Legally Speaking
Do You Own the Software You Buy?
Exrminating the fine print concerning your rights in your copies of purchased software.

SOFTWARE COMPANIES HAVE mass-marketed computer programs for the past few decades on terms that typically purport to restrict the right of end users to resell or otherwise transfer their interests in copies of software they have purchased. The restrictions are usually stated in documents known as shrunk-wrap or click-through "licenses." Vendors of other types of digital content sometimes distribute their works with similar restrictions.

Shrink-wraps are documents inserted in packaged software, often just under the clear plastic wrap surrounding the package, informing purchasers they are not owners of copies of programs they just bought, but instead have rights in the program that are limited by the terms of a license agreement. Click-throughs are similar in substance, although the "license" terms only become manifest when you try to install the software and are directed to click "I agree" to certain terms.

Most of us ignore these documents and the restrictions they contain. Because we bought our copy of that software, we think we own it, regardless of what any "license" document says. We are also quite confident the vendor won't take any action against us, even if we do violate one of the terms, because realistically the vendor can't monitor every end user of its products.

The debate over whether mass-market transactions like these are really "sales" of goods, notwithstanding the "license" label, has been going on for decades. Strangely enough, it has never been definitively resolved. A recent appellate court ruling has upheld the license characterization, but a further appeal is under way in that case. This ruling is also at odds with other appellate court decisions. So things are still up in the air on the ultimate issue. This column explains what is at stake in these battles over your rights in your copies of purchased software.

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Three Legal Options
The distinction between "sales" and "licenses" really matters when assessing the risk of liability to copyright holders if resale restrictions are ignored.

Copyright law allows rights holders to control only the first sale of a copy of a protected work to members of the public. After the first sale, the owner of that copy is entitled to resell or otherwise transfer (for example, give as a gift or lend it to others) the copy free from risk of copyright liability. Bookstores and libraries are among the institutions made possible by copyright law's first-sale doctrine.
What happens if copyright owners try to restrict resales through license restrictions? There are three possible outcomes.

First, the effort to restrict resales may be deemed a nullity, as it was in a famous 1908 Supreme Court case, *Bobbs-Merrill Co. v. Straus*. Bobbs-Merrill sold books to Straus containing a prominent notice that resale of the books except at a stated price would be treated as copyright infringement. When Straus sold the books for a lower price, Bobbs-Merrill sued for infringement. The Court refused to enforce this resale restriction, saying that the copyright owner was entitled to control only the first sale of copies of its works to the public.

Second, a resale restriction may be enforceable against the purchaser insofar as he has agreed not to resell his copy, but it would be unenforceable against anyone to whom the purchaser might subsequently sell his copy.

This result might seem odd, but there is a fundamental difference between contract and property rights: Contracts only bind those who have agreed to whatever terms the contract provides; property rights create obligations that are good against the world.

A first-sale purchaser may thus have breached a contractual obligation to the copyright owner if it resells its copy of the work in violation of a resale restriction, but he is not a copyright infringer.

Those who purchase copies of copyrighted works from owners of first-sale copies are not at risk of either copyright or contract liability. These third-party purchasers are also free to resell their copies to a fourth party without fear that either is at risk of any liability to the copyright owner.

Third, courts may rule that the first-sale rule does not apply to mass market “license” transactions involving copies of copyrighted works because no “sale” has taken place. Under this interpretation, secondary markets in those copies are illegal. Anyone who purports to resell the copies is a copyright infringer for distributing copies of copyrighted works without getting permission from the copyright owner.

**Vernor and Augusto**

My March 2009 Legally Speaking column (“When is a ‘License’ Really a Sale?”) discussed two lower-court decisions in which copyright owners challenged the resale of copies of copyrighted works on eBay. In both cases, the courts ruled that copyright’s first-sale rule applied, notwithstanding transfer restrictions, because of economic realities of the transactions.

The plaintiff in *Vernor v. Autodesk* asked the court to declare that he was the owner of copies of Autodesk software he purchased from one of Autodesk’s customers and that he was entitled under the first-sale doctrine to resell those copies on eBay.

Autodesk claimed no sale had taken place because the software was licensed on terms that forbade transfer of the copy to third parties. Autodesk asked the court to declare that sales of these copies on eBay constituted copyright infringement.

**UMG v. Augusto** involved promotional CDs of music. Augusto purchased these CDs at flea markets, online auctions, and used CD stores. Language on the CD packaging indicated they were licensed for personal use only and could not lawfully be sold or otherwise transferred to third parties. When Augusto started selling UMG promotional CDs on eBay, UMG sued him for infringement.

My March 2009 column predicted that Autodesk and UMG would appeal the trial court rulings against them, and that the software industry could be expected to push very hard for a reversal, particularly in the *Vernor* case.

The Ninth Circuit Court of Appeals heard the arguments in *Vernor* and *Augusto* on the same day. In September 2010, the appellate court ruled in favor of Autodesk. Yet it upheld Augusto’s first-sale claim.

In assessing whether the first-sale rule should apply to mass-market transactions like these, it is useful to compare the economic realities test used by the trial courts in the *Vernor* and *Augusto* cases and the labeling and restrictions test adopted by the Ninth Circuit in *Vernor*.

**Economic Realities Test**

Under this test, a copyright owner’s characterization of a transaction as a license, rather than a sale, is not dispositive. It is instead only one factor among many that should be weighed in determining the true nature of the transaction.

Other factors include whether the purchaser has the right of perpetual possession of the copy, whether the rights holder has the right and ability to reclaim the copy if the license terms are violated, whether the purchaser has paid substantial sums for the privilege of permanent possession, and whether the purchaser has the right to discard or destroy the copy. The marketing channels through which the copy was obtained (such as purchasing packages of software at Walmart or Office Depot) may also be relevant.

Under the economic realities test,
Vernor and Augusto seem to be owners of copies. Those from whom they obtained the products had, it seems, the right of perpetual possession in the copies, and they could destroy or discard the copies if they wished. The software in Vernor had been purchased through a mass-market transaction, and the CDs in Augusto had been mailed for free to people who had not requested the CDs and indeed, UMG had not even kept track of the persons to whom the promotional CDs had been sent.

In a previous case, U.S. v. Wise, the Ninth Circuit reversed a conviction for criminal copyright infringement because the actress from whom Wise obtained a copy of a movie was the owner of that copy, notwithstanding various restrictions on what she could do with the copy, including transfers to third parties.

In Vernor's petition for rehearing by the full Ninth Circuit Court of Appeals, he argues the Ninth Circuit's ruling is in conflict with Wise and with precedents from other appellate courts, including Bobbs-Merrill.

Labeling and Restrictions Test

The Ninth Circuit in Vernor relied in part on MAI Systems Corp. v. Peak Computer, in which a Ninth Circuit panel in 1993 ruled that customers of Peak's computers, on which Peak software was installed, were not owners of copies of this software, but rather licensees. Owners of copies of copyrighted software are entitled to make copies for their use and to authorize third parties to make use-copies; non-owners are not entitled to this privilege.

MAI provided maintenance services for Peak computers to Peak customers. When MAI technicians turned on Peak computers to service them, they made temporary copies of Peak software in the random access memory. Peak argued, and the Ninth Circuit agreed, that these copies were infringing because they were not authorized by Peak.

MAI v. Peak cited no authority and offered no analysis in support of its ruling that Peak's customers were non-owners of their copies of Peak software. Peak's characterization of the transaction as a license was, for that panel, dispositive.

The three-judge panel decision in Vernor did not rely on the license label alone as a basis for rejecting Vernor's first-sale argument. But the license label was, as in MAI v. Peak, given considerable weight. The court directed that two other factors be taken into account: whether the license restricted transfers of the copies and whether it contained other substantial restrictions. The panel ruled that Autodesk should prevail against Vernor under this test. The restrictions in Augusto, by contrast, were less substantial than those in Vernor.

Conclusion

Software companies have been cheered by the Ninth Circuit's ruling in Vernor. But the rest of us should be worried about its implications. Think about what Vernor may mean for flea markets, bookstores, libraries, garage sales, and auction sites. Even selling a used computer loaded with software is infringing on this theory. Think also about how easy it is for a vendor to put a "license" label on a mass-marketed product with copyrighted or patented components that states that any transfer of that copy to third parties will subject the transferor to copyright or patent infringement charges.

Consumers enjoy significant benefits from the existence of secondary markets. The first-sale limit on patent and copyrights is essential to the operation of those markets. Vernor and Augusto's cases are important to the future of competition in product markets and to preservation of the long-standing balancing principle in copyright law that the first-sale rule represents.

Pamela Samuelson (pam@law.berkeley.edu) is the Richard M. Sherman Distinguished Professor of Law and Information at the University of California, Berkeley.

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