

## Could Software Imports from Europe Bypass U.S. First Sale and IP Exhaustion Laws?

by Raymond L. Sweigart and Marcus Lemmon

*On July 3, the Court of Justice of the European Union (CJEU) ruled that a sale of a digital copy of software exhausted the copyright owner's exclusive distribution rights to the copy under Europe's first sale doctrine.<sup>1</sup> As a result, one who acquires a digital copy of software, whether by a perpetual license or title purchase and whether by disk or download, may now sell the copy to another without violating European copyright law. Though software companies should be primarily concerned with adjusting to this development in Europe, this ruling may have implications in the U.S. market as well. Due to the current lack of clarity regarding copyright exhaustion of legally purchased products that are then imported to the U.S. market, software companies may also wonder whether they need to prepare for an influx of software lawfully purchased in Europe and resold in America.*

### Differing First Sale Laws

In the United States, the first sale doctrine is embodied in 17 U.S.C. § 109(a), which states that "the owner of a particular copy... lawfully made under this title... is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy." However, § 109(d) makes it clear that this right does not "extend to any person who has acquired possession of the copy ... by rental, lease, loan, or otherwise, without acquiring ownership of it." Thus, a U.S. licensee, including most typical "purchasers" of software, may not sell or otherwise transfer its license to another party.<sup>2</sup>

The European Union (EU), on the other hand, has a substantially different law governing the first sale doctrine as applied to software. Article 4(2) of Council Directive 2009/24/EC states that "the first sale in the

<sup>1</sup> Case C-128/11, *UsedSoft GmbH v Oracle International Corp.*, 2012 EUR-Lex CELEX LEXIS \_\_ (July 3, 2012).

<sup>2</sup> *Quality King Distributors, Inc. v. L'Anza Research International, Inc.*, 532 U.S. 135, 147 (1998); *Vernor v. Autodesk, Inc.*, 623 F. 3d 1102 (9th Cir, 2010).

Community of a copy of a program by the rightholder ... shall exhaust the distribution right within the Community of that copy ...." Though this law had typically been applied to physical copies of software (such as a copy purchased from a physical retailer on a CD-ROM), the application of the law to digital downloads is by no means a stretch in light of the language used in the Directive. Further, the CJEU held that even if the software is acquired under a license agreement prohibiting further transfer, the copyright owner has no power to enforce this provision or otherwise prevent resale of the copy.

### The *UsedSoft* Decision

Oracle offers its customers downloadable "client-server software." The user rights license for this program includes the right to store a copy of the program permanently on a server and to allow up to 25 users to access it by downloading it to the main memory of their workstation computers. The license agreement also provides the customer a non-transferable user right for an unlimited period of time. UsedSoft, a German company, markets licenses acquired from Oracle customers. Oracle commenced proceedings against UsedSoft in the German courts, seeking injunctive and other relief. The first instance court and the Court of Appeals held for Oracle, but the German Federal Supreme Court referred the matter to the CJEU asking it to interpret, in this context, the directive. The CJEU ruled that the right of software developers to control *distribution* of a specific piece of software is exhausted once the developer has been paid for it. According to the court, it makes no difference whether the copy of the computer program was made available by means of a download or on a DVD/CD-ROM. Consequently, the software developer cannot prohibit any type of second-hand sale.

The court further stated that the directive authorizes any reproduction that is necessary for the use of the computer program by the lawful acquirer in accordance with its intended purpose. However, the Court did make clear that an original acquirer of a tangible or intangible copy of a computer program for which the copyright holder's right of distribution is exhausted must make the copy downloaded onto his own computer unusable at the time of resale. If he continues to use it, he would infringe the copyright holder's exclusive right of reproduction of his computer program. In contrast to the exclusive right of distribution, the exclusive right of reproduction is not exhausted by the first sale. In this context, the court also pointed out that the copyright holder may use technical protective measures such as product keys in order to make sure that the original acquirer of the software in fact makes its copy unusable.

### U.S. Copyright Exhaustion on Imports

Thus, in light of the CJEU's holding, software companies must now be concerned as to whether a sale or license of a software copy that is then resold or transferred to a third party in the EU can then be lawfully resold in the United States. Article 4(2) makes clear only that a sale of software within the EU exhausts all rights within the EU, and therefore U.S. law governing exhaustion of intellectual property rights on products produced abroad will likely control. Unfortunately, due to the four-four split in the Supreme Court decision in *Costco v. Omega*, there will not be a clear answer on this issue until the Supreme Court hears and decides a case raising similar issues next term, *Kirtsaeng v. John Wiley & Sons, Inc.*

In *Costco*,<sup>3</sup> the Ninth Circuit held that the first sale doctrine applies only to products made within the United States, and as a result allowed Omega to enforce its copyrights, preventing Costco from selling Omega watches that had been imported from abroad. Similarly, in *Kirtsaeng*<sup>4</sup> the Second Circuit prohibited importation and sale of textbooks produced and purchased abroad. The nearest Supreme Court precedent

<sup>3</sup> *OMEGA SA v. Costco Wholesale Corp.*, 541 F. 3d 982 (9th Cir, 2008), *aff'd*, 131 S.Ct 565 (2012) (4-4 decision).

<sup>4</sup> *John Wiley & Sons, Inc. v. Kirtsaeng*, 654 F.3d 210 (2nd Cir, 2011), *cert. granted*, (U.S. Apr. 16, 2012) (No. 11-697).

on the other hand, *Quality King*, permitted the re-importation and sale of products that were originally produced in the United States, and shipped abroad and sold there at a reduced price.

Even if the Supreme Court were to rule that the first sale by a right-holder abroad exhausts U.S. copyright, there is still one more hurdle that a potential importer will have to overcome: the different laws regarding the first sale doctrine as applied to licenses described above. Because U.S. law expressly prohibits applying the first sale doctrine to licenses, any importer will have to convince a court that the CJEU's holding should be applied to any imported software that was licensed rather than sold outright.

### Further Protections

Both in the U.S. and within the European Union, copyright protection against software resellers based on business and/or technical solutions may ultimately prove to be a less risky option than a potential court ruling. Time-limited licenses, for example, can push software further towards the license end of the spectrum. This approach may even potentially change the result in the European Union, which allows a copyright owner to prohibit "further rentals" after a time-limited license. Similarly, protective digital rights management software, though often unpopular with users, can help prevent the copies of software from being disseminated beyond their original point of installation. Finally, the software-as-a-service model is explicitly excluded from the CJEU's ruling, and therefore this business model may become appealing to many companies in the future.

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