights theory in its holistic philosophy and approach to copyright law as expressed by Goldstein’s concept of the “copyright optimist” discussed *supra*. GOLDSTEIN, *supra* note 20; *supra* notes 27–31 and accompanying text. Goldstein does not directly cite William Blackstone although he does refer to the “practical intuition and economic analysis” of the past two hundred years in U.S. and England that has produced same prescription as natural rights theory on the Continent. GOLDSTEIN, *supra* note 20, at 178–79.

38. See Netanel, *supra* note 24, at 12. Professor Netanel cited the Supreme Court in *Fogerty v. Fantasy, Inc.*, 510 U.S. 517, 526 (1994) as stating that

Professor Netanel also noted that the receptiveness of lower courts and the legislature to the absolute proprietary model of intellectual property (including copyright) has been on the rise.³⁹ He cited Judge Frank Easterbrook, author of the landmark *ProCD v. Zeidenberg*⁴⁰ opinion, discussed *infra*, as a strong advocate for the property rights/market approach to intellectual property. Judge Easterbrook wrote in his article *Intellectual Property is Still Property* that “except in the rarest case we should treat IP and physical property identically in the law,” supporting narrow exceptions to copyright.⁴¹ The *ProCD* opinion openly advocated the price discrimination model, consistent with the “property rights” paradigm, as a method of and justification for the property rights model.⁴² When Professor Goldstein published his initial treatise, *Copyright’s Highway* in 1994, he had written that “with few exceptions—most notably opinions written by Justice Oliver Wendell Holmes, decades ago—the Court’s attitude has been to treat copyright’s cup as half empty, not half full.”⁴³ Professor Goldstein believed that the Supreme Court had drawn an imaginary line around the public’s home space immunizing the activity in the home from copyright infringement.⁴⁴

“copyrights are monopoly privileges that . . . while ‘intended to motivate . . . create activity . . . by provision of a special reward,’ are limited in nature and must ultimately serve the public good.”); cf. see Netanel, *supra* note 24, at 18. Netanel cited work by Professor Merges that has criticized “incentive theory as ‘crude’ and ‘two-dimensional.’” *Id.* at 18 n.49.

39. See Netanel, *supra* note 24, at 13.

40. *ProCD v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996); see *infra* notes 80–84 and accompanying text. Netanel, *supra* note 24, at 13.

41. See Frank H. Easterbrook, *Intellectual Property is Still Property*, 13 HARV. J.L. & PUB. POL’Y 108, 118 (1990).

42. See *ProCD*, 86 F.3d at 1449–50.

43. GOLDSTEIN, *supra* note 20, at 33.

44. See GOLDSTEIN, *supra* note 20, at 202. Goldstein’s work, *Copyright’s Highway*, was first published in 1994 following *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417 (1984) but before *MGM Studios, Inc. v. Grokster, Ltd.*, 545 U.S. 913 (2005). *Sony* held that private copying of television broadcasts by means of videotaping did not constitute infringement and was protected by fair use. *Sony*, 464 U.S. at 423–24. In *Grokster*, the Court found that private peer to peer file sharing of copyrighted music did constitute copyright infringement based on an inducement theory of contributory infringement. *Grokster*, 545 U.S. at 929–30. Unlike *Sony*, neither the individuals nor the technology companies facilitating the “sharing” were immunized by fair use. *Id.*

A great deal had changed between the first publication of *Copyright's Highway* in 1994, and Professor Netanel's article written in 2007. The DMCA was passed in 1998, granting sweeping powers to copyright holders to prevent anti-circumvention technologies on digital devices containing their copyrighted works, and the Supreme Court found that private sharing of copyrighted music without a license was infringement and commercial interests that facilitated such private copying could be found liable for secondary infringement.⁴⁵ Congress seems to have become a "copyright optimist," if not an increasing number of the courts. This historical tension between the natural rights justification for intellectual property that Professor Goldstein found in the "practical intuition and economic analysis" of American intellectual history and the more cautious acceptance of limited protection for intellectual property balanced with other interests as claimed by Professor Netanel in the Supreme Court jurisprudence reflects the heart of the argument of this Article. The influence of the "property rights" theory has risen and begun to displace the "traditional incentives" theory in so far as judicial copyright doctrine on the first sale privilege is concerned.

Armed with a natural rights foundation for intellectual property, the adherents of the proprietary model that invests (near) absolute control in the copyright holder would **re-write** Article I, Section 8, clause 8, of the Constitution to state:

To **reward** the Progress of Science and useful Arts, by securing for **unlimited** Times to authors (read: investors in the creative product of authors) [and inventors] the exclusive Right to their respective Writings [and Discoveries].

Of course that would require a constitutional amendment, or would it?

Even assuming the "traditional incentives" model has some vibrancy in the courts, most commentators agree that defining and calibrating the optimal incentives mechanism remains elusive, and in fact severely limits the usefulness of

45. Digital Millennium Copyright Act of 1998, Pub. L. No. 105-304, 112 Stat. 2860 (enacted H.R. 2281) (1998). *Grokster*, 545 U.S. at 919 (The music industry brought numerous lawsuits in the 2000's against individuals for private copying of music.).

the utilitarian theory.⁴⁶

Courts, however, do not have the luxury of waiting for proven theory and must make decisions which arguably are motivated by underlying assumptions about the effect and impact of their decisions on real actors in society, the copyright holders (authors or their investors), business interests not aligned with copyright holders, and the consuming public itself. Yet, coherent but divergent outcomes for similar fact patterns will occur because of the lack of consensus on the appropriate theory for copyright justification.

For example, assume that a music producer seeks to limit the ability of a consumer to transfer a copy of a CD to a third party (the CD copy is authentic and rightfully in the possession of the consumer). The same music producer sues different consumers on similar fact patterns in different courts. In each case the CD had been packaged with a “license agreement” that contained language consistent with Ninth Circuit’s decision in *Vernor v. Autodesk*. One district court, whose reasoning follows the “property rights” paradigm that “maximal control” by the asset owner is justified by the underlying economic theory—and natural rights philosophy associated with that view—finds in favor of the music producer; holding that the CD may only remain in the indefinite possession of the original purchaser. This strand of utilitarian theory, namely the Demsetz economic model, does not associate too much protection with monopoly inefficiencies. Professor Goldstein’s depiction of the “copyright optimists” and Judge Easterbrook’s *ProCD* opinion illustrate the paradigm’s central tenet that more protection is directly related to more societal welfare and the market

46. Peter Menell wrote “recent work has shown that the holy grail of a perfectly calibrated incentive system is unattainable.” Menell, *supra* note 20, at 163. William Fisher wrote that the practical necessity of integrating the various incentive theories to produce a workable framework remained elusive. Fisher, *supra* note 21, at 21. He concluded that, “[u]ntil that challenge is successfully met, the power of the utilitarian approach to provide guidance to lawmakers will be sharply limited.” *Id.* I would note that Fisher’s use of term “utilitarian approach” is associated with that strand of utilitarian theory supporting the “traditional incentives” model where protection is “balanced” against access by users of creative works in order to optimize societal welfare. The other strand of utilitarian theory that supports the Demsetz model argues that societal welfare is optimized by maximizing protection and thus no balancing is required.

implicitly minimizes the existence of negative externalities.

In the opposite case, an outcome finding against the music producer has justificatory force for a court whose rationale followed the theory that there is a point where over-protection leads to monopoly inefficiencies. Similarly if societal welfare is defined more broadly than wealth maximization, then an outcome which valued access to creative works for purposes of fair use and secondary markets for their independent contribution to societal welfare would have even greater justificatory force.

The “traditional incentives” scholarship referred to the protection-access paradigm where on the one end too much protection created inefficiencies and on the other end too much access dis-incentivized creative production. For purposes of this Article, the focus is on the pendulum swinging between a model of (near) absolute control by the copyright holder, which I have termed a “property rights” theory or paradigm of copyright, and something less than absolute control, which I have adopted the term “traditional incentives” theory or model of copyright, where limits on the copyright holder’s ability to control the distribution of its work are acknowledged and supported.

B. Context

Before turning to the main argument of the Article contained in Parts II and III, it is helpful to set the stage by examining a myriad of topics all related to judicial and legislative treatment of software. First, CONTU, the commission established by Congress to consider the appropriate treatment of computer programs (software), is discussed as well as the statute that was produced by that process, § 117, the essential copying doctrine.⁴⁷ Next, the Article discusses the legislative histories of § 117 and § 109, the first sale doctrine, because the commentators and courts have relied on constructions of § 117 to inform § 109 decisions.⁴⁸ *Vernor II* relied on its prior construction of § 117 for its rationale and outcome of its decision concerning § 109’s

47. 17 U.S.C. § 117 (1998); CONTU stands for Commission on New Technological Uses of Copyrighted Works.

48. See *infra* notes 59–72, 223–26, and accompanying text.

first sale doctrine.⁴⁹ Also, the court's construction of § 117 has been infused with strong "property rights" theory spilling over to § 109's construction as well.

Next, the Article examines several judicial decisions of the circuit courts in the 1990's and early 2000's that involved software licensing for the role they played in later decisions, especially those relevant to the main discussion of this Article. A central tenet of this Article, namely that the contemporary pro-software decisions suffered from an analytical error of confusing contract for copyright analysis, can be traced to the analytical approach of these early decisions of *ProCD v. Zeidenberg*⁵⁰ and *Bowers v. Baystate*.⁵¹ These decisions also represented the displacement of the "traditional incentives" theory by rise of the "property rights" theory of justification for the special protection afforded copyright holders. Since the decisions couched their opinions in contract reasoning, the jurisprudential copyright theory at work in the rationale of the courts was not detected. This confusion infected the later first sale software decisions as well as the commentary on these decisions that continued to be distracted by the contract critique. Finally, the Article discusses the attempted passage of Article 2B to the UCC, which was meant to resolve some questions related to software licensing, because of its heated debate and particular effect on the commentary during the 1990's surrounding treatment of software transactions.

1. CONTU and Status of Software

In 1983, the Third Circuit found software to be copyrightable subject matter.⁵² Also, Congress had commissioned a group named CONTU to study and recommend legislation for the treatment of computer programs (referred to herein as software) in the intellectual property legal regime.⁵³ Based on their recommendations,

49. See *Vernor v. Autodesk, Inc. (Vernor II)*, 621 F.3d 1102, 1115 (9th Cir. 2010).

50. *ProCD v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996).

51. *Bowers v. Baystate Techs., Inc.*, 320 F.3d 1317 (Fed. Cir. 2003).

52. See *Apple Computer, Inc. v. Franklin Computer Corp.*, 714 F.2d 1240, 1253 (3d Cir. 1983).

53. See Richard H. Stern, *Section 117 of the Copyright Act: Charter of the Software Users' Rights or an Illusory Promise?*, 7 W. NEW ENG. L. REV. 459, 460 (1985).

Congress passed § 117 of the Computer Software Copyright Act in 1980.⁵⁴ Section 117 known as the “essential copying” doctrine was designed to provide a safe harbor for software users from triggering the right of reproduction in the normal operation of their software.⁵⁵ By the late 1980’s there was significant criticism by scholars of the construction of § 117 by the courts, which were finding that many software users did not qualify for the benefits of the statute.⁵⁶

Ironically the stated purpose of § 117 had been to solve the problem of the pre-digital Copyright Act, namely that “use” of the computer program involved the exclusive right to reproduce.⁵⁷ Think of the pre-digital example of a book. To read a book, or make normal use of it, did not invoke the copyright holder’s exclusive right of reproduction. Reading a digital book on a computer (or other digital device) does invoke that right as the computer (or other electronic device) automatically makes copies of digital content in the processing of the data. Without a license from the copyright holder or some other exemption, the user is committing copyright infringement which can carry serious penalties.⁵⁸

54. *Id.*

55. *Id.* at 461–66.

56. *Id.* at 483–85. Stern’s reference to the phrase, “illusory promise” in his title, was the effect, he argued, for software users because of the court’s narrow construction of § 117. *Id.* Stern wrote that Congress’ act to replace “rightful possessor” with “owner,” amounted to a “modification [that] left the door open to extensive sleight of hand in the name of bailments, leases, licenses and other putatively *non-sale* transactions.” *Id.* at 467 (emphasis in original); see also Pamela Samuelson, *Modifying Copyrighted Software: Adjusting Copyright Doctrine to Accommodate a New Technology*, 28 JURIMETRICS J. 179, 191–92, 221 (1988) (Samuelson criticized CONTU as well as Congress for failure to satisfactorily ensure software users the ability to make essential copies and adaptations. Samuelson argued for a private person use exemption as an extension of the fair use holding of *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417 (1984)).

57. See Robert A. Kreis, *Section 117 of the Copyright Act*, 1991 BYU L. REV. 1497, 1522 (1991); Stern, *supra* note 53, at 463.

58. See Aaron Perzanowski, *Fixing RAM Copies*, 104 NW. U. L. REV. 1067, 1070 (2010). Professor Perzanowski discussed the “RAM Copy Doctrine” established by the Ninth Circuit in its decision, *MAI Sys. Corp. v. Peak Computer*, 991 F.2d 511 (9th Cir. 1993). Perzanowski noted that the Ninth Circuit sided with the copyright holders and the decision over time came to stand for “the notion that all RAM instantiations, however fleeting, are copies.” Cf. *Cartoon Network LP v. CSC Holdings, Inc.*, 536 F.3d 121, 139–40 (2nd Cir. 2008). In this more recent decision by the Second Circuit, Perzanowski noted that “[a]lthough *Peak* continues to represent the dominant approach, the Second Circuit’s decision in *Cartoon Network v. CSC Holdings* suggests that courts

Nevertheless, the courts have been comfortable, in fact motivated to agree with the software producer's characterization of ownership thereby depriving most software users (i.e. licensees are not owners) of the benefit of § 117's safe harbor from copyright infringement.

2. *Legislative History of §§ 109 and 117*

The legislative history of §§ 109 and 117 does not lend great support for a broad or synthetic view of ownership favored by the critics of the pro-software producer decisions.⁵⁹ The statutory language of both § 109 and § 117 uses the term "owner" when referring to the possessor of a copy.⁶⁰ CONTU had recommended that § 117 apply to all "rightful possessors."⁶¹ Without explanation Congress substituted the term "owner" for "rightful possessor."⁶² Despite inquiry to the Copyright Office, no explanation has been provided for this

remain willing to consider claims of infringement based on temporary instantiations with sensitivity to the unique facts of particular cases." See Perzanowski, at 1080. On November 10, 2011, the RIAA sent a cease and desist letter to ReDigi, Inc. claiming that its business of assisting legitimate owners of digital music to resell copies of their music constituted copyright infringement. Matthew Laser, *RIAA wants ReDigi out of the business of selling "used" iTunes tracks*, ARS TECHNICA (Nov. 15, 2011), <http://arstechnica.com/tech-policy/news/2011/11/riaa-wants-redigi-out-of-the-business-of-selling-used-itunes-tracks.ars> (last visited Nov. 29, 2011). ReDigi ensures that the original copy of music is deleted but in the process of transferring the copy a second copy of the digital song is created. As the RIAA pointed out there is no digital first sale right. *Id.* If this were found to be willful infringement penalties can be as high as \$150,000 per work infringed (as the RIAA points out). *Id.* There is no decision on whether this practice would be considered fair use. *Id.*

59. See Kreis, *supra* note 57, at 1516, 1536–37, 1539 (Kreis claimed that Congress had made a conscious decision to not follow the recommendations of CONTU and use the term "rightful possessor." *Id.* at 1537. He also claimed that Congress knew how to use that term because in the 1990 amendment to Section 109 (b) (1) to prohibit rentals of computer software programs, Congress used both terms "owner" and "possessor." *Id.* at 1536. The broader category of a person in "possession" of a copy of a computer program was used to define those parties who did not have right under first sale doctrine to rent their copies. In contrast, the text of Section 109 (a) containing the first sale doctrine itself contains the narrow term "owner." *Id.* Kreiss argued, however, that "rightful possessors" of computer programs without benefit of formal title have the right to make essential copies and archival copies of the program in the normal operation of the computer running the programs through contract theory of implied license. *Id.* at 1539. That view still would not give software users the right to sell or otherwise alienate the copy of software.).

60. 17 U.S.C. §§ 109, 117 (1998).

61. Stern, *supra* note 53, at 460 n.8; Samuelson, *supra* note 56, at 188.

62. Samuelson, *supra* note 56, at 188.

change and the legislative history is silent.⁶³ *MAI v. Peak*⁶⁴ was the first circuit court decision to interpret the term “owner” in the context of § 117. As discussed *infra*, the Ninth Circuit offered little rationale or reasoning but found that the magic words of “license” controlling, with the effect that the software users did not have the benefit of § 117.⁶⁵

As commentators have noted, Congress’ affirmative act to replace “rightful possessor” with “owner” in § 117 weighs against the argument that “possession” is enough based on traditional statutory construction.⁶⁶ If not in 1980, certainly in 1998 when § 117 was amended, Congress would have known that the standard license agreement governing distribution of software contained language stating that the user is a licensee not an owner of a copy of software. The effect of using the term “owner” not “rightful possessor” in the statutory language was to give software publishers greater control over the distribution of their software.⁶⁷

Commentators have argued that Congress appeared to intend the narrower construction in § 109 as well. In an article written by Stephen Kyle Tapp and Daniel E. Wanat in 1991, they noted that Congress had an opportunity in 1984 and 1990 when amending § 109 to amend subsection (d) which limits the application of § 109, or the first sale doctrine, to those in possession of a copy but have not acquired ownership of it.⁶⁸ Tapp and Wanat noted that if the amended § 117 was to be read in harmony with § 109 (a) and (d) an owner of a copy only, and not a possessor, would be granted the privileges embodied within both sections.⁶⁹

The upshot has been a very narrow construction of the essential copying doctrine such that if the copyright holder (e.g., software producer) unilaterally claims that its

63. See Stern, *supra* note 53, at 460.

64. See *MAI Sys. Corp. v. Peak Computer*, 991 F.2d 511, 519 n.5 (9th Cir. 1993).

65. See *infra* note 224 and accompanying text.

66. See Stern, *supra* note 53, at 467 (The implication is that Congress made an affirmative choice to narrow the scope of the intended beneficiary of the statute from the broader category of possessor despite the recommendation of CONTU).

67. See Samuelson, *supra* note 56, at 188–89.

68. See Stephen Kyle Tapp & Daniel E. Wanat, *Computer Software Copyright Issues: Section 117 and Fair Use*, 22 MEM. ST. U. L. REV. 197 (1992).

69. See *id.* at 214–15, 215 n.67.

users/licensees are not owners the court has upheld that characterization.⁷⁰ To make matters worse, courts have been inclined to inject a narrow, “property rights” driven construction of § 117 into their reasoning for § 109 first sale doctrine decisions involving software. As will be discussed *infra*, the Ninth Circuit in *Vernor v. Autodesk (Vernor II)* found no difficulty relying on its prior construction of § 117 to resolve a § 109 case.⁷¹ The Ninth Circuit added a few bells and whistles, constructing a multi-factor test that was substantively equivalent to their prior § 117 rationale.⁷²

The problem with this approach is that it fails to examine the different underlying purposes of §§ 109 and 117. Section 117 came into being as a narrow statutory doctrine with the purpose of conforming the practical realities of software use to traditional copyright principles. Even if arguably that purpose has been thwarted by the software industry’s licensing practices and courts recognition of such, the history and purpose of § 109 is much larger. It was born of common law doctrine, and then codified into statute. Over a century old, it has traditionally been associated with serving one of the primary interests of copyright, namely the availability and accessibility of creative works to society. I argue that courts should exercise greater scrutiny to distinguish these legislative acts and give greater deference to a vibrant, robust first sale doctrine. This would further the venerable purpose of the doctrine and the broader interests of copyright.

3. *Judicial Decisions Concerning Software*

Turning to the significant decisions of the period related to software, there were the circuit court decisions of *Step-Saver v. Wyse Tech*⁷³ in the Third Circuit, *ProCD v. Zeidenberg*⁷⁴ in the Seventh Circuit, and *Bowers v. Baystate*⁷⁵ in the Federal Circuit.

In 1991, in *Step-Saver*, the Third Circuit addressed the question of whether an end user license agreement (“EULA”)

70. *Id.* at 239.

71. See *Vernor v. Autodesk, Inc. (Vernor II)*, 621 F.3d 1102, 1114–15 (9th Cir. 2010).

72. *Id.* at 1110–11.

73. *Step-Saver Data Sys. v. Wyse Tech.*, 939 F.2d 91 (3d Cir. 1991).

74. *ProCD v. Zeidenberg*, 86 F.3d 1447, 1447 (7th Cir. 1996).

75. *Bowers v. Baystate Techs., Inc.*, 320 F.3d 1317, 1317 (Fed. Cir. 2003).

that disclaimed UCC warranties was enforceable against a buyer of software who alleged that he had not assented to those terms.⁷⁶ The Third Circuit applied the UCC but found that the EULA attached to the product constituted an additional term after purchase of the product and had been rejected by the buyer.⁷⁷ The court held for the buyer. In response to the software producer claiming this decision would have dire consequences for the industry, Judge Wisdom, author of the *Step-Saver* opinion, included a lengthy (and often quoted) footnote on his view of software licensing practices. Judge Wisdom noted that software producers started their licensing practices in the 1980's in an effort to avoid first sale doctrine because they feared the rental and copying of their software.⁷⁸ With the 1990 amendment to § 109 prohibiting rental of computer programs, Judge Wisdom believed that it was no longer necessary for software producers to structure their transaction as a license rather than a sale, referring to the "fiction" of the license.⁷⁹

Following this decision, Judge Easterbrook authored the *ProCD* opinion in 1996 for the Seventh Circuit, and found a EULA enforceable where the user/licensee was restricted from using the software for commercial purposes.⁸⁰ Construing the UCC and relying on contract principles, the Seventh Circuit distinguished *Step-Saver*, declaring UCC section 2-207 irrelevant to the case, and relying on a construction of UCC section 2-204 and UCC section 2-606.⁸¹ *ProCD* also found no preemption of copyright law, noting that generally private contracts are not affected by preemption.⁸² Language in the opinion waxed prolifically about the importance of private ordering to the optimal functioning of the markets and society, evidencing a "property rights" theory

76. See *Step-Saver*, 939 F.2d at 93.

77. *Id.* at 105–06. The Third Circuit relied on its construction of UCC § 2-207—often referred to as the "battle of the forms" provision. *Id.*

78. *Id.* at 96 n.7.

79. See *id.*

80. *ProCD v. Zeidenberg*, 86 F.3d 1447, 1455 (7th Cir. 1996). The rationale of *ProCD* reflects the influence of the utilitarian branch of "property rights" paradigm inspired by Demsetz economic theory. It supports maximal control of copyrighted works and believes that price discrimination will lead to optimal allocation of creative works. First sale poses leakage to the model and is disfavored.

81. See *id.* 1452–53.

82. *Id.* at 1453–54.

of copyright.⁸³

The Seventh Circuit was sensitive to the fact that it relied on contract reasoning rather than copyright analysis. As if anticipating the criticism that followed, the opinion expressed the limited scope of its (intended) effect by noting:

A copyright is a right against the world. Contracts, by contrast, generally affect only their parties; strangers may do as they please, so contracts do not create “exclusive rights.” Someone who found a copy of SelectPhone (trademark) on the street would not be affected by the shrinkwrap license—though the federal copyright laws of their own force would limit the finder’s ability to copy or transmit the application program.⁸⁴

Lacking the benefit of prophetic foresight, the Seventh Circuit had no idea that less than a decade later the Ninth Circuit would essentially find that someone picking up a copy of a software on the street could be obligated to comply with similar restrictions as those of *ProCD*.⁸⁵ The flaw in *ProCD*’s reasoning was finding privity, upon which a contract analysis depends. More striking was that this defect didn’t prevent a sweeping statement that copyright is a right against the world, but contract is limited to its parties. Belief in the exclusive role of markets, an integral part of the “property rights” theory of intellectual property, helps to explain this irrational exuberance.

In 2002, the Federal Circuit, in *Bowers*, addressed the question of whether a shrink wrap license (EULA) could contract away the fair use right of reverse engineering software established by judicial doctrine.⁸⁶ In that case, Baystate (accused of copyright infringement by reverse

83. *Id.* at 1454–55. *ProCD* was influenced by the Supreme Court decision, *Carnival Cruise Lines v. Shute*, 499 U.S. 585 (1991), which found that the forum selection clause on the back of a pre-printed ticket sent to the buyer after payment had been made was enforceable. *Carnival Cruise*, 499 U.S. at 596. *ProCD* analogized generally to the custom in the travel, entertainment and insurance industries where money now, terms later is normal course of business. *ProCD*, 86 F.3d at 1454–55. Of course those service businesses do not have the benefit of a federally created right in copyright granting them special protection in the marketplace.

84. *See id.* at 1454.

85. *See Vernor v. Autodesk, Inc. (Vernor II)*, 621 F.3d 1102, 1102 (9th Cir. 2010).

86. *See Bowers v. Baystate Techs., Inc.*, 320 F.3d 1317, 1317, 1323–24 (Fed. Cir. 2003).

engineering Bower's software) obtained copies of the software product according to the opinion.⁸⁷ What did that mean? He picked up a copy at his local retail store? As the dissent correctly pointed out there was not a negotiated contract and it was a stretch of the imagination to pretend there was "mutual assent" to the "waiver" of the judicial doctrine establishing a fair use right to reverse engineer software to obtain access to non-protectable ideas buried in the source code of the program.⁸⁸

Bowers' majority argued that they were following *ProCD* and famously quoted from the opinion about the difference between copyright and contract.⁸⁹ What difference is there, as the dissent pointed out, if a simple EULA (read: notice) is slapped on every retail package distributed around the world?⁹⁰

The mere presence of a shrink wrap license agreement does not prove ***mutual assent*** as the Federal Circuit claimed in *Bowers*.⁹¹ More importantly it does not prove ***privity***, a bedrock principle of contract theory for assigning rights and duties. That is the fallacy of logic that began with *ProCD*, continued through *Bowers*, then leaped further into imaginary space in the pro-software first sale decisions. As the district judge pointed out in *ProCD* the software user

87. *Id.* at 1322.

88. *Id.* at 1336–37 (Prior circuit doctrine had established that reverse engineering source code to obtain access to unprotected elements of the code may be protectable activity under the fair use doctrine as it supports innovation through the promotion of interoperability of products.)

89. *Id.* at 1325.

90. *Id.* at 1336–37 (citing *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 157 (2005)). Judge Dyk wrote in his dissent that the majority's ruling was akin to a "black dot" state law that could not be upheld. *Id.* He argued that:

[a] state is not free to eliminate the fair use defense. Enforcement of a total ban on reverse engineering would conflict with the Copyright Act itself by protecting otherwise unprotectable [sic] material. If state law provided that a copyright holder could bar fair use of the copyrighted material by placing a black dot on each copy of the work offered for sale, there would be no question but that the state law would be preempted. A state law that allowed a copyright holder to simply label its products so as to eliminate a fair use defense would 'substantially impede' the public's right to fair use and allow the copyright holder, through state law, to protect material that the Congress has determined must be free to all under the Copyright Act.

Id.

91. *See id.* at 1323–24.

never assented to the shrink wrap agreement that purported to restrict his use of the software to non-commercial uses.⁹² Zeidenberg purchased the software at a local retail store, according to the opinion, not directly from ProCD, the software retailer.⁹³ Where is the privity between ProCD and Zeidenberg? Both *ProCD* and earlier court in *Step-Saver* applied UCC provisions to the outcome of their decisions.⁹⁴ The courts have implicitly (without express UCC provisions) attached “restrictions” (rather than benefits) that affect downstream parties (i.e. end users) who legitimately purchase the software product.⁹⁵

Despite the Seventh Circuit’s famous claim that its decision grounded in contract was not a claim against the world, the effect of its reasoning, conflating contract analysis with copyright analysis, was to lay the groundwork and basis for just that—a contract, called a EULA, operating as a right against the world, against every anonymous retailer, and consumer purchasing a software product with a EULA (read: notice) affixed to it.⁹⁶

The fatal flaw inherent in this analysis is the fiction of “mutual assent” and “implied privity” as cover for a multitude of sins. Instead of transparently arguing for unlimited, unfettered property right of the copyright holder justified in copyright, the courts found copyright infringement, favoring content producer (namely software producers in these decisions) but relied on a contract analysis. The fiction of the

92. See *ProCD, Inc. v. Zeidenberg*, 908 F. Supp 640, 644 (W.D. Wis. 1996).

93. *Id.* at 645.

94. See *ProCD*, 86 F.3d at 1447; *Step-Saver Data Sys. v. Wyse Tech.*, 939 F.2d 91, 91 (3d Cir. 1991).

95. There seems to be a reverse logic in how courts have considered the UCC in the context of software transactions. Traditionally manufacturers avoided exposure to consumers of UCC warranties by asserting a lack of vertical privity with the consumers. UCC 2-318 modified the common law rule that a seller’s warranties only apply to the party in privity. This provision attaches the warranties to downstream parties that have contact with the product. Depending on the alternative rule adopted by the state, the immediate family/household may be the beneficiary of the warranty or more broadly any person who could reasonably be expected to “use, consume or be affected” by the goods.

96. See Mark A. Lemley, *Beyond Preemption: The Law and Policy of Intellectual Property Licensing*, 87 CALIF. L. REV. 111, 148 (1999) [hereinafter *Beyond Preemption*] (Lemley argued that the passage of UCC2B would “usher in an era of ‘private legislation.’”). Notwithstanding the (general) failure of adoption of UCC2B, I argue that judicial doctrine is accomplishing that goal.

license that *Step-Saver* referred to is really the fiction of “mutual assent” as cover for a copyright theory of unlimited property rights invested in the content producer.

4. UCC 2B

This section briefly reviews the controversy over the passage of UCC2B as another influential factor in the debate over the contemporary software decisions. During the 1990's the heated debate and controversy over the passage of a separate article to the UCC to govern transactions involving computer software, entitled UCC2B, framed the debate as one focused on contract theory and nominally questions of preemption.⁹⁷ UCC2B proposed a separate section to the UCC for the establishment of default rules for the treatment of contracts involving computer information, i.e., software. These proposed rules included terms about warranties and self-help remedies that a software producer could avail itself of in event of a defaulting customer. The criticism of UCC2B was that it would contract away rights that software users would otherwise enjoy under existing statute or judicial doctrine, including the right to transfer a copy of their software, or the right to reverse engineer the software to obtain the underlying “ideas” not protected by copyright.⁹⁸ UCC2B was generally perceived as pro-software industry and criticized by a diverse group of parties including the American Library Association, the FTC, several state AG's and many scholars, to name a few.⁹⁹ Although it eventually

97. See *id.* at 118–26, 136–46.

98. *Id.*

99. See Dorte Toft, *Opponents Blast Proposed Software Law*, CNN.COM, Jul. 12, 1999, <http://www.cnn.com/TECH/computing/9907/12/ucita.idg/index.html>. UCC2B was originally a project of the ALI and NCCUSL to draft and support state by state adoption of a new article to the UCC to address specifically information technology transactions including software. UCITA 101 & 102, AMERICAN LIBRARY ASSOCIATION, <http://www.ala.org/ala/issuesadvocacy/copyright/ucita/ucita101.cfm> (last visited Nov. 28, 2011); There was a great deal of controversy and criticism of initial drafts by consumer groups including Americans for Fair Electronic Commerce (“AFFECT”), American Library Association, State AG's, IT professional organizations, even the FTC and many scholars. *Id.*; UCITA: *Uniform Computer Information Transactions Act*, JAMESSHUGGINS.COM, <http://www.jamesshuggins.com/h/tek1/ucita.htm> (last visited Dec. 13, 2011). In April 1999, ALI withdrew. NCCUSL continued its efforts, renaming the article UCITA (stand-alone legislation) and hoped to gain state-by-state passage. By 2000 they had two states adopt the law, Virginia and Maryland. *UCITA Online: The Uniform Computer Information Transactions*

failed as a legislative process, many of the stated fears of the critics, notably that software producers would: (a) gain rights to disclaim warranties through a EULA, (b) prevent reverse engineering through a EULA, or (c) prevent transfer of a copy of software through a EULA, have come true as part of the judicial doctrine.¹⁰⁰

At the dawn of the new millennium, there was a lack of clarity in the law related to questions of software licensing. Trends favoring the interests of software industry from the prior decade included the Ninth Circuit's assertion in *MAI v. Peak* that for purposes of § 117 a software licensee is not an owner of a copy of software, and the Seventh Circuit's holding in *ProCD v. Zeidenberg* that parties can "contract around" copyright doctrine via a EULA, and that is good for society because it furthers the practice of price discrimination. Courts following the "property rights" theory of copyright would be expected to sympathize with software industry's efforts to establish default rules in UCC2B, and arguably inclined to develop judicial doctrine that reached the same results.

During the period of 2000 to 2003, two district courts sitting in the Ninth Circuit addressed the question of whether a EULA could defeat the first sale doctrine when the party asserting the first sale defense was a third party reseller clearly not in privity with the software producer. All three decisions involved the same software producer, Adobe, and very similar fact patterns. The two district courts arrived at

Act (UCITA) is a Proposed State Contract Law, UCITAONLINE.COM, <http://www.ucitaonline.com> (last visited Dec. 13, 2011); *Uniform Computer Information Transactions Act*, WIKIPEDIA, http://en.wikipedia.org/wiki/Uniform_Computer_Information_Transactions_Act (last visited Dec. 13, 2011). However, four states, Iowa, Vermont, North Carolina, and West Virginia, adopted "bomb-shelter" laws providing that their citizens were specifically shielded from the effects of the law. See Alorie Gilbert, *Supporters Back Away From Software Bill*, CNET News (Aug. 7, 2003), <http://news.cnet.com/2100-1028-5061061.html>.

100. See *Vernor v. Autodesk, Inc. (Vernor II)*, 621 F.3d 1102, 1102 (9th Cir. 2010). The Ninth Circuit found that EULA prevented anyone who possessed a copy of the software from exercising first sale rights to transfer a copy of the software without permission of the software producer. *Id.* See *Bowers v. Baystate Techs., Inc.*, 320 F.3d 1317, 1317 (Fed. Cir. 2003). The Federal Circuit found that the EULA effectively prevented user from reverse engineering to discover the unprotected elements of the software code, despite prior judicial doctrine holding that that activity was deemed fair use. *Id.*

divergent outcomes with the Northern District favoring the software producer, and the Central District favoring the reseller defendant. The following section analyzes these decisions and demonstrates how the courts' express rationale followed contract reasoning where the more coherent justification for the divergent decisions lies in their adherence to the competing copyright theories of "property rights" and "traditional incentives."

5. *Dueling Decisions on Software Licensing and First Sale Doctrine*

A great deal has changed in the economy and society since 1908 when the Supreme Court fashioned the first sale doctrine in its decision *Bobbs-Merrill v. Straus*. For the consumer, the first sale doctrine has been clear in the hard copy world of distribution of books, music and film. Even if the consumer did not recognize the doctrine by name they were familiar with the concept. The expectation that a book purchased from a bookstore could later be given to a friend, donated to the library or sold at a used bookstore would be a familiar one.

The digital age has transformed how society accesses and uses copyrighted works. In the 21st century, consumers have become accustomed to purchasing software for their PC's for various purposes from utility, word processing and accounting, to entertainment and games. Most consumers have some vague idea that these products come with more restrictions than their hard copy book purchased at the bookstore (or online from vendor such as Amazon), but they probably do not know the specific contours of these restrictions. They probably do not read the terms of the EULA that the software producer included with the software product. It has become customary for software producers to include a EULA that restricts transferability of the software product and thus either totally or partially obstructs (or arguably attempts to) the applicability of copyright law's first sale doctrine to the software product.

As discussed *supra*, *ProCD* found these EULAs enforceable and their restrictions on the type of use of the software binding on the purchaser of the software product.¹⁰¹

101. See *ProCD v. Zeidenberg*, 86 F.3d 1447, 1447 (7th Cir. 1996).

In the trio of Adobe decisions discussed below, the *ProCD* opinion is pushed to another level; it is not the user but a reseller who has been sued for copyright infringement by the software producer for attempting to ignore the license restrictions contained in the EULA. Despite *ProCD*'s declaration that if someone picked up the software on the street the license restriction would not be binding upon them, the software producer, Adobe, argued that its restrictions were binding even on someone who picked up the software on the street, so to speak.¹⁰²

At the dawn of the new millennium, three actions for copyright infringement with very similar fact patterns were decided with split decisions between two district courts. In the initial decision, *One Stop Micro v. Adobe Systems, Inc.*,¹⁰³ the district court of the Northern District of California found in favor of the software producer holding that the first sale doctrine did not apply. One year later in *Softman Products Co., LLC v. Adobe Systems, Inc.*,¹⁰⁴ the district court of the Central District of California arrived at the opposite result, finding against Adobe on grounds that first sale doctrine did apply. Finally, in the following year, 2002, in *Adobe Systems, Inc. v. Stargate*,¹⁰⁵ its second decision involving Adobe and a third reseller, the district court of the Northern District of California again found that first sale doctrine did not apply. As they both sit in the Ninth Circuit they could not help but notice and respond to the other's decision.

102. *Id.* The difference between *ProCD*'s fact situation on the one hand and *One Stop* and *Stargate* on the other is that in the former the user/licensee was the initial purchaser of the software. I critique the privity analysis of *ProCD*; however, I also argue that even *ProCD*'s purported limited scope was violated in the *One Stop* and *Stargate* decisions. *ProCD* argued that the initial purchaser had privity but that someone else who happened to obtain copies of the software could not be held to the restrictions contained in the EULA. *Id.* at 1454. *One Stop* and *Stargate* had fact patterns where the resellers had obtained the copies of software from third parties rather than directly from the software producer, or the software producer's distributor or retailer. See *infra* notes 103–05 and accompanying text. Nevertheless the restrictions including similar use restrictions as *ProCD* were found enforceable as a copyright action.

103. *Adobe Sys. Inc. v. One Stop Micro, Inc.*, 84 F. Supp. 2d 1086 (N.D. Cal. 2000).

104. *SoftMan Prods. Co. v. Adobe Sys. Inc.*, 171 F. Supp. 2d 1075 (C.D. Cal. 2001).

105. *Adobe Sys. Inc. v. Stargate Software Inc.*, 216 F. Supp. 2d 1051 (N.D. Cal. 2002).

In every case, Adobe sued the reseller for copyright infringement based on violations of its licensing agreements. These were authentic copies but Adobe argued that its license agreements conditioned its exclusive right of distribution such that any violation of these restrictions constituted copyright infringement. In each case, the reseller argued that its distribution was protected by the first sale doctrine. In some instances, it was a restriction specifying that distribution was limited to only educational users, and in others it was a bundling restriction, i.e., the software disks could not be unbundled and sold separately.¹⁰⁶ Adobe argued that it licensed rather than sold all copies of its software so the first sale doctrine did not apply.¹⁰⁷ Since it had licensed certain software with restrictions and the resellers in question violated the terms of the license, Adobe argued that these resellers were infringing its copyright.¹⁰⁸

On very similar fact patterns, the two district courts reached diametrically different outcomes. In all three cases, there was a) no privity between the software producer and the three different software resellers, b) a cause of action brought by software producer in copyright, and c) the situation where the software producer attempted to enforce license restrictions similar to *ProCD*. All three courts avoided developing a strong rationale based on copyright theory, and their contract approach was foundationally weak for the lack of privity and mutual assent, bedrock principles of contract theory.

Next, this Article turns to the commentary on these first sale decisions involving software. The distraction of the contract critique led to a failure to scrutinize the heritage of these decisions and to recognize the shift in the theoretical justification of copyright underlying the pro-software decisions.

106. See *One Stop*, 84 F. Supp. 2d at 1088; *SoftMan*, 171 F. Supp. 2d at 1080; *Stargate*, 216 F. Supp. 2d at 1052.

107. *Id.*

108. *Id.*

6. *Academic Commentary on First Sale Software Decisions*

Scholars have been unpersuasive in their arguments that a “rightful possessor” of a copyrighted work should benefit from the same privileges under copyright as an “owner.” As described *supra*, the courts have largely followed the opposite course, borrowing the very narrow statutory construction of “owner” from § 117 decisions, and adopting the software producer’s characterization of the transaction as a “license” not a “sale” as expressed in the software industry’s standard EULA. The commentary’s critical analysis of the pro-software first sale decisions has failed to emphasize the flawed contract reasoning employed by the courts in the express reasoning of their decisions, or to draw attention to the underlying copyright rationale at work in these decisions.

This section examines two articles focused directly on software licensing and first sale doctrine, which include the 2004 article by John A. Rothchild, *The Incredible Shrinking First Sale Rule: Are Software Resale Limits Lawful?*,¹⁰⁹ and the recent article by Brian Carver, *Why License Agreements Do Not Control Copy Ownership: First Sales and Essential Copies*.¹¹⁰ Both articles critique the current trend by courts to uphold the software industry’s position that the license transaction is a license not a sale, and first sale is not triggered. They rely on arguments based on the UCC, general commercial law, and analogous patent decisions, rather than the heritage and theoretical foundation of the pro-software first sale decisions.

The Incredible Shrinking First Sale Rule argued that software publishers employed a strategy of preventing users of software from gaining ownership rights through their distribution strategy of restrictive license agreements.¹¹¹ The article went on to argue that this strategy failed because the UCC would not recognize these restrictions on title.¹¹² Unfortunately the article provided no authority supporting this specific point that the UCC prevents software publishers

109. John A. Rothchild, *The Incredible Shrinking First-Sale Rule: Are Software Resale Limits Lawful?*, 57 RUTGERS L. REV. 1 (2004).

110. Carver, *supra* note 12.

111. See Rothchild, *supra* note 109, at 37.

112. *Id.* at 39.

from restricting the transfer of title in copies of their copyrighted works.

The only judicial support for the statement that restrictions on title would not be recognized was a 1907 Sixth Circuit decision involving patent law and price discrimination. In *John D. Park & Sons Co. v. Hartman*,¹¹³ an opinion by Judge, later Supreme Court Justice, Lurton, involved a drug manufacturer that based on its proprietary formula attempted to exercise price control over the distribution of its products.¹¹⁴ The attempt to enforce the price restrictions was struck down.¹¹⁵ It was a leap to go from a patent license attempting price control to a copyright license retaining rights of ownership and restricting manner (not price) of distribution of the copyrighted material. Neither the legal theory nor the facts underlying *Hartman* supported a convincing rationale for its connection to or critique of the contemporary pro-software decisions. Nevertheless, after citing *Hartman*, the article continued its argument by stating:

Thus, if a software publisher sells software copies to a distributor, who is bound contractually to distribute the copies only to specified users or under specified circumstances, but who faithlessly distributes the copies in violation of the contract, the transaction nonetheless transfers good title to the acquirer.¹¹⁶

This statement was supported by a footnote with two lengthy paragraphs. The first paragraph began, Courts that have failed to appreciate this point, then went on to list several decisions including the decisions of *One Stop* and *Stargate*.¹¹⁷ The next paragraph stated, “courts that have applied the principle correctly” and cited the decision of *Softman*.¹¹⁸ There were no circuit court decisions involving copyright and first sale supporting the statement. In another footnote, the article conceded that “the majority of courts conclude that copies of software are licensed, not sold.”¹¹⁹ In

113. *Park & Sons Co. v. Hartman*, 153 F. 24 (6th Cir. 1907).

114. See Rothchild, *supra* note 109, at 41–42.

115. *Id.* at 42.

116. *Id.* at 42–43.

117. *Id.* at 42–43 n.151.

118. *Id.*

119. *Id.* at 27 n.84.

the following footnote, the article acknowledged that this was the view of the Copyright Office.¹²⁰ The article seemed to offer more support for the opposite view it claimed to be taking.

Next, the article attempted to analogize to commercial law arguing that such limitations may create a security interest, as an academic point.¹²¹ There was no judicial authority to support this claim. As discussed *infra* the pro-content producers' decisions, beginning with *Platt & Munk Co., Inc., v. Republic Graphics, Inc.*¹²² and *American International Pictures v. Foreman*,¹²³ view intellectual property as special, and not subject to same treatment as other tangible property.¹²⁴ In *American International Pictures*, the Fifth Circuit expressly held that copyright holders could effectively restrict transfer of title in their copyrighted works through the use of license agreements.¹²⁵ In this 1978 decision, film producers successfully argued that the first sale doctrine did not apply to the resale of film prints.¹²⁶ *The Incredible Shrinking First Sale Rule: Are Software Resale Limits Lawful* overlooked this decision. Until the underlying rationale for this view is examined and critiqued, it will be difficult to move beyond the current majority view of the courts.

The article, *Why License Agreements Do Not Control Copy Ownership: First Sales and Essential Copies*, made the argument that indefinite possession should be the dispositive factor determining ownership in a copy, and the courts have it wrong.¹²⁷ In a section with the heading "Magic Words Cases," the article argued that a line of decisions which held that a license agreement did control ownership were all in error.¹²⁸ It included the line of Ninth Circuit § 117 decisions referred to as *MAI Trio* as the progenitor of this unfortunate

120. *Id.* at 28 n.85.

121. *Id.* at 39-40.

122. *Platt & Monk Co. v. Republic Graphics, Inc.*, 315 F.2d 847 (2d Cir. 1963).

123. *Am. Int'l Pictures, Inc. v. Foreman*, 576 F.2d 661 (5th Cir. 1978).

124. *See infra* notes 142-72 and accompanying text.

125. *Am. Int'l Pictures, Inc.*, 576 F.2d 661.

126. *Id.*

127. *See Carver, supra* note 12, at 1925-29.

128. *Id.* at 1899-1901.

occurrence.¹²⁹ The criticism of *MAI* echoed by earlier commentators was its lack of substantive analysis or rationale for its conclusion (contained in a footnote) that, “Since *MAI* (software producer) licensed its software, the Peak customers do not qualify as ‘owners’ of the software and are not eligible for protection under § 117.”¹³⁰ As will be discussed *infra*, *Vernor II* did rely on *MAI Trio* for its finding in favor of the software producer.¹³¹

The article cited the 1994 district court decision, *Microsoft v. Harmony*¹³² as another example of a decision failing to apply the correct reasoning.¹³³ Neither the precedent cited by *Harmony*, nor the express reliance on copyright rather than contract analysis by the decision, is explored in this article. A focus on the flaws inherent in the contract analysis as well as an investigation of the copyright theory heritage of the pro-software decisions may have led to a more persuasive critique of those decisions.

The article analogized to the patent exhaustion decisions where the Supreme Court found limits on the patent holder’s control of its distribution right: the recent Supreme Court decision, *Quanta v. LG Electronics*,¹³⁴ decided in 2008, and the legacy decision of *Motion Picture Patents v. Universal Film Mfg. Co.*,¹³⁵ decided in 1917.¹³⁶ These decisions involved anti-competitive behavior of a different nature than in *Vernor II*, and particularly in the case of *Quanta*, a fairly complex fact pattern. Like Professor Samuelson wrote more than

129. *Id.*

130. *See id.* at 1900.

131. *See infra* Part II.E.

132. *Microsoft Corp. v. Harmony Computers & Elecs., Inc.*, 846 F. Supp. 208 (E.D.N.Y. 1994).

133. *See Carver, supra* note 12, at 1901. *Harmony* was a software licensing and first sale decision. *Id.* Professor Carver’s main criticism of *Harmony* was it that it “furthered the unfortunate trend of short statements that fail to carefully distinguish between copyright and copies, [when it wrote,] ‘Entering a license agreement is not a ‘sale’ for purposes of the first sale doctrine.’” *Id.* In fact as discussed *infra*, *Harmony*, unlike the *MAI Trio*, did rely on earlier authority to support its application of copyright reasoning that found that the software producer had demonstrated a course of conduct to retain title in the copies of the work. *See infra* notes 190–94 and accompanying text. These earlier influences on *Harmony* were not explored in this Article.

134. *Quanta Computer, Inc. v. LG Elecs., Inc.*, 553 U.S. 617 (2008).

135. *Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 243 U.S. 502 (1917).

136. *See Samuelson, supra* note 56, at 195–96.

twenty years earlier in her article *Modifying Copyrighted Software: Adjusting Copyright Doctrine to Accommodate a New Technology*,¹³⁷ Professor Carver's article cited the principles enunciated in *Motion Picture Patents* that criticized restraints on alienation as "obnoxious to the public interest."¹³⁸ *Motion Picture Patents* also contained the famous statement by the Supreme Court that "the primary purpose of our patent laws is not the creation of private fortunes for the owners of the patents, but is 'to promote progress of science and the useful arts,'" referring to the balance of the monopoly and the public interest.¹³⁹ The principles enunciated could have been developed further to support the argument for a shift in the judicial doctrine of copyright.¹⁴⁰

In contrast, this Article offers an explanatory analytical framework for the pro-software decisions. In so doing, it attempts to expose the underlying weaknesses of the decisions' express reasoning based on flawed contract analysis and misplaced statutory construction. Rather than focusing on the contract debate ostensibly at work in the express reasoning of the decisions, this Article argues that the competing copyright theories at work more coherently explain the divergent outcomes of the decisions.

Parts II and III argue that the unifying rationale for the divergent outcomes in the split decisions of *One Stop* and *Stargate* on the one hand, and *Softman* on the other lies in their underlying theoretical justification which yielded two different models and rationales for copyright holders' rights.

137. See Samuelson, *supra* note 56, at 196.

138. *Id.* at 196 n.81.

139. *Motion Picture Patents*, 243 U.S. at 511.

140. In *Motion Picture Patents*, the patent holder had argued that its patented film projectors could only be used in conjunction with film prints supplied by it and any violation of this restriction constituted patent infringement. *Id.* at 518. The Supreme Court held that a patent holder could not extend the patent monopoly by mandating the use of non-patented supplies with the patented product. *Id.* In *Quanta Computer*, the Supreme Court ruled that patent exhaustion applied to the facts of the case and the patent holder could not prevail on its claim of patent infringement. *Quanta*, 553 U.S. at 2122. Professor Carver's statement, relying on *Quanta*, that "the Supreme Court has found all manner of contractual restrictions on the sale and use of a tangible thing embodying a copyrighted or patent invention invalid" is overbroad. Carver, *supra* note 12, at 1944. Neither *Quanta* nor *Motion Pictures* (which the article discussed in the same section supporting the aforementioned statement) addressed copyright. More importantly, *Quanta* specifically excluded a question arising out of contract. *Quanta*, 553 U.S. at 2122 n.7.

As discussed in Part II, *One Stop* and *Stargate* are more justifiably explained by tracing their heritage to several earlier decisions involving not only software but also other content, film prints and children's toys. The "inherent rights" copyright doctrine implicit in these pre-digital decisions represents the "natural rights" branch in the "property rights" paradigm of copyright. This copyright theory offers a more coherent rationale for these decisions than the weak foundational theory of contract.

Part II begins with an analysis of *Platt* because of its articulation for the premise of "special" rights of intellectual property, a concept that *American International Pictures* applied to its first sale decision involving distribution of film prints. *American International Pictures*, influenced by *Platt*, articulated the "inherent rights" doctrine of copyright ownership. This copyright doctrine, consistent with the principles of the "property rights" justification for copyright law, was followed in the subsequent software first sale decisions of *Microsoft v. Harmony* and *ISC-Bunker Ramo Corp. v. Altech, Inc.*¹⁴¹ As discussed *infra*, the contemporary decisions, beginning with the district court level decisions of *One Stop* and *Stargate*, through to the recent Ninth Circuit decision, *Vernor II* committed the analytical error of confusing contract analysis for copyright analysis; however, all of these decisions can be rationalized with the "property rights" theory of copyright. The decisions that found against the software producer and construed the first sale doctrine more broadly are best explained by adherence to the "traditional incentives" theory of copyright.

Part III discusses *Softman* in the context of the progenitor first sale decision, *Bobbs-Merrill*, as well as a line of decisions finding for limitations on the copyright holder's power to retain title. These decisions support the "traditional incentives" model of drawing a limit on the power of the copyright holder in order to ensure the benefits of availability and accessibility of creative works to the society at large. At the moment this is the minority view of the courts, and arguably overruled by precedent of Ninth Circuit in its recent decision, *Vernor II*. Nevertheless, the theory and rationale of

141. *ISC-Bunker Ramo Corp. v. Altech, Inc.*, 765 F. Supp. 1310 (N.D. Ill. 1990).

the "traditional incentives" model forms the best fit with the progenitor first sale decision, *Bobbs-Merrill*, and fulfills those promises made over a century ago.

II. PROPERTY RIGHTS THEORY AND THE PRO-COPYRIGHT HOLDER DECISIONS

Before reaching the contemporary software decisions including *Vernor II* in the Ninth Circuit, this section traces the heritage of the Northern District of California's first pro-software producer/first sale decision of *One Stop* to an early pre-digital decision of the Fifth Circuit, *American International Pictures (AIP II)* that involved the distribution of film prints. Going further back, *AIP II* cited the Second Circuit decision, *Platt & Munk v. Republic Graphics, Inc. (Platt)*, authored by Judge Friendly. *Platt* expressed support for the principle that a federally created right of copyright is treated differently when there is a clash or conflict with state derived rights. Influenced by *Platt*, *AIP II* promulgated the doctrine of "inherent rights" of copyright ownership, which represents the natural rights branch of the "property rights" paradigm of copyright. The software first sale decisions of *Harmony* and *ISC-Bunker* cited *AIP II*, and clearly followed its copyright rationale of the "inherent rights" doctrine ("*AIP II Trio*"). *One Stop* represents the fragile link between *AIP II Trio* decisions, and the recent decision of the Ninth Circuit, *Vernor v. Autodesk*. The analytical break from copyright to contract rationale was influenced by the factors discussed *supra*. The most cogent explanation for the decisions of *Vernor II* and the earlier pro-software first sale decisions of *One Stop* and *Stargate* is the "property rights" paradigm of copyright.

A. *Special Nature of Copyright: One Stop and Back to Platt*

The court in *One Stop* began its copyright analysis of the first sale question by citing the current codification of the doctrine in section 109(a) of the 1976 Copyright Act.¹⁴² Next, it stated that "[t]he first sale doctrine is only triggered by an actual sale. Accordingly, a copyright owner does not forfeit his right of distribution by entering into a licensing

142. See *Adobe Sys. Inc. v. One Stop Micro, Inc.*, 84 F. Supp. 2d 1086, 1089 (N.D. Cal. 2000).

agreement.”¹⁴³ *One Stop* relied on *Harmony* and *ISC-Bunker*.¹⁴⁴ The authorities cited by these decisions can be traced to the earlier Fifth Circuit decision, *American International Pictures v. Foreman*.¹⁴⁵

American International Pictures addressed the question of burden of proof to prove title to a film print where the defendant/reseller raised the first sale doctrine as a defense to a claim of copyright infringement by the plaintiff/film producers.¹⁴⁶ The chain of title in the copies at issue was not proved and the lower court found in favor of the party in possession of the copyrighted article relying on common law doctrines for real and personal property.¹⁴⁷ The Fifth Circuit not only reversed the lower court but criticized and rejected its reasoning finding it inapplicable to a case involving intellectual property.¹⁴⁸

The Fifth Circuit cited and relied upon the earlier Second Circuit decision authored by Judge Friendly, *Platt & Munk Co. v. Republic Graphics, Inc.*¹⁴⁹ In *Platt*, a decision in the pre-digital era of 1963, the Second Circuit considered the question of whether an unpaid manufacturer under contract with a copyright holder could avail itself of the common law self-help remedy of selling (otherwise disposing of) the manufactured merchandise (under copyright protection) in order to satisfy an unpaid bill by the copyright holder.¹⁵⁰ *Platt* considered carefully the arguments of both sides, copyright holder and manufacturer, and found both of them unpersuasive.¹⁵¹ The Second Circuit chose a third path which was to grant the unpaid manufacturer the right to seek adjudication in court to determine whether the copyright holder's failure to satisfy the contract was unjustified.¹⁵² Only then would the manufacturer have the right under first

143. *Id.*

144. *Id.*

145. See *Microsoft Corp. v. Harmony Computers & Elecs., Inc.*, 846 F. Supp. 208, 212 (E.D.N.Y. 1994); *ISC-Bunker*, 765 F. Supp. at 1314.

146. See *Am. Int'l Pictures, Inc. v. Foreman (AIP II)*, 576 F.2d 661, 664.

147. See *Am. Int'l Pictures, Inc. v. Foreman (AIP I)*, 400 F. Supp. 928, 934–35 (S.D. Ala. 1975).

148. See *AIP II*, 576 F.2d at 664–65.

149. *Id.* at 664.

150. See *Platt & Monk Co. v. Republic Graphics, Inc.*, 315 F.2d 847, 854 (2d Cir. 1963).

151. *Id.* at 851–53.

152. *Id.* at 855.

sale doctrine to sell or otherwise dispose of the merchandise.¹⁵³

The Second Circuit devoted some effort to explaining the control a copyright holder exercises in the rightful transfer of its title in any object containing its copyright.¹⁵⁴ In response to the manufacturer arguing that it had lawful possession of the merchandise for purposes of the first sale doctrine, the Second Circuit cited the example of the book agent who had rights of possession in a book, not authority to sell the book, and thus the party who purchased the book never received rightful title to the book.¹⁵⁵ The Second Circuit stated:

[I]t does not matter whether the party offering to sell without [the proprietor's] authority be a thief, or one in possession only by a breach of trust, or [by] some other less blamable means of acquisition. The *absence of [the proprietor's] authority* to sell his literary property constitutes the *defect of title*, no matter how that want of authority arises. Owing to *the peculiar character of this kind of property*, the absence of the author's authority to sell is a defect of *title*, and not a mere want of power.¹⁵⁶

The Second Circuit's reference to an "absence of authority" and "defect of title" appeared to support a strong "property rights" approach; it implied that the property owner, or copyright holder, must authorize the transfer of title. The Second Circuit appeared to have implied that this is the general rule but under certain circumstances exceptions were warranted. The opinion turned to the specific facts of the case and noted that under some circumstances transfer of title could be compelled and that this was one of those situations before the court.¹⁵⁷ The Second Circuit found that the copyright holder could not unjustifiably avoid the obligations of a contract as it had argued in the briefs.¹⁵⁸

Nevertheless, the copyright holder was entitled to differential treatment from a chattel owner (i.e. non-

153. *Id.*

154. *Id.* at 852.

155. *Id.* at 854.

156. *Id.* at 852 (emphasis added).

157. *Id.* at 854.

158. *Id.* at 855.

copyrighted property). Turning to the question of whether the manufacturer could avail itself of the self-help remedy available for chattel, the Second Circuit found special preferences for a federal created right under copyright law:

Where the copyright owner makes a good faith claim that its failure to pay for the goods was justified, the manufacturer ought not to be allowed to resort to the normal remedy of self-help with the result of impairing the rights granted by federal copyright law; to that extent state contract or lien law must yield to the federally created right.¹⁵⁹

Platt enunciated the principle that a federally created right of copyright may be treated differently when there is a clash or conflict with state derived rights. *Platt* did not cite any direct authority for this principle. This raised the question of why should manufactured goods, such as childrens' toys, in the *Platt* fact pattern be treated differently because there was a copyright associated with those particular manufactured goods? One explanation could be the hierarchy of rights, copyright traces its source of authority to the federal Constitution Article I. *Platt* was not analyzed or decided on the basis of preemption so that does not satisfactorily answer the question. Another possibility relates to an assumption of the underlying theory of copyright that motivated and drove the reasoning of *Platt*. As discussed *supra*, copyright law (as well as patent law) has traditionally rested on a utilitarian theoretical justification most commonly understood as the "traditional incentives" model that balances protection with access. However, natural rights theory has also been a competing justification for copyright. *Platt* evidenced a natural rights justification for copyright. Its opinion included a great deal of doctrine supporting strong rights for the copyright holder. As discussed below, the Fifth Circuit in *American International Pictures*, was influenced by this part of the Second Circuit's opinion.

The reasoning of the opinion in *AIP II* evidenced a doctrine referred to herein as "inherent rights" characterized by strong ownership rights vested in the copyright holder. This copyright doctrine runs through the subsequent software first sale decisions of *Harmony* and *ISC-Bunker*. As dis-

159. *Id.*

cussed *infra*, the “inherent rights” doctrine provides a more coherent rationale for the pro-software outcomes than the contract based reasoning expressed in the contemporary decisions of *One Stop*, *Stargate*, and *Vernor II*.

B. Articulation of the “Inherent Rights” Doctrine of Copyright Ownership: American International Pictures

In its opinion, *American International Pictures*, the Fifth Circuit addressed the question of burden of proof to prove title to a film print.¹⁶⁰ The defendant, a merchant trading in film prints, had been sued by the film producers who argued that they had not given authorization to transfer title to the films. The lower court found in favor of the defendant, the party in possession of the copyrighted article, relying on common law doctrines for real and personal property.¹⁶¹ Analogizing to common law principles of chattel governing questions of title, the defendant argued that title should be presumed as the copyrighted work had entered the stream of commerce. The Fifth Circuit reversed the lower court.¹⁶² If EFF had been around in 1978, it might have sounded a similar alarm at the Fifth Circuit’s decision in *American International Pictures*. Similarly to Timothy Vernor, a merchant trading on eBay, *AIP II*’s decision and rationale could have been argued to have a chilling effect on secondary markets.

The Fifth Circuit cited dicta from *Platt* that “an unwitting purchaser who buys a copy in the secondary market can be held liable for infringement if the copy was not the subject of a first sale by the copyright holder.”¹⁶³ As discussed *supra*, *Platt* articulated the principle that the federal right of copyright may support differential treatment for copyrighted works when in conflict with state derived common law rights. In holding for the film print reseller, the district court in *AIP I* had relied on the common law principles of property that possession is a rebuttable presumption and serves the public good by supporting the “free circulation of goods in commerce.”¹⁶⁴ These principles

160. See *AIP II*, 576 F.2d at 663–64.

161. See *AIP I*, 400 F. Supp. at 934–35.

162. See *AIP II*, 576 F.2d at 665–66.

163. *Id.* at 664.

164. See *AIP I*, 400 F. Supp. at 933.

are consistent with the utilitarian theory associated with “traditional incentives” model, which favors secondary markets and greater access and availability of creative works.

The Fifth Circuit, however, expressly criticized and rejected the lower court’s reasoning finding it inapplicable to a case involving intellectual property.¹⁶⁵ The Fifth Circuit, consistent with a natural rights justification, argued that copyright law bestowed strong rights in the copyright holder:

Here the plaintiffs’ evidence established a ***course of conduct***, unrebutted as to the specific films in the complaint, consistent with an ***intention*** to retain all the rights associated with the grant of copyright to the films in question. We have located no copyright case holding that possession of a copy by a third person overcomes the rights of the copyright holder in such circumstances. Rather, because ***copyright law favors the rights of the copyright holder***, the person claiming authority to copy or vend generally must show that his authority to do so flows from the copyright holder.¹⁶⁶

“Course of conduct” referred to the film producers’ practice of executing agreements with parties who received copies of film prints, stating that no transfer of title in the film print had been granted.¹⁶⁷ The court went on to clearly state that a copyright holder can avoid the trigger of first sale doctrine through such a course of conduct:

The [film producer]’s evidence, although flawed by its generality and gaps in the personal knowledge of the corporate witnesses, ***demonstrated that the [film producer] had consistently attempted to retain title*** (emphasis added) to the films involved in the complaint. [The film print reseller]’s evidence, suggesting that first sales of other films had been made, demonstrated only that [copyright holder] had not treated all films consistently. [The film print reseller]’s general evidence, unrelated to any film in the complaint, thus left unrebutted the [film producer]’s proof that, whatever their treatment of other films, they had consistently avoided

165. See *AIP II*, 576 F.2d at 664–65.

166. *Id.* at 665. (emphasis added). The Fifth Circuit does not cite *Bobbs-Merrill*. This Article argues that the Fifth Circuit’s decision in *AIP II* is in direct conflict with *Bobbs-Merrill*. See *infra* Part III.B.

167. See *id.*

first sales of the films in this suit.¹⁶⁸

The Fifth Circuit reversed the lower court, and debunked the idea that presumption of possession was lawful.¹⁶⁹ The district court judge was persuaded by defendant's testimony that many of the agreements that film producers used seemed more like a sale than a lease.¹⁷⁰ In one case with United Artists Corporation ("UA"), UA had distributed motion picture prints as "life-of-print" leases but the court found that the terms of the transaction, single lump sum payment and no obligation to return the print seemed more like a sale.¹⁷¹ The Fifth Circuit, however, was not persuaded. They found that defendant could not trace the particular film prints at issue to a legal document evidencing a sale.¹⁷²

The key terms for the Fifth Circuit were "intent" and "course of conduct." The Fifth Circuit did not expressly name a new doctrine in copyright law; however, the reasoning of the Fifth Circuit decision supports a **copyright doctrine of inherent rights** of the copyright holder. To determine intent the court fashioned a standard, the "course of conduct," to determine if the copyright holder demonstrated its manifested intent to retain title in its copyrighted works. The Fifth Circuit cited several authorities for general principles that support a copyright doctrine of "inherent rights." They included control by the copyright holder in the retention of rights, deference to the copyright holders' intent regarding any transfer of those rights, and even preferences granted to ownership rights of copyright holders in the objects or products containing that copyright compared to owners of general chattel.¹⁷³

For the principle of the control of the rights associated with copyright ownership, the Fifth Circuit cited another Fifth Circuit decision, *Tennessee Fabricating Co. v. Moultrie Manufacturing Co.*,¹⁷⁴ claiming that "the copyright certificate

168. *Id.* at 665-66.

169. *See id.* at 664-65.

170. *See* Am. Int'l Pictures, Inc. v. Foreman (*AIP I*), 400 F. Supp. 928, 934 (S.D. Ala. 1975).

171. *See id.* at 932.

172. *See AIP II*, 576 F.2d at 665-66.

173. *See id.* at 665.

174. *Tennessee Fabricating Co. v. Moultrie Mfg. Co.*, 421 F.2d 279 (5th Cir. 1970), *cert. denied*, 398 U.S. 928 (1970).

is prima facie evidence that the copyright holder retains all rights granted by the copyright.”¹⁷⁵ Deference to the copyright holder was stated by the Fifth Circuit in its statement that “copyright law favors the rights of the copyright holder, the person claiming authority to copy or vend generally must show that his authority to do so flows from the copyright holder.”¹⁷⁶ It cited several district court decisions in the Second Circuit.¹⁷⁷ The court summed up this principle with the statement that: “[n]one of these cases suggests that mere possession of a copy is sufficient to meet this burden.”¹⁷⁸

Applying the “inherent rights” doctrine and the corresponding “course of conduct” standard derived from the reasoning of *AIP II*, the issue is framed as a copyright one: has there been a voluntary transfer of title such that the one in possession of a copy of the work should be treated as an owner for purposes of the first sale doctrine. If the content producer has established a course of conduct of consistently licensing the software copies, and expressly retaining its title in such copies, then its licensee is a “rightful possessor” of such copyrightable copy, but first sale doctrine is not triggered. Where a course of conduct is established then the burden is on the possessor to show that the copyright holder did transfer title in a first sale such that the copyholder’s exclusive right to distribute became subject to the first sale doctrine.

The divergent outcomes between the lower court and the Fifth Circuit reflect the competing copyright theories at work. The lower court had followed the traditional utilitarian theory of copyright that deadweight losses from monopoly copyright are offset by traditional doctrines such as first sale that promote greater accessibility and availability of copyrighted works. The Fifth Circuit, influenced by the Second Circuit in *Platt*, followed the competing natural rights

175. *AIP II*, 576 F.2d at 665.

176. *Id.*

177. See, e.g., *Von Tilzer v. Jerry Vogel Music Co., Inc.*, 53 F. Supp. 191 (D.C.N.Y. 1943), *aff’d*, 158 F.2d 516 (2d Cir. 1946); *Edward B. Marks Music Corp. v. Jerry Vogel Music Co.*, 47 F. Supp. 490 (D.C.N.Y. 1942), *aff’d*, 140 F.2d 266 (2d Cir. 1944), *modified*, 140 F.2d 268 (2d Cir. 1944); *Schellberg v. Empringham*, 36 F.2d 991 (D.C.N.Y. 1929).

178. See *AIP II*, 576 F.2d at 665.

justification for copyright, and felt little concern about circumscribing the effect of the first sale doctrine. The language of *AIP II* such as emphasis on need to show "voluntary transfer" of title clearly supports a theory of strong property rights vested in the copyright holder. As discussed *supra*, the "natural rights" influence on the "inherent rights" doctrine has historical roots in the early development of copyright in the U.S.¹⁷⁹

C. Application of the "Inherent Rights" Copyright Doctrine to Software: ISC-Bunker and Harmony

ISC-Bunker and *Harmony* were two software decisions involving first sale doctrine that looked to the progenitor *American International Pictures* for guidance on the question of whether the "possessor" of the software had the benefit of the first sale doctrine in a claim by the copyright holder for infringement.¹⁸⁰ *ISC-Bunker* involved a company, ISC-Bunker Ramo Corp. ("ISC"), who serviced computers and sold used computers.¹⁸¹ Part of ISC's business model was not only to sell computer systems, which included a license to the software contained therein, but also provide maintenance and support to its customers. It sued its competitor, Altech, arguing that Altech had infringed its copyright in the software contained in the computer systems.¹⁸² In the other case, Microsoft sued Harmony, a software reseller, for committing copyright infringement by the unauthorized unbundling and reselling its software.¹⁸³

Citing *American International Pictures*, *ISC-Bunker* found that "Altech had **no authority** to possess ISC's software."¹⁸⁴ The court reasoned that any such authority must come from ISC, who, as the copyright holder, has the exclusive right to control distribution of its software. The court found that "ISC, **through its licensing agreements**, has specifically limited distribution to licensed customers

179. See Ginsburg, *supra* note 20, at 1023; see *supra* Part I.A.

180. See *ISC-Bunker Ramo Corp. v. Altech, Inc.*, 765 F. Supp. 1310, 1314 (N.D. Ill. 1990); *Microsoft Corp. v. Harmony Computers & Elecs., Inc.*, 846 F. Supp. 208, 212, 212-13 (E.D.N.Y. 1994).

181. See *ISC-Bunker*, 765 F. Supp. at 1314.

182. *Id.*

183. See *Harmony*, 846 F. Supp. at 210.

184. See *ISC-Bunker*, 765 F. Supp. at 1331 (emphasis added).

only, and proscribed any further distribution of its software.”¹⁸⁵ Finally, the court concluded that “Altech has ***no lawful right to possess*** ISC software, and has ***acquired no title*** (emphasis added) to or other rights in that software.”¹⁸⁶

ISC-Bunker’s statement of the authority of the copyright holder to determine the transfer of title harkened back to *Platt*’s statement that the “absence of the author’s authority to sell is a ***defect of title***.”¹⁸⁷ This is also consistent with the natural rights theory of copyright. Authority is derived solely from the intention of the copyright holder. The court’s reference to ISC’s conduct “through its licensing agreements” was similar to *AIP II*’s description of the film publishers’ behavior as a “course of conduct” demonstrating its intent to retain rights of ownership in a copyrighted article while making such article available to the public. That standard “course of conduct” as enunciated by *AIP II* was followed in *ISC-Bunker* with its analysis of the copyright holders’ general practices in its licensing agreements of retaining rights of title in the copyrighted material. *ISC-Bunker* applied a copyright “inherent rights” doctrine based on principles of manifested intent of the copyright holder rather than contract principles that would analyze the mutual intention of the parties.

Harmony considered whether the first sale doctrine shielded a reseller of software products from a claim of copyright infringement by the software producer/copyright holder, Microsoft.¹⁸⁸ This reseller had not entered into an agreement directly with Microsoft but had purchased the products from another reseller, then resold those products in violation of the licensing restrictions.¹⁸⁹ After stating the first sale doctrine, the court applied the standard from *AIP II*, word for word, referring directly to the *AIP II* language of “chain of title” and “course of conduct.”¹⁹⁰

Harmony found that a copyright holder may license its rights and still retain the title such that first sale doctrine is

185. *Id.* (emphasis added).

186. *Id.* (emphasis added).

187. *Platt & Monk Co. v. Republic Graphics, Inc.*, 315 F.2d 847, 852 (2d Cir. 1963) (emphasis added).

188. *See Harmony*, 846 F. Supp. at 210.

189. *Id.*

190. *See id.* at 213.

not triggered:

Defendant's failure to trace their Microsoft Products to a "first sale" by the copyright holder is aggravated by the fact that plaintiff has "established a **course of conduct** . . . consistent with an **intention to retain all the rights** associated with the grant of copyright" of the Microsoft Products.¹⁹¹

Just like in *AIP II*, there was no discussion in *Harmony* of contract principles of mutual assent of the parties, but only a copyright analysis of the demonstrated intent by the copyright holder to retain its rights of ownership in the copyrighted article. Ultimately the Fifth Circuit in *AIP II*, as the Eastern District Court of New York did later in *Harmony*, concluded that the copyright holder had retained its rights of ownership and not transferred title such that first sale doctrine would apply.

In *Harmony* the reseller claimed that the first sale doctrine applied because he had acquired the software through a valid licensing agreement.¹⁹² The court in *Harmony* cited *ISC-Bunker*, rejecting that rationale: "Entering a license agreement is not a 'sale' for purposes of the first sale doctrine."¹⁹³

ISC-Bunker, as discussed *supra*, built on *AIP II*'s copyright rationale of inherent rights. The court distinguished a (rightful) possession of a copyrighted article, without title to the article because the copyright holder chose to retain the title, from one who has received an authorized transfer of title from the copyright holder. *Harmony* made this distinction even clearer when it stated that "the only chain of distribution that Microsoft authorizes is one in which all possessors of Microsoft Products have only a license to use, rather than actual ownership of the Products."¹⁹⁴ The rationale in both of these decisions is consistent with natural rights theory of copyright.

In *Harmony*, the "possessor" of the software, was a reseller who did not intend to install or use the software and had not entered into a reseller agreement with the software

191. *Id.* (emphasis added).

192. *See id.* at 210.

193. *Id.* at 213.

194. *Id.*

producer/copyright holder, Microsoft. This did not matter to the court because it followed *AIP III*'s copyright doctrine of "inherent rights" of ownership. A copyright holder's rights cannot be abridged by a third party even an innocent third party. *Harmony* stated:

A licensee who has failed to satisfy a condition of the license or has materially breached the licensing contract has no rights to give a sublicensee under which the sublicensee can take cover in a copyright infringement case, and therefore, both the licensee and the sublicensee can be held liable for acting without authorization and thereby infringing the licensor's copyright.¹⁹⁵

Finally, the court addressed the question of whether the software producer had a claim of copyright infringement or breach of contract. The court noted that in this case it was clearly copyright infringement because there was no privity between the parties.¹⁹⁶ It noted, however, that even if there had been a distribution agreement between the parties the copyright holder/software producer could have still brought a copyright infringement claim for exceeding the scope of the copyright license.¹⁹⁷ *Harmony* recognized the lack of privity in the reseller fact pattern, something that the later pro-software decisions failed to do.

Harmony expressly followed *AIP II*'s inherent rights doctrine of copyright ownership. The copyright holder may expressly retain title in its distribution of the product. The spirit of *Platt* lived on through *AIP II*, then in the digital age, in the opinions of *ISC-Bunker* and *Harmony*. *Platt* had emphasized that an "absence of the author's authority to sell is a defect of title."¹⁹⁸ *Harmony* interpreted this to mean that where the copyright holder expressly retains title, no transfer has occurred, and there is no first sale.

The "inherent rights" rationale based on natural rights theory runs through *ISC-Bunker* and *Harmony*. It is predicated on the assumption that the copyright holders, in these cases software producers, rather than toy producers or film producers, needed greater protection as a reward for

195. *Id.* at 214.

196. *Id.*

197. *Id.*

198. *Platt & Monk Co. v. Republic Graphics, Inc.*, 315 F.2d 847, 852 (2d Cir. 1963).

their contribution to societal welfare. The rationales and outcomes of these decisions are aligned in a purely natural rights theory of copyright, but they are also consistent with the “property rights” paradigm. The “inherent rights” rationale forms the natural rights branch of the hybrid “property rights” paradigm that includes the utilitarian strand of economic theory inspired by the work of Harold Demsetz.

Next, the Article turns to the district court decisions in *One Stop* and *Stargate*, then the Ninth Circuit decision in *Vernor II*. All of these decisions reached a pro-software outcome; however, the analytical break from *AIP II*’s coherent copyright analysis, and the attempt to inject contract principles into the rationale of the decision, diminished the justificatory force of these decisions. Their rationales and outcomes are misaligned; the jurisprudential foundation of the “property rights” paradigm provides coherency to their outcomes finding in favor of the content (software) producer.

D. Analytical Break – Conflating Contract with Copyright Analysis: One Stop and Stargate

In *One Stop*, Adobe brought a copyright action and the Northern District Court of California began its analysis citing the copyright doctrine of first sale.¹⁹⁹ Then, it quickly shifted to an analysis that resembled a contract theory approach. By framing the question as whether the transaction at issue constituted a sale or a license, the court began a lengthy investigation and analysis of the contract at issue and the circumstances surrounding the particular transaction.²⁰⁰ The statement that “the Court must give effect to the **mutual intention of the parties**” (emphasis added) most transparently revealed the contract theory approach employed by the court.²⁰¹ *One Stop*’s opinion set up this discussion with the section sub-heading: “OCRA—sale or license;” OCRA an acronym for the title of the agreement that Adobe used to document the transaction.²⁰² After a few sentences referring to the relevant copyright statute and a

199. See *Adobe Sys. Inc. v. One Stop Micro, Inc.*, 84 F. Supp. 2d 1086, 1089 (N.D. Cal. 2000).

200. See *id.* at 1090.

201. *Id.*

202. *Id.* at 1089.

few prior decisions on the copyright doctrine, the court then devoted several pages to detailed references to the language of the agreement and testimony from the parties related to the commercial practices of the parties. It went on to state, "The parties' intent is inferred exclusively from the language of the contract, assuming the language is 'clear and explicit.'"²⁰³ The court found that the transaction was a license and first sale doctrine did not apply.²⁰⁴

Two years after *One Stop*, Adobe brought a copyright infringement suit against another reseller, *Stargate*, under similar circumstances again in the Northern District Court of California.²⁰⁵ Similar to *One Stop*, the court zigzagged in method from copyright analysis to contract analysis. After a brief introduction to first sale doctrine, it quickly turned to an examination of the agreement at issue to determine if there had been a sale, triggering the first sale doctrine.²⁰⁶ The court found it important that the agreement imposed numerous restrictions on title, citing the restriction that resellers distribute pursuant to the terms of a EULA.²⁰⁷ There was less testimony from various parties on software licensing practices as in *One Stop*, but the court quoted from *One Stop* that "these numerous restrictions imposed by Adobe indicate a license rather than a sale because they undeniably interfere with reseller's ability to further distribute the software."²⁰⁸ This rationale can not be grounded in contract theory because of the absence of vertical privity. "Inherent rights" doctrine, grounded in natural rights theory, offers a cogent rationale for the district court's outcome. It supports the unilateral right of the copyright holder to place limits on the distribution of its copyrighted works.

In *Stargate*, the reseller raised the "economic realities" argument, lifted directly from the opinion of *Softman*, the intervening decision between *One Stop* and *Stargate*, from the Central District of California, that had ruled against

203. *Id.* at 1090.

204. *See id.* at 1092.

205. *See Adobe Sys. Inc. v. Stargate Software Inc.*, 216 F. Supp. 2d 1051, 1052–53 (N.D. Cal. 2002).

206. *See id.* at 1055–56.

207. *Id.* at 1057.

208. *Id.* (citing *One Stop*, 84 F. Supp. at 1091).

Adobe.²⁰⁹ Instead of relying on copyright analysis the Northern District of California responded in kind arguing that the transaction at issue, repeating the phrase “economic realities” of the transaction, favored its finding that by the terms of the license agreement at issue there was no sale and thus no triggering of first sale.²¹⁰

The court’s statements that “Adobe has *elected* (emphasis added) to distribute its products via license rather than sale,” as well as statement that “Adobe characterizes each transaction it concluded through the *entire stream of commerce* (emphasis added) relevant,” hinted at something different than a contract theory approach but were undeveloped.²¹¹ This could have been developed more fully to support of a copyright theory approach based on the “inherent rights” doctrine enunciated by *AIP II*, and followed by *Harmony* and *ISC-Bunker*. Falling back to contract principles, *Stargate* wrapped up its opinion by opining on the importance to society of the “right to contract freely.”²¹² Here the court harkened back to its earlier opinion in *One Stop* when it stated the importance of “giving effect to the mutual intention of the parties.”²¹³ This also echoed the faulty reasoning of *ProCD* and *Bowers* claiming that the effect of their decision was really limited because of an imagined version of privity.²¹⁴

One Stop and *Stargate* represent the fragile link to the earlier first sale decisions of *AIP II*, *Harmony*, and *ISC-Bunker*, that unabashedly applied a copyright doctrine of “inherent rights” consistent with a “property rights” justification for copyright law. They also represent the analytical break where the court applied flawed contract reasoning instead of relying expressly on the “property rights”

209. See *SoftMan Prods. Co. v. Adobe Sys. Inc.*, 171 F. Supp. 2d 1075, 1084 (C.D. Cal. 2001).

210. See *Stargate*, 216 F. Supp. 2d at 1055.

211. *Id.* at 1056.

212. *Id.* at 1059. Judge Ware quoted directly from the Ohio Supreme Court’s opinion, when it stated that “[t]he right to contract freely with the expectation that the contract shall endure according to its terms is as fundamental to the society as the right to write and to speak without restraint.” *Blount v. Smith*, 12 Ohio St. 2d 41, 47 (1967).

213. See *Adobe Sys. Inc. v. One Stop Micro, Inc.*, 84 F. Supp. 2d 1086, 1090 (N.D. Cal. 2000).

214. See *ProCD v. Zeidenberg*, 86 F.3d 1447, 1454 (7th Cir. 1996); *Bowers v. Baystate Techs., Inc.*, 320 F.3d 1317, 1325 (Fed. Cir. 2003).

theory that offers justificatory force to its outcome. This misdirection becomes more apparent in the Ninth Circuit's *Vernor II* decision, which made no explicit reference to those earlier pro-copyright holder decisions.

E. Alternative Rationale for Vernor v. Autodesk (Vernor II)

On September 10, 2010, the Ninth Circuit reversed the decision of the District Court of the Western District of Washington, and found that the licensing agreement used by Autodesk prevented Timothy Vernor from benefiting from the first sale doctrine.²¹⁵ Timothy Vernor, who had purchased an authentic copy of Autodesk software from a third party, had attempted to resell such software on eBay. The license agreement attached to the software restricted its use to the initial purchaser and prohibited further transfer without Autodesk's express permission. Timothy Vernor had claimed that the first sale doctrine shielded his sale of the software from an action of copyright infringement. The lower court had found in favor of Timothy Vernor.

In its analysis, the Ninth Circuit carried out a strained examination of its own precedent, *United States v. Wise*,²¹⁶ a criminal prosecution case, and the *MAI* trio, § 117 cases.²¹⁷ *United States v. Wise* was a Ninth Circuit decision from the late 1970's involving criminal prosecution of distribution of film prints. In that decision, the court found that in the case of certain film prints (not all, or even a majority) the Government had failed to meet its burden of proof that there was an absence of first sale, such that the defendant would be guilty of copyright infringement. In those instances the court found a number of factors important to its decision including the factor of indefinite possession.²¹⁸ The lower court in *Vernor I* found that factor critical to the outcome of the decision.²¹⁹

215. See *Vernor v. Autodesk, Inc. (Vernor II)*, 621 F.3d 1102, 1116 (9th Cir. 2010).

216. See *Vernor II*, 621 F.3d at 1110–11.

217. See *id.* at 1111.

218. *Id.* The doctrine enunciated by *Wise* was as opaque as the murky fact situation in the case.

219. See *Vernor v. Autodesk, Inc. (Vernor I)*, 555 F. Supp. 2d 1164, 1170 (W.D. Wash. 2008).

The Ninth Circuit considered the District Court's decision to rely on *Wise* but found that the two decisions were not in direct conflict, arguing that the earlier decision, *Wise*, stated several factors to consider, none of which were dispositive.²²⁰ The Ninth Circuit finally arrived at its holding by examining the specific license agreement in question and finding specific conditions that supported its multi-factor test finding that licensee was not an owner for purposes of first sale.²²¹ Nevertheless, the Ninth Circuit found that its holding was consistent with its construction of both the *MAI* trio and *Wise*.²²²

Examining the specific license agreement would indicate a contract theory approach similar to that employed in *One Stop* and *Stargate*. The Ninth Circuit appeared to really re-fashion *Wise* by developing the three factor test to determine whether the transaction was a license or a sale. All the factors, including label of license, restrictions on transfer and notable use restrictions, required an examination of the language of the specific license agreement. This approach suffered from the same analytical error as *One Stop* and *Stargate* as it required the illogical leap to hold a party, the reseller, not in privity to the software producer/copyright holder bound to an agreement under a contract theory. In copyright, any user of a copyrighted article, whether or not in privity with the rights holder, can be held liable for infringement of the rights of the copyright holder.

In *MAI* trio,²²³ there were three decisions by the Ninth Circuit that construed § 117 and involved the question of whether the defendant could be considered an "owner" for purposes of benefiting from § 117's safe harbor from copyright infringement. Starting with *MAI v. Peak*'s famous footnote stating that where software is licensed, the users cannot qualify as owners, the other decisions followed suit in their construction of § 117.²²⁴ In *Vernor I*, the lower court did not

220. See *Vernor II*, 621 F.3d at 1110–11.

221. *Id.* at 1111, 1113.

222. *Id.* at 1111.

223. *Wall Data Inc. v. Los Angeles Cnty. Sheriff's Dep't*, 447 F.3d 769, 785 (9th Cir. 2006); *Triad Sys. Corp. v. Se. Express Co.*, 64 F.3d 1330, 1333 (9th Cir. 1995); *MAI Sys. Corp. v. Peak Computer*, 991 F.2d 511, 511 (9th Cir. 1993). [hereinafter, collectively, the *MAI* trio].

224. See *MAI*, 991 F.2d at 519 n.5. The Ninth Circuit stated in this often quoted footnote, "[s]ince MAI licensed its software, the Peak customers do not

challenge that interpretation even for a parallel application of a § 117 construction to a § 109 (first sale) fact pattern and decision. In fact *Vernor I* stated that if it followed *MAI* trio decisions it would find in favor of Autodesk.²²⁵ The lower court had found that these decisions were irreconcilably in conflict and chose to rely on *Wise*, for the putative reason that it followed Ninth Circuit precedent of choosing the earlier decision in conflicting decisions.²²⁶

The Ninth Circuit in *Vernor II* reached a pro-software producer outcome consistent with its heritage of pro-content producer decisions but without arguably a satisfactory rationale for that result as suggested by commentators.²²⁷ The analytical break from *AIP II*'s rationale began with *One Stop* but was complete with the *Vernor II*'s decision. The Ninth Circuit seemed to be completely unaware of earlier precedent in the area of first sale doctrine, beginning with *American International Pictures* and *Platt*, and continuing through *Harmony* and *ISC-Bunker*.²²⁸ *One Stop* cited *ISC-Bunker*, quoted from *Harmony*, but failed to fully appreciate and follow their copyright theory approach. One is left understanding *Vernor II* either based on (a) the thin reed of statutory construction of *MAI Trio* of the related § 117 doctrine; or (b) a re-fashioned construction of *Wise* based on a weak contract theory that the parties intended to restrict title in this particular transaction.

qualify as 'owners' of the software and are not eligible for protection under Section 117." Professor Carver argued that "the entire framing of the question as one of 'license versus sale' presents a false dichotomy that should be avoided." See Carver, *supra* note 12 at 1934.

225. See *Vernor v. Autodesk, Inc. (Vernor I)*, 555 F. Supp. 2d 1164, 1172 (W.D. Wash. 2008).

226. See *id.*

227. See Carver, *supra* note 12, at 1900.

228. Cf. The Ninth Circuit referred briefly to two Supreme Court decisions involving first sale doctrine. *Vernor v. Autodesk, Inc. (Vernor II)*, 621 F.3d 1102, 1107 (9th Cir. 2010). In dicta in *Quality King*, the Court referred to Section 109 (d), which lists exceptions to the Section 109 first sale rule, such as bailee and lessee. *Quality King Distrib., Inc. v. L'Anza Research Int'l Inc.*, 523 U.S. 135, 147 (1998). Surprisingly the Court added in its opinion, "licensee," although that term or category does not exist in the actual statute. *Id.* The Ninth Circuit also discussed *Bobbs-Merrill* for its reference to a lack of a contract or licensing agreement between the parties. *Vernor II*, 621 F.3d at 1107. As discussed *infra*, the Ninth Circuit looked narrowly at the language of *Bobbs-Merrill*, missing its reference to a lack of privity between the parties. *Bobbs-Merrill Co. v. Strauss*, 210 U.S. 339, 339 (1908).

Like the District Court of Northern California in *One Stop* and *Stargate*, the Ninth Circuit did evidence some spirit of *AIP II* by describing Autodesk's global licensing practice and policy in its opinion. *Vernor II* described Autodesk's licensing practices as one where it reserves title to the software copies.²²⁹ Discussing in more detail the practices, the Ninth Circuit stated:

Since at least 1986, Autodesk has offered AutoCAD to customers pursuant to an accompanying software license agreement ("SLA") The SLA . . . first recites that Autodesk retains title to all copies [I]t imposes transfer restrictions, prohibiting customers from renting, leasing, or transferring the software without Autodesk's prior consent²³⁰

The Ninth Circuit also noted that "Autodesk takes measures to enforce these license requirements."²³¹ All of the above can be coherently rationalized by the "inherent rights" doctrine of copyright ownership, and the natural rights branch of the "property rights" paradigm of copyright. The copyright holders had established a "course of conduct" consistent with an intention to retain all the rights associated with the grant of copyright to the material at issue. Arguably the multi-factor test developed by the Ninth Circuit test that in *Vernor II* was really a restatement of *AIP*'s "course of conduct" standard.

Neither of the factors that the district court in *Vernor I* believed to be dispositive appeared in the final test that the Ninth Circuit fashioned for analyzing the question of whether the transaction should be treated as a sale or a license. The Ninth Circuit all but ignored the importance of factors of "indefinite possession" or "full price" discussed in *Wise*. In essence the surface doctrinal language of the opinion respected the precedent of *Wise* but not the outcome. Those factors speak to the limits on control by the copyright holders' right to control distribution of its creative works, and inform the "rightful possessor" theory advanced by the express reasoning of *Softman*. The "rightful possessor" rationale coherently fits with the "traditional incentives" theory of

229. *Vernor v. Autodesk, Inc. (Vernor II)*, 621 F.3d 1102, 1103 (9th Cir. 2010).

230. *Id.* at 1104.

231. *Id.*

copyright.²³² On the other hand, the test fashioned by *Vernor II*, echoed its unclaimed heritage, namely an emphasis on the copyright holder's power to unilaterally place reservations on title, effectively avoiding the first sale doctrine. All of the pro-software producer decisions are consistent with the "property rights" based theory of copyright that relies on a natural rights justification, and believes that markets and private ordering are the best (if not exclusive) mechanism for production and allocation of creative works for the optimal societal welfare.

III. TRADITIONAL INCENTIVES THEORY AND THE PRINCIPLES OF *BOBBS-MERRILL*

Part II argued that the pro-software decisions suffered from analytical error of confusing contract with copyright analysis. Going a step further it also argued that the recent pro-software decisions, *One Stop*, *Stargate*, and *Vernor II*, could best be reconciled with their predecessor software decisions of *Harmony* and *ISC-Bunker*, as well as the pre-digital pro-content producer decision of *AIP II*, and the doctrinal tenets of *Platt*, by rationalizing them with the "property rights" theory of intellectual property.

At this point the reader may wonder why go further, what is there left to say. Software producers were happy with the outcome of *Vernor II*.²³³ The state of digital commerce, however, is at a critical inflection point where the debate and discussion about the values that society expects to be promoted and upheld by copyright law demands more scrutiny and public debate. As the title to Professor Rothchild's article portends, the first sale doctrine is indeed "an incredible shrinking rule," as the current trend of digital commerce is to shrink if not to eliminate any vestige of the first sale rule. Book retailers, such as Amazon and Barnes & Noble, who distribute the popular e-book readers, Kindle and

232. See *infra* notes 246–70 and accompanying text.

233. See Steven Seidenberg, *Court Ruling May Give Copyright Owners More Restricting Rights*, INSIDE COUNSEL (Dec. 2010), available at <http://www.insidecounsel.com/Issues/2010/December-2010/Pages/Court-Ruling-May-Give-Copyright-Owners-Restricting-Rights.aspx?page=1> ("What this ruling [*Vernor v. Autodesk* decision] means to software companies is that they can continue business as usual," says Suzanne Bell, a partner at Wilson Sonsini Goodrich & Rosati, quoted in this Article.).

Nook, are accomplishing in the marketplace what *Bobbs-Merrill* renounced at the turn of the last century. Consumers who purchase the reader can download full texts of a book and keep the book “indefinitely” but they are prevented from fully exercising the traditional rights of first sale, namely to transfer or otherwise dispose of that copy of the book at their pleasure. The Kindle, in books, and the iPod, in music, illustrate the emergence of tethered devices where the consumer can only access the content through proprietary interfaces controlled by the content producer.

Although currently the minority view, the “traditional incentives” theory of intellectual property forms the best fit, in my opinion, with the principles of the progenitor first sale decision, *Bobbs-Merrill*, as well as the plain language of the constitutional mandate for the intellectual property regime.

Part III begins with an examination of the principles enunciated by *Bobbs-Merrill* and analyzes how those principles should animate the analysis and construction of the first sale doctrine. To understand the divergence in the current debate, it is helpful to apply the *Bobbs-Merrill* analysis to the historical decisions of *Platt* and *AIP II*. As argued *supra*, *Platt* can be read to find a narrower construction of its opinion than adherents of the “property rights” theory may be inclined; however *AIP II*’s analysis cannot be harmonized with *Bobbs-Merrill* and represents the harbinger of the “property” approach to the first sale doctrine as held by the current majority view. Then, the discussion turns to the “minority” view decisions of *AIP I*, *Softman*, and *Vernor I*, and how they can be understood in the context of the principles of *Bobbs-Merrill*. Although the fact patterns and outcomes of these minority decisions are consistent with *Bobbs-Merrill*, they failed to rationalize their decisions with the principles and analysis of *Bobbs-Merrill*.

Finally, the Article proposes a model of “constructive ownership” building on the “rightful possessor” theory of ownership but adding a third prong for the special case of software. This model if adopted by the courts would limit *Vernor II* to its facts applying to most cases of software (assuming it met the conditions of the model) but not to other digital media. It is the contention of this Article that this “constructive ownership” model more faithfully fulfills the promises of *Bobbs-Merrill* and the original intention of the

constitutional mandate for the intellectual property regime.

A. Bobbs-Merrill *Doctrine on First Sale*

The first sale doctrine was first promulgated in the Supreme Court decision, *Bobbs-Merrill Co. v. Straus* in 1908.²³⁴ The Court held that the exclusive right to “vend” under the copyright statute applied only to the first sale of the copyrighted work.²³⁵ In that case the publisher, Bobbs-Merrill, had attempted to control the re-sale price of a particular book, “The Castaway,” by inserting in the inside cover of the book a notice stating that it was a violation of its copyright to sell such copy of the book for less than one dollar.²³⁶ The retailer, Macy’s, attempted to do so and was sued by the publisher for copyright infringement.²³⁷

Bobbs-Merrill, the publisher and copyright owner, had argued that its exclusive right to vend (distribute) included the right to determine how much of that right it parted with and how much it retained to itself.²³⁸ The Court responded by framing the question in a way that transparently revealed the Court’s concern about the effect of the copyright holder’s intent to unilaterally determine the scope and meaning of the right to vend. To the question of what does the statute mean in granting the right to vend, the Court responded:

Was it intended to create a right which would permit the holder of the copyright to fasten, **by notice in a book** or upon one of the articles mentioned within the statute, a restriction upon the **subsequent alienation** of the subject-matter of copyright after the owner had parted with the title to one who had acquired **full dominion** over it and had given a **satisfactory price** for it?²³⁹

To that rhetorical question, the Court answered in the negative.²⁴⁰ The similarity between the pointed references by the Court to the salient characteristics of that case and those of the current software cases in the Ninth Circuit is striking. In 1908, the Court referred to (a) a notice affixed to the

234. See *Bobbs-Merrill Co. v. Strauss*, 210 U.S. 339, 339 (1908).

235. See *id.* at 350–51.

236. *Id.* at 341.

237. *Id.* at 341–42.

238. *Id.* at 349–50.

239. *Id.* (emphasis added).

240. See *id.* at 350.

copyright article; (b) one who had acquired “full dominion” over the article, and (c) one had paid a “satisfactory price” for the article.²⁴¹ In 2010, *Vernor II* considered a case where the reseller Timothy Vernor had purchased a copy of software with a EULA attached to it, and there were no further obligations of payment or return. Similar parallel construction can be drawn with pro-software decisions, *One Stop* and *Stargate*, as well decisions, *Softman* and *Vernor I*, finding against the software producer.

Vernor II hurriedly dismissed *Bobbs-Merrill* with a reference to the statement that in the *Bobbs-Merrill* opinion the case before it did not involve a claim of a contract limitation or license agreement. However, what *Vernor II* failed to notice was that in the next sentence the Court restated its holding but with the particular caveat that between these parties there was ***no privity of contract***. As discussed *supra*, this is the fatal flaw of the reasoning of the pro-software decisions. Finding privity between Timothy Vernor and Autodesk, or between the resellers, *One Stop* and *Stargate*, and the software producer, Adobe, is simply illusory. The only difference between Macy’s, as a retailer, in 1908 and the resellers of current era, is the later adoption of the UCC and the courts apparent practice of seeing privity everywhere and nowhere.

As a result of *Bobbs-Merrill*, consumers can exercise the right to lend, sell or otherwise dispose of their copies of books, DVD’s and CD’s. Apart from legislative action restricting the renting of music and software, consumers can enjoy the renting of movies.²⁴² *Bobbs-Merrill* worked under several theories of intellectual property. It curbed the anti-competitive behavior of copyright producers (then book publishers) attempting to avoid or control competition in secondary markets through price discrimination (i.e., keep used books from being too cheap). It also served to promote and preserve the delicate balance between producers and users, promoting availability of creative works. Finally in a common law theory of property, it affirmed the common law aversion to restraints on alienation. *Bobbs-Merrill* articulated and fashioned the first sale doctrine by defining the

241. *Id.* at 350–51.

242. *See* The Copyright Act, 17 U.S.C. § 109(b)(1)(A) (2008).

right to vend (now distribute) as something less than an unlimited, unfettered right. It read into the statutory right this limitation, namely that the copyright holder exhausts its right to control vending (distributing) after a transfer of lawful possession (updated in 1976 Act to use term “first sale”).

Bobbs-Merrill does not work under the relatively recent theory of “property rights” discussed *supra*. In fact the price discrimination model enshrined by the “property rights” model runs absolutely contrary to the facts and holding of *Bobbs-Merrill*. Also, the reference to “property” values by the model is misleading as its true focus is its exclusive reliance on the role of markets and the holy sanctity of “private ordering” (i.e., contract) to motivate, incentivize and reward the investors of copyrighted works. This misapprehension, intentional or not, has continued in the courts by convincing themselves that under the cover of contract “it’s only a right among parties.” Is it really a contract, when the boiler plate, pre-printed document (read: notice), is affixed to a copyrighted work and found binding on a third party reseller? Where is the distinction from the situation in *Bobbs-Merrill* where Macy’s, the retailer, attempted to re-sell the book in violation of the publisher’s printed notice in the cover of the book.²⁴³ It is the fiction of contract; the principles of “mutual assent” and “privity” are assumed.

B. Platt and American International Pictures Scrutinized Under Bobbs-Merrill

In Part II, this Article argued that *Platt* and *AIP II* laid the groundwork for a copyright analysis of inherent rights grounded in a “property rights” theory of copyright. Arguably the language in the opinions supported that premise. As discussed *supra*, the Second Circuit spoke louder than necessary for the needs of the case before it. The special treatment of intellectual property espoused in the opinion supported the particular holding of the decision. The Second Circuit compelled the unpaid manufacturer to seek adjudication of its claim before disposing of the copyrighted articles. In *AIP II*, however, there was stronger evidence that the Fifth Circuit meant to carry the principles of *Platt* further

243. See *Bobbs-Merrill*, 210 U.S. at 350–51.

and endow the copyright holder with special rights, rights arguably stronger than *Bobbs-Merrill* intended.

Considering the principles espoused in *Bobbs-Merrill* particularly the references to **alienation**, **full dominion** and **satisfactory price**,²⁴⁴ one could infer a preference for finding as *AIP I* did. In the absence of evidence of theft or counterfeiting, the presumption should be that lawful transfer had occurred. Otherwise, it would seem that a contrary holding, one similar to *AIP II*'s doctrine and holding, would support the contention of the publisher, *Bobbs-Merrill*, which the Court derisively referred to as (wrongly) assuming it had the right to determine how much of that right it parted with and how much it retained to itself.²⁴⁵ The reseller in *AIP II* had no more privity with the film producers than did Macy's in the original *Bobbs-Merrill* decision. Therefore, *AIP II* and *Bobbs-Merrill* are not in harmony.

C. *AIP I*, *Vernor I*, and *Softman* Re-Rationalized Under *Bobbs-Merrill*

Next, this section analyzes the decisions that found against the content producer/copyright holder decisions, *AIP I*, *Vernor I*, and *Softman*, in the context of the *Bobbs-Merrill* principles. None of these decisions including *AIP I* closely followed or expressly relied on *Bobbs-Merrill* for their rationale and outcome. These opinions would have been more persuasive if they had been more closely aligned with the principles of *Bobbs-Merrill*, which applied a copyright analysis supported by a "traditional incentives" theory of intellectual property. These "minority view" decisions had fact patterns and outcomes consistent with *Bobbs-Merrill*.

Bobbs-Merrill can be viewed as standing for four interdependent principles. This section compares the analysis of these opinions to the rubric of the four

244. *Id.* at 350.

245. *See id.* at 349–50. The Supreme Court stated "[i]t is the contention of the appellant that the Circuit Court erred in failing to give effect to the provision of Section 4952, protecting owners of the copyright in the sole right of vending the copyrighted book or other article, and the argument is that the statute vested the whole field of the right of exclusive sale in the copyright owner; **that he can part with it to another to the extent that he sees fit, and may withhold to himself, by proper reservation, so much of the rights as he pleases.**" *Id.* (emphasis added).

interdependent principles articulated by *Bobbs-Merrill*. In its critique of these opinions, this Article also examines all of the opinions' implicit or explicit reasoning in support of the "traditional incentives" theory of intellectual property. The Court found in favor of the retailer, Macy's, because all four had been satisfied.²⁴⁶ First, the Court found that Macy's exercised full dominion over the copyrighted article, the novel "The Castaway."²⁴⁷ There was no evidence that the publisher had rented or leased the novel with the obligation to return it after a finite period of time.²⁴⁸ Second, the Court found that Macy's had paid a "satisfactory" price for the article.²⁴⁹ Third, its decision supported the alienation right generally preferred in common law; or stated conversely, a decision supporting the publisher would have constituted a restraint on alienation, disfavored generally in the common law.²⁵⁰ Finally, the Court found no privity between the parties, which would have led to an analysis of a binding agreement that may have altered the above analysis.²⁵¹ All three decisions that found against the copyright holder, film producer in *AIP I*, software producer in *Softman* and *Vernor I*, construed the first sale doctrine consistent with the principles outlined above. In most cases, however, the principles have to be inferred from the factual circumstances and the holdings; the opinions did not expressly recite in full the *Bobbs-Merrill*'s analysis.

In *AIP I*'s discussion of the life-of-print leases, the court raised principles one and two without making an explicit connection to *Bobbs-Merrill*. Rather than cite or discuss *Bobbs-Merrill*, the district court cited another district court decision, sitting in the Second Circuit, for its exposition of the first sale doctrine. The court found that the "single lump sum payment" and the fact that the "[customer] is not obligated to return [the film print]" left "little doubt but that, in reality, they are nothing more than sales."²⁵² *AIP I* emphasized the

246. See *id.* at 350–51.

247. *Id.* at 350.

248. *Id.* at 349–50.

249. *Id.*

250. See *id.* at 350.

251. *Id.* at 350–51.

252. *Am. Int'l Pictures, Inc. v. Foreman (AIP I)*, 400 F. Supp. 928, 932 (S.D. Ala. 1975).

third principle, the common law's disfavor for restraints on alienation, by expressing its support for the principle that possession is lawful (in absence of contrary evidence).²⁵³ Lack of privity was not discussed in *AIP I*; neither contract analysis nor principles were invoked by *AIP I* or *AIP II*.

AIP I devoted a great deal of its opinion to discussion of the policy concerns of a contrary result which would support the power of the copyright holder to retain title in its distribution practice. Supporting the view that societal welfare is optimized by promoting access and availability of copyrighted articles, *AIP I* argued that its holding was "consistent with that policy of law which seeks to provide for free circulation of goods in commerce."²⁵⁴ It also supported limitations on copyright holder's power when it stated, "[f]urthermore, this allocation is consistent with the limited scope of the copyright proprietor's statutory monopoly which 'reflects a balance of competing claims upon the public interest.'"²⁵⁵ *AIP I* further demonstrated its support for the "traditional incentives" definition of societal welfare when it noted that:

Creative work is to be encouraged and rewarded, but private motivation must ultimately serve the cause of promoting broad public availability of literature, music and other arts. The practical and undesirable effects on "public availability" resulting from a ruling that all those in the defendant's position are copyright infringers unless they can bear the burden of tracing their chain of title back to a "first sale" by the copyright proprietor are self-evident (internal citations omitted).²⁵⁶

AIP I focused more on its reliance on common law principles of tangible property. *AIP I* did not make the analytical error of confusing contract analysis with copyright analysis; however, it failed to persuasively bring its copyright analysis under *Bobbs-Merrill*. Rather than focus on a discussion of analogous common law property doctrines, it could have argued that its rationale and holding were consistent with *Bobbs-Merrill*'s principles, namely full dominion, satisfactory price, alienation and lack of privity.

253. See *id.* at 933.

254. *Id.*

255. *Id.*

256. *Id.* at 933-34.

Vernor I conducted a more strained analysis of precedent in the Ninth Circuit including *Wise* and *MAI* trio. Relying on *Wise*, the court found that “the critical factor is whether the transferee required that the prints be returned” echoing the first principle of *Bobbs-Merrill*, exercising “full dominion” over the article.²⁵⁷ The fact pattern of *Vernor I* satisfied principle two of *Bobbs-Merrill* as there was no further obligation to pay for the software copy. *Vernor I*’s reliance on *Wise* formed a shaky foundation for several reasons. First, it could have been distinguished by the procedural posture of being a criminal prosecution, with a murky factual situation, and a court hesitant to find liability. Next, *Wise* did not clearly articulate a doctrine which is probably why it was not that difficult for *Vernor II* to construe a very different reading of the opinion. The analysis is as opaque as the factual situation; a great deal of the discussion focused on specific circumstances of each transaction which would evidence a contract analysis although it cited copyright doctrine as well. *Vernor I* failed to even reference *Bobbs-Merrill*. In its first sale doctrine analysis, it referenced the recent Supreme Court decision *Quality King*.²⁵⁸

Vernor I did not expressly discuss the policy preference of an aversion to restraints on alienation; the holding, however, of *Vernor I*, finding for first sale, supported the *Bobbs-Merrill* principle of alienation. The eBay brief in support of Timothy Vernor expressed its support for this principle arguing strongly that a finding of no first sale would have deleterious effects on secondary markets like its own.²⁵⁹ On the question of lack of privity, *Vernor I* expressly raised the lack of privity and mutual assent as problems for Autodesk’s argument that the license agreement bound the reseller from attempting to resell the software. The court pointed to the apparent anomaly in Autodesk’s contract claim, when it stated, “[a]utodesk does not explain how a nontransferable license can bind subsequent transferees.”²⁶⁰

257. See *Vernor v. Autodesk, Inc. (Vernor I)*, 555 F. Supp. 2d 1164, 1170 (W.D. Wash. 2008).

258. *Id.* at 1168.

259. See Brief for eBay, Inc. as Amici Curiae Supporting Respondents, *Vernor v. Autodesk, Inc.*, 621 F.3d 1102 (2010) (No. 09-35969), at 7–9.

260. See *Vernor I*, 555 F. Supp. 2d at 1176 (As the court noted, “[a]utodesk failed to surmount the thorny issues of privity and mutual assent inherent in its

Vernor I expressly disclaimed making policy judgments in its exercise of a mechanical construction of prior precedent.²⁶¹ Its adoption and construction of prior precedent, however, followed the “traditional incentives” approach. By construing *Wise* as finding “indefinite possession” dispositive, the court adhered to the rationale that (a) some limitation of copyright holder’s power is necessary for the proper functioning of copyright law and policy and (b) the promotion of secondary markets contributes to the societal welfare as justified by copyright law and policy.

Softman’s opinion most closely expressed the *Bobbs-Merrill* principles starting with principles one and two of “full dominion” and “satisfactory price.” *Softman* argued that “if a transaction involves a single payment giving the buyer an unlimited period in which it has a right of possession, the transaction is a sale,” and first sale has been triggered.²⁶² *Softman* did not directly address the question of restraints on alienation although the factual circumstances and holding fit well with the *Bobbs-Merrill* model. Like Macy’s the retailer of the books, the reseller *Softman* attempted to resell copies of software; however, the copyright holder, Adobe attempted to impose restrictions on the manner in which the articles would be resold. Adobe’s attempt to enforce a price discrimination model (educational vs. non-educational uses) was very similar to *Bobbs-Merrill*’s attempt to control the price of its downstream market. *Softman*’s rejection of Adobe’s position was consistent with the *Bobbs-Merrill* decision.

Although *Softman* did not expressly refer to a “lack of privity” in its opinion, it addressed rather the question of assent. The court found no basis for assent by *Softman* to the terms of the Adobe license agreement by analyzing the facts that the reseller did not attempt to install or use the software product.²⁶³ *Softman* cited *Bobbs-Merrill* but not quite accurately. *Bobbs-Merrill* created the doctrine. *Softman* argued

contention that its License binds Mr. Vernor and his customers, it has ignored the terms of the License itself Given the ‘nontransferable’ terms of the License, and Autodesk’s failure to cite authority for the proposition that the License binds downstream transferees, the court will not consider the issue further in this order.”).

261. See *id.* at 1174.

262. See *SoftMan Prods. Co. v. Adobe Sys. Inc.*, 171 F. Supp. 2d 1075, 1086 (C.D. Cal. 2001).

263. See *id.* at 1087.

in several places in its opinion that the factual circumstances of the software transaction that included: (a) a single price and (b) indefinite term of possession, indicated a sale, thus invoking the first sale doctrine.²⁶⁴ The support for these statements was not *Bobbs-Merrill* but several articles and interestingly *ProCD v. Zeidenberg*.²⁶⁵ *ProCD* enforced the right of the software producer to incorporate price discrimination into its licensing strategy. Softman's reliance on *ProCD* only makes sense when considering the "Assent" section where the court in *Softman* found that in this case, Softman the reseller, neither installed nor operated the software so could not have assented to the software producer restrictions.²⁶⁶ This is where *Softman* went astray, like *One Stop* and *Stargate*, conflating contract and copyright analysis.²⁶⁷

Softman expressly demonstrated its support for the "traditional incentives" theory in its discussion of the "public interest" test for injunctive relief.²⁶⁸ It was interesting that the opinion devoted discussion to this topic as the court had already held that there was no infringement. Nevertheless, its concern about unchecked power of copyright holders was expressed with some gravity. First, the opinion noted that Adobe's attempt to impose the terms of the EULA represented an effort to deprive customers of rights they should enjoy under copyright law and such restrictions were "inconsistent with the balance of rights set forth in intellectual property law."²⁶⁹ In the next paragraph, *Softman*

264. *See id.* at 1085.

265. *Id.* at 1087.

266. *Id.*

267. *SoftMan* also relied on the article by David A. Rice entitled "Licensing the Use of Computer Program Copies and the Copyright Act First Sale Doctrine." Professor Rice's article relied heavily on its reading of *Wise*, namely that indefinite possession is dispositive of the first sale question, as well as analogous principles from tangible property law and UCC principles on the construction of leases and loan transactions. *See Rice, supra* note 12, at 173–74. *Wise* has now been essentially overruled by *Vernor II*, and as this Article argued, it never provided a strong foundation for the broad construction of the first sale doctrine. Reliance on analogous principles from property law or UCC was an inferior strategy to relying on the authority that is supreme both in hierarchy and subject matter, namely the *Bobbs-Merrill* rationale. *See supra* notes 234–43 and accompanying text.

268. *See SoftMan*, 171 F. Supp. 2d at 1090–91.

269. *Id.* at 1090.

makes several references to the “unlimited” and “unchecked” power that software producers attempt to exert in the marketplace.²⁷⁰ *Softman* clearly supported a “traditional incentives” theory of intellectual property with the concomitant belief that limits on copyright holder’s power are important for the optimal societal welfare. *Softman*’s argument would have been strengthened by an explicit reliance on *Bobbs-Merrill*.

D. Vernor II *Versus* Bobbs-Merrill

Applying the *Bobbs-Merrill* principles to *Vernor II*, it would at first glance appear that they are in conflict and cannot be reconciled. Just like *AIP II*, there was no privity between the software reseller, Timothy Vernor, and Autodesk. An outcome for Timothy Vernor would also appear to satisfy the principles of *Bobbs-Merrill*. He had indefinite possession of the article, which would appear to satisfy the principle of “full dominion.” He also had paid a satisfactory price and had no further obligation for payments. Finally, an outcome in his favor would support the common law’s aversion to restraints against alienation.

The question, however, of whether a software user exercises “full dominion” may be more complex than in the case of other copyrighted articles including digital media such as an e-book, CD or DVD. Quite often, the relationship between software producer and user is not static but dynamic. By that I mean that licensing of software often involves the ***continuing license*** of software in the form of updates and fixes. Conceptually it can be said then that there is no exhaustion as long as there is a continuing license of copyrightable material to the user. This point is discussed below in the next section. For this reason, the proposed model includes a special exception for software if it satisfies the condition of a continuing license of copyrighted material to the user/licensee.

270. See *id.* at 1091 (The court warned that “Adobe seeks a vast and seemingly **unlimited power** to control prices and all channels of distribution A system of ‘licensing’ which grants software publishers this degree of unchecked **power** to control the market deserves to be the object of careful scrutiny.” (emphasis added)).

E. Software is Special

In the case of software, there has been the general problem, identified by many others, that the legal regime is ill-suited to appropriately protect (on both ends of the protection spectrum) the innovation.²⁷¹ Software is structurally different from all other forms of creative works that fall under copyright protection.²⁷² The value of the program is not in the text or language of the program; it is in the behavior or function of the program.²⁷³ It is what the program can do for the user that gives it commercial and utilitarian value. The problem, both commercial and conceptual, is that the value of the software that is derived from genuine creative and innovative effort is vulnerable to theft by a competitor.

It is helpful to understand the value equation. The same software code, or text, can be used by a customer in a wide range of uses, with a corresponding business value. Depending on the configuration and installation of the software, the value to the customer, as reflected in the bargain struck by the producer and customer for the price of the licensed use, can easily range from \$100,000 to multi-million dollars for the same text, the same software code. If a competitor gained access to the software, it could easily determine the competitive functional aspects of the software and unfairly benefit from the innovation of the original software producer/developer. A competitor may do this legally or illegally (i.e., violating current copyright norms). As the software producer knows it will be difficult to detect if that has occurred, and it will necessarily involve a time-consuming and costly process to effectively stop the activity through injunctive relief and/or damages. Under the current copyright regime, there is no protection for the behavior of the

271. See generally J. H. Reichman, *Electronic Information Tools — The Outer Edge of World Intellectual Property Law*, 17 U. DAYTON L. REV. 797 (1992); Pamela Samuelson et al., *A Manifesto Concerning the Legal Protection of Computer Programs*, 94 COLUM. L. REV. 2308 (1994) [hereinafter *A Manifesto*]; Pamela Samuelson, *Benson Revisited: The Case Against Patent Protection for Algorithms and Other Computer Program-Related Inventions*, 39 EMORY L.J. 1025, 1148–54 (1990); Pamela Samuelson, *CONTU Revisited: The Case Against Copyright Protection for Computer Programs in Machine-Readable Form*, 1984 DUKE L.J. 663, 762–69 (1984).

272. See *A Manifesto*, *supra* note 271, at 2318–19.

273. See *id.* at 2318.

program so the competitor may very well legally obtain the valuable, competitive aspects of the program. For very rational reasons, software producers have attempted to combat that vulnerability by controlling the access, use and location of their software code. Software producers have taken measures to restrict the transfer rights of the software user to prevent access by competitors to the software, a direct impact on the first sale doctrine of copyright.

In 1994, Professor Pamela Samuelson and three others published *A Manifesto Concerning the Legal Protection of Computer Programs*.²⁷⁴ *A Manifesto* proposed a "market-oriented legal regime" aimed at protecting against cloning of program behavior and other industrial design elements of software.²⁷⁵ Professor Samuelson et al. argued that the current copyright regime was both over-protective and under-protective. By protecting substantial similarity of the text of computer software, the more valuable parts of the computer program, referred to as the behavior of the program, were often not protected.²⁷⁶ However, the parts of the program that were protected, namely the "text" or language of the program, received far greater protection than was necessary to incentivize innovation and likely led to market destructive effects.²⁷⁷

A Manifesto recommended a two part solution. The first part, the anti-cloning protection, would essentially provide the developer with lead time protection in order to incentivize its investment in innovation but without causing some of the market destructive effects of overprotection.²⁷⁸ Although the article avoided either committing to a judicial or legislative solution, or a proposed timeframe, it was clear that they supported something significantly shorter than protection under current copyright regime, probably three to five years.²⁷⁹ The article hinted that software developers may be motivated to lobby Congress for such a legislative solution, but, in the alternative, they analogized a common law approach to the unfair competition "hot news" doctrine

274. *See id.* at 2308.

275. *Id.* at 2412–20.

276. *Id.* at 2347–56.

277. *Id.* at 2356–61.

278. *Id.* at 2413–14.

279. *Id.* at 2408.

fashioned nearly a century ago by the Supreme Court.²⁸⁰ The second part of their proposal was a registration system whereby developers could register those elements of the program that had benefited from the anti-cloning protection to some form of licensing scheme.²⁸¹ Again, the article avoided a firm commitment on options, but several possibilities from voluntary to compulsory licensing, including the hybrid of the current music collectives in the U.S, were discussed.²⁸²

In the evaluation of the three options that the article proposed between “do nothing” and their full fledged proposal, it appears that the order of things followed the “do nothing” option, as far as the development of a special legal regime (or common law rule) for software.²⁸³ A *Manifesto* anticipated this possibility by noting that software companies may believe that they have accomplished what they need in the regulatory framework with a combination of copyright, patent and trade secret protection.²⁸⁴ They have also benefited from the “property rights” theory approach in the evolution of judicial doctrine of the copyright privileges of first sale, fair use and the essential copying doctrine. By successfully convincing the courts that the instrument of the license agreement (EULA) sanctifies the characterization of the transaction as one between a licensor/copyright owner and a licensee/user, rather than “owner” of a copy, software producers have achieved high level of control over their intellectual property.

Relying on a 1992 report by the former Congressional Office of Technology Assessment,²⁸⁵ A *Manifesto* noted the dangers of not addressing the specific needs of software by the legal regime:

[It] may be easier for Congress to achieve a proper balance in policy objectives through a *sui generis* approach to software protection than could be achieved through use of

280. *Id.* at 2423–24.

281. *Id.* at 2426.

282. *Id.* at 2427–29.

283. *Id.* at 2421–22.

284. *Id.* at 2421.

285. See CONG. OFFICE OF TECHNOLOGY, OTA-TCT-527, FINDING A BALANCE: COMPUTER SOFTWARE, INTELLECTUAL PROPERTY AND THE CHALLENGE OF TECHNOLOGICAL CHANGE 26–27 (1992).

existing legal regimes wherein ***changes in scope of protection to accommodate software might distort principles of protection as applied to other categories of works.***²⁸⁶

A central tenet of this Article is that the judicial doctrine has evolved to accommodate software and in the process it has distorted the important principles of *Bobbs-Merrill* with respect to the first sale doctrine. This trend line began with *ProCD* and its conflation of privity and assent combined with strong adherence to the “property rights” theory and economic model of price discrimination. *Bowers* continued *ProCD* approach adopting the imaginary privity concept.

By ignoring the absence of privity, the courts granted wide berth to copyright holder’s ability to dictate whether the copyright law privileges, such as first sale, fair use or essential copying, existed by decreeing that they do not. In the case of the first sale doctrine, as has been discussed *supra*, the Ninth Circuit has now decreed that a copyright holder can control the terms of ownership, including the question of transfer of title. Such limitations on the right of a purchaser of a copy of software to sell, lend or otherwise dispose of such copy, as specified by the terms of the EULA (read: notice) affixed to the product, travels with the product to whomever may obtain it (lawfully) in the stream of commerce. Now the pivot.

The special nature of software has moved the courts to favor the software producers. In *Stargate*, the court notably called for “enhanced copyright protection” for software:

This Court notes that ***software is unique*** from other forms of copyrighted information. Technology and software, in particular, has radically transformed the way information is created and exchanged. ***Software fundamentally differs from more traditional forms of medium***, such as print or phonographic materials, in that software can be both, more readily and easily copied on a mass scale in an extraordinarily short amount of time

286. A *Manifesto*, *supra* note 271, 2313–14 (emphasis added). It is interesting to note that Professor Goldstein wrote favorably about a *sui generis* approach to software in both his 1994 and 2003 editions of his book, *Copyright’s Highway*. See GOLDSTEIN, *supra* note 20, at 215–16; PAUL GOLDSTEIN, *COPYRIGHT’S HIGHWAY: FROM GUTENBERG TO THE CELESTIAL JUKEBOX*, 199 (2003).

and relatively inexpensively. One of the primary advantages of software, its ability to record, concentrate and convey information with unprecedented ease and speed, makes it extraordinarily vulnerable to illegal copying and piracy. This Court finds that ***it is important to acknowledge these special characteristics of the software industry and provide enhanced copyright protection for its inventors and developers.***²⁸⁷

Applying the conceptual framework that where the software producer continues to license copyrighted material to the user, exhaustion has not occurred, then it follows that the software producer may rightfully control the distribution such that first sale doctrine would not apply. Next, the article concludes with a brief summary of the “constructive ownership” model, which incorporates the special case of software.

F. Proposed Model of “Constructive Ownership”

As digital commerce becomes more pervasive in mainstream culture, society is at an inflection point where questions of the balance of the protection-access paradigm are critically important. Current trends with e-readers, such as a Kindle or Nook, mp3 players, such as the iPod, already have limited the traditional first sale rights that the public had enjoyed in the pre-digital world since *Bobbs-Merrill*. These digital devices are structured such that the consumer/user has “indefinite possession” of the works on the device but no rights of ownership including first sale. The distinction between possession and ownership requires greater scrutiny and discussion because of the serious implications for access and availability of creative works in the digital culture. The critical factor distinguishing the “traditional incentives” theory from the “property rights” theory on the first sale question is that of “possession.” The former view takes umbrage with the assumption that “indefinite possession” is not equivalent to a transfer of title and essentially a trigger of the first sale. Conversely, “property rights” theorists would not find an analytical problem with “indefinite possession” and no effective transfer of title.

287. *Adobe Sys. Inc. v. Stargate Software Inc.*, 216 F. Supp. 2d 1051, 1059 (N.D. Cal. 2002) (emphasis added).

I propose a new model under a theory of “constructive ownership” whereby the first sale doctrine is updated for the digital era. The model builds on the “rightful possessor” theory embraced by the “minority” view of the courts, but adds a third prong specifically for the special case of software. The first two prongs come from those minority decisions and commentary discussed *supra*, namely (a) no obligation for continuing payment or as *Bobbs-Merrill* stated “a satisfactory price” and (b) no obligation to return the article or as *Bobbs-Merrill* stated “acquired full dominion” over the article. The third prong would be (c) in the case of computer programs (i.e. software), no continuing license of copyrighted material by the copyright holder. This reflects the special case of software. Conceptually there is no exhaustion where the software producer continues to license updates and fixes to the computer program.

This model of “constructive ownership” would be consistent with principles of *Bobbs-Merrill* and the “traditional incentives” theory that assumes the importance of balancing protection with access as justified by the Constitution. As Professor Samuelson wrote over twenty years ago, the first sale doctrine had been “drafted [in the statute] more narrowly than its common law roots would have predicted.”²⁸⁸ The Supreme Court, in its 1908 *Bobbs-Merrill* decision, reset the balance between the copyright holders and the public; the proposal for a “constructive ownership” approach to the first sale doctrine offers the possibility of a new millennium recalibration of the first sale judicial doctrine to fit the digital culture of the 21st century. The implications of the “constructive ownership” model would be drawing a line between software distribution (assuming there is a continuing license of copyright), and the distribution of digital media, including books, music and other traditional creative works. The latter would be subject to the first sale doctrine, allowing the user to freely transfer their copies.²⁸⁹

288. See Samuelson, *supra* note 56, at 197.

289. The significant caveat here is that the anti-circumvention provisions of the Digital Millennium Act of 1998 still provide content producers with a mechanism to “lock in” content. The narrow application of this model would imply that courts would not apply *Vernor II* to the distribution of tangible DVD’s and CD’s even if the packaging included a EULA similar to that used by

CONCLUSION

All of the software decisions, whether they favored or disfavored the software producer, on the question of first sale doctrine are best understood through the prism of the underlying theory for copyright justification. The pro-software decisions are best rationalized by their adherence, claimed or unclaimed, to the “property rights” theory. Relying on the 1970’s economic theory of Harold Demsetz and buttressed by a “natural rights” justification as articulated by Professor Goldstein, “property rights” adherents have no patience for other values in copyright other than maximum control over the property by the owner and the sanctity of markets as an instrument in the hands of the owner of such property.

The courts and Congress have become strong “property rights” adherents.²⁹⁰ The courts have attempted to distract the focus of their rationales and outcomes from copyright theory. Under the cover of flawed contract reasoning, the courts argued that their decisions were “between parties” and not “a right against the world.” The logic is fatally flawed. If a copyright holder slaps a EULA (read: notice) on to the packaging of a DVD, then puts such DVD into the stream of global commerce, its rights are against the conceivably millions of consumers who purchase that DVD around the world. The trend began with *ProCD* and *Bowers* finding privity where it didn’t exist, resulting in a subterfuge for the real work that was going on. The transformation of copyright law has occurred from one justified by “traditional

Autodesk in *Vernor II*. Tackling the effect of the digital locks sanctioned by the DMCA on the first sale doctrine is another project.

290. See *supra* notes 59–96 and accompanying text (discussion of Congressional enactment of § 117 and the courts’ construction of the statute). The Digital Millennium Copyright Act has largely been considered a legislative victory for copyright industries. See Robert P. Merges, *One Hundred Years of Solicitude: Intellectual Property Law, 1900-2000*, 88 CALIF. L. REV. 2187, 2201 (2000) (noting that copyright scholars “argue that the rushed, industry backed DMCA is very deeply flawed.”). See also Pamela Samuelson, *Intellectual Property and the Digital Economy: Why the Anti-Circumvention Regulations Need to be Revised*, 14 BERKELEY TECH. L.J. 519 (1999). In his book, *Wired Shut*, Tarleton Gillespie noted that “in statutes like the DMCA, this logic is used not just to tip the copyright scales toward corporate owners, but to construct and stabilize particular arrangements of cultural distribution that work hand in hand with these interests, and often against the public welfare.” TARLETON GILLESPIE, *WIRED SHUT* 197 (MIT 2007).

incentives,” as articulated by the decisions of *AIP I*, *SoftMan*, and (weakly) *Vernor I*, to one justified by “property rights,” as articulated by *AIP II*, *Harmony*, *ISC-Bunker*, *One Stop*, *Stargate*, and finally the Ninth Circuit’s decision in *Vernor II*.

The courts have shaped judicial doctrine to accommodate software and in the process distorted the important principles of *Bobbs-Merrill*. *Bobbs-Merrill*’s rationale and outcome supported the “traditional incentives” approach to copyright, namely that societal welfare is maximized by the proper balance between protection of the copyrighted work and the public’s access to copyrighted works. In *Bobbs-Merrill*, the Supreme Court clearly argued against absolute control by the copyright holder of the distribution of its copyrighted works. The implication of the “property rights” evolution of the judicial doctrine is clearly a severe restriction in the public’s access to copyrighted works. The proposed “constructive ownership” model attempts to recalibrate judicial doctrine to be consistent with the important value to society of promoting the balance between protection to the copyright holder and the public’s access to copyrighted works.