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# Digital Exhaustion: North American Observations

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## 6. Digital exhaustion: North American observations

*Ariel Katz\**

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### I. INTRODUCTION

Rumor has it that the first-sale doctrine is dying. As the importance of systems of distribution and access built around books, CDs, and other tangible artefacts diminishes, the legal rules supporting such systems will become obsolete. In the brave new world, where works in digital formats are no longer distributed and enjoyed as particular identifiable objects, but “exist as data flows [that] rarely reside in a material object for more than a transitory period of time, [and] where copies blink into and out of existence on a nearly constant basis,”<sup>1</sup> the first-sale doctrine, forged in the era of the physical copy, will lose its prominence in the world of copyright and commerce, and may only occupy a backstage role together with the yellowing used books, dusty records, and crumbling films.

Some (e.g., librarians, consumer advocates) mourn the loss of their beloved doctrine with trepidation, while others (e.g., publishers) rejoice in seeing its demise. Both camps assume that the doctrine is confined to the transfer of tangible copies, and that it limits only copyright owners’ distribution right, not other exclusive rights. Thus, they believe, you can resell, lend, or give away your *book*, or you can resell, lend, or give away your e-book *reader*, but you cannot resell, lend, or give away your e-book while keeping your reader. Because an e-book cannot be transferred across devices without reproducing the digital file, those reproductions place its transfer beyond the scope of the first-sale doctrine. Moreover, in the post-copy world that is on the horizon, where cloud computing and streaming technologies allow you to access works from anywhere, but nowhere in particular, there isn’t even a particular copy that one can transfer and to which the doctrine could apply.<sup>2</sup>

The death prognosis for the first-sale doctrine further relies on the proliferation of contractual and licensing conditions that purport to prohibit one buyer from transferring what she purchased to another, even if such a transfer were otherwise technically possible and legally permissible.<sup>3</sup> If those contractual and licensing conditions are enforceable (and many assume they usually are) then the first-sale doctrine may be legally alive, but practically dead.

In this chapter I argue that the rumor of the doctrine’s death is premature.

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<sup>1</sup> Aaron Perzanowski & Jason Schultz, *Legislating Digital Exhaustion*, 29 BERKELEY TECH. L.J. 1535, 1539 (2014).

<sup>2</sup> *Id.*

<sup>3</sup> *Id.* at 1539–44.

The death prognosis regards the first-sale doctrine merely as a statutory exception, and one that limits only the copyright owner's distribution right, but not other rights. The doctrine, thus, protects defendants who can show that their acts fall within the bounds of the statutory exception, but any mismatch would be fatal. This view, in turn, depends on certain assumptions about the meaning of the several exclusive rights statutorily granted to copyright owners, the meaning of the first-sale doctrine, and what the interaction among them entails. But none of these assumptions is self-evident. The law on digital exhaustion is anything but settled, and is capable of being interpreted differently.

This chapter offers a different understanding of the first-sale doctrine. As a "first sale" doctrine it may limit the distribution right, but its statutory presence merely affirms a broader principle of exhaustion—one of several copyright law principles that limit the copyright owner's powers,<sup>4</sup> as well as a species of a broader genus of principles that limit the exercise of private power more generally.<sup>5</sup> Exhaustion guards against encroachment by copyright owners upon important rights and interests of others, or even by copyright law itself upon other areas of law.<sup>6</sup> It thus secures an area into which the copyright owner's exclusive rights were never meant to extend, and it thus demarcates a boundary between the respective intellectual and personal property rights of copyright owners and users.<sup>7</sup> As I explain below, the doctrine isn't a creature of statute; the statute merely codifies some aspects of the general principles that underlie it. Instead of limiting courts in applying those principles, codification serves as "a statutory bulwark against courts deviating from [them]."<sup>8</sup> Therefore, the fact that a defendant's act does not fall within the bounds of the statutory exception should not prevent courts from applying the general principle of exhaustion. The death prognosis rests on the first and narrow view, which also implies that only legislative reform can expand exhaustion beyond that limited statutory scope. Under the second view, however, the doctrine may be not only alive, but also kicking.

In this chapter I will show that the second view is both plausible and sound. I do that by critiquing *Capitol Records v. ReDigi*,<sup>9</sup> where the U.S. District Court for the Southern District of New York adopted the first view. I will show that the U.S. Supreme

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<sup>4</sup> Aaron Perzanowski & Jason Schultz, *Digital Exhaustion*, 58 UCLA L. REV. 889, 908 (2011) [hereinafter Perzanowski & Schultz, *Digital Exhaustion*].

<sup>5</sup> Ariel Katz, *Intellectual Property, Antitrust and the Rule of Law: Between Private Power and State Power*, 17 THEORETICAL INQUIRIES L. 633 (2016).

<sup>6</sup> John F. Duffy & Richard Hynes, *Statutory Domain and the Commercial Law of Intellectual Property*, 102 VA. L. REV. 1 (2016); see also Ariel Katz, Aaron Perzanowski, & Guy A. Rub, *The Interaction of Exhaustion and the General Law: A Reply to Duffy and Hynes*, 102 VA. L. REV. ONLINE 8 (2016) [hereinafter Katz et al., *The Interaction*]. In federal states, such as the United States or Canada, this demarcation can also reflect the boundaries between the legislative competence of the federal legislature and states or provinces. See Herbert Hovenkamp, *Patent Exhaustion and Federalism: A Historical Note*, 102 VA. L. REV. ONLINE 25 (2016).

<sup>7</sup> Aaron Perzanowski & Jason Schultz, *Reconciling Intellectual and Personal Property*, 90 NOTRE DAME L. REV. 1211, 1224 (2014) [hereinafter Perzanowski & Schultz, *Reconciling*].

<sup>8</sup> *Kirtsaeng v. John Wiley & Sons, Inc.*, 133 S. Ct. 1351, 1387 (2013) (Ginsburg, J., dissenting). This point is consistent with the majority opinion. See *infra* Part II(B)(1).

<sup>9</sup> *Capitol Records, LLC v. ReDigi Inc.*, 934 F. Supp. 2d 640 (S.D.N.Y. 2013).

Court's judgment in *Kirtsaeng v. John Wiley & Sons*,<sup>10</sup> issued eleven days earlier, should have oriented the district court in another direction. I will also critique *ReDigi* through the lens of *Théberge v. Galerie d'Art du Petit Champlain*,<sup>11</sup> and other Canadian cases. These cases will show that copyright law, at least in the United States and Canada, is supple enough to recognize digital exhaustion.

This chapter will also argue that, conceptually, embracing digital exhaustion is not difficult. The technologies may seem complicated, and digital goods may seem new and glitzy, but the legal principles at play aren't new. Once we abstract away from the technological details and some doctrinal ambiguities and recall that the legal significance of property rights, including intellectual property rights, lies not in the object to which the property rights relate, but in the legal relations between people with respect to that object, we can realize what exhaustion simply means: the right to transfer a lawfully obtained bundle of rights with respect to a work from one person to another, without seeking the copyright owner's permission. The bundle of rights may relate to a tangible object embodying a work (such as a book), or it may comprise a set of permissions obtained under a license in relation to a work in digital format (such as a license to download an e-book and install it on one or more devices). In principle, exhaustion could apply to the latter bundle just as it applies to the former. Therefore, the legal significance of the technological differences between works embodied in discrete tangible objects and works in digital formats that are not similarly tethered, and the legal significance of whether a transaction is classified as a "sale" or a "license," may not be as important as they initially seem. With some exceptions, the common law has generally favored allowing people to freely alienate their entitlements, and disfavored attempts to restrain them. The courts that created the first-sale doctrine applied this principle to copyright, and legislatures later codified it.<sup>12</sup> Legislators may choose to limit this principle, or expand it, or only provide greater clarity in how to apply it, but there is no a priori reason preventing courts from applying this principle to digital works even without legislative action.

## II. THE FIRST-SALE DOCTRINE AND DIGITAL WORKS

### A. *Capitol Records v. ReDigi*

Section 109(a) of the U.S. Copyright Act provides that, notwithstanding the copyright owner's public distribution right under Section 106(3), "the owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord."<sup>13</sup>

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<sup>10</sup> *Kirtsaeng*, 133 S. Ct. 1351.

<sup>11</sup> *Théberge v. Galerie d'Art du Petit Champlain Inc.*, [2002] 2 S.C.R. 336 (Can.).

<sup>12</sup> See *infra* Part II(B)(1).

<sup>13</sup> 17 U.S.C. § 109(a).

ReDigi, Inc. launched “a ‘virtual’ marketplace for ‘pre-owned’ digital music”<sup>14</sup>—a service permitting individuals to resell songs they purchased on iTunes. ReDigi’s process “involve[d] ‘migrating’ a user’s file, packet by packet—‘analogous to a train’—from the user’s computer to the Cloud Locker so that data does not exist in two places at any one time.”<sup>15</sup> This way, it hoped, its activities would be considered a transfer of possession of copies—permitted under Section 109—rather than an impermissible reproduction of the work.

Capitol Records did not agree with ReDigi’s interpretation and brought an action against it. The court agreed with the plaintiff. It held that the first-sale doctrine could not protect ReDigi.<sup>16</sup> ReDigi’s activities implicated not only the distribution of copies but also their reproduction, because “the plain text of the Copyright Act makes clear that reproduction occurs when a copyrighted work is fixed in a new *material object*.”<sup>17</sup> This finding proved fatal to ReDigi’s first-sale defense because according to the court, the first-sale doctrine can protect ReDigi only against assertions of the *distribution* right but not against the violation of other rights.<sup>18</sup> The court also found Section 109(a) inapplicable because “as an unlawful reproduction, a digital music file sold on ReDigi is not ‘lawfully made under this title.’”<sup>19</sup> Finally, it reasoned, Section 109(a) applies only to distribution by “the owner of a *particular* copy or phonorecord ... of *that* copy or phonorecord.” Even though a ReDigi user “owns the phonorecord that was created when she purchased and downloaded a song from iTunes to her hard disk,” to sell that song through ReDigi “she must produce a new phonorecord on the ReDigi server.” It is therefore impossible for the user to sell her “particular” phonorecord on ReDigi and the statutory defense does not apply.<sup>20</sup> In the court’s view, “the first sale defense is limited to material items, like records, that the copyright owner put into the stream of commerce.” The court also declined to entertain any interpretation of the Act that could allow digital first-sale. It held that the Act unambiguously precludes any such outcome, and concluded that an alternative interpretation would amount to an amendment to the Copyright Act, which is “a legislative prerogative that courts are unauthorized and ill suited to attempt.”<sup>21</sup>

In the sections below I show that (a) the court could have legitimately interpreted the Copyright Act differently as to recognize digital first-sale; (b) ReDigi should not have been found to infringe the reproduction right; and (c) even if it did, it is entirely plausible to conceive a digital exhaustion rule that permits this type of copying.

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<sup>14</sup> Capitol Records, LLC v. ReDigi Inc., 934 F. Supp. 2d 640, 645 (S.D.N.Y. 2013).

<sup>15</sup> *Id.*

<sup>16</sup> *Id.* at 659–60.

<sup>17</sup> *Id.* at 648.

<sup>18</sup> *Id.* at 655.

<sup>19</sup> *Id.*

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

## B. ReDigi: Alternative Interpretation

### I. The first-sale doctrine is not fully coextensive with Section 109

In concluding that interpreting the Copyright Act in a way that would permit digital first-sale would encroach on the prerogative of the legislature, the court in *ReDigi* assumed that the first-sale doctrine is a creature of statute, and as such it must be confined by the four corners of its language. Yet, eleven days earlier, the Supreme Court decided *Kirtsaeng*, a decision that should have oriented the district court in another direction. Unfortunately, although the district court cited this decision, it failed to appreciate its full meaning and its bearing on the case before it.

In *Kirtsaeng* the Court had to decide whether the first-sale doctrine applied to copies made abroad and imported into the United States without the consent of the copyright owner. The majority held that it did. In reaching this conclusion, the majority, per Justice Breyer, emphasized that the first-sale doctrine does not owe its origin to the statute, and that Section 109 merely codifies the common-law refusal to permit restraints on alienation, which harkens back at least to the early 17th century. This recognition, combined with the presumption that, unless the contrary is evident, “[s]tatutes which invade the common law ... are to be read with a presumption favoring the retention of long-established and familiar principles,”<sup>22</sup> led the majority to reject an interpretation that would limit the scope of the first-sale doctrine to copies made in the United States.<sup>23</sup>

Justice Ginsburg’s dissent is equally instructive. She did not disagree with the majority’s general characterization of the doctrine, its common law origin, or the general relationships between statutes and the common law, though she was convinced it was evident that Congress intended to exclude copies made abroad from the ambit of Section 109(a). She concluded, however, that the first-sale doctrine would still apply to such copies *after* the copyright holder authorized their importation. Even though she could not anchor this proposition in the statutory language, she reasoned, based on the statutory history, that the term “distribute” in Section 106(3) already incorporates the first-sale doctrine. Acknowledging that this interpretation means that Section 109(a)’s codification of that doctrine adds little to the regulatory regime, she insisted that the section is not redundant, because it prevents courts from deviating from the doctrine in a way that increases copyright owners’ control over downstream distribution,<sup>24</sup> and because in some specific instances it even expands the doctrine’s scope.<sup>25</sup> Therefore, even though the Court was divided on the doctrine’s application to the importation of

<sup>22</sup> *Kirtsaeng v. John Wiley & Sons, Inc.*, 133 S. Ct. 1351, 1363 (2013) (quoting *Isbrandtsen Co. v. Johnson*, 343 U.S. 779, 783 (1952) (omission by the Court)).

<sup>23</sup> For a survey of earlier cases applying exhaustion principles in the U.S., see Perzanowski & Schultz, *Digital Exhaustion*, *supra* note 4, at 912–22.

<sup>24</sup> *Kirtsaeng*, 133 S. Ct. at 1387 (Ginsburg, J., dissenting).

<sup>25</sup> *Id.* at 1387 n.20. Section 109 expands the scope of exhaustion beyond that recognized in *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339 (1908). *Bobbs-Merrill* held that the copyright owner could not control sales beyond the first authorized sale. *Id.* at 350–51. Section 109, however, makes it lawful for the owner of a lawfully made copy to resell it, regardless of whether a previous authorized sale had taken place. See John A. Rothchild, *Exhaustion of Intellectual Property Rights and the Principle of Territoriality in the United States*, in RESEARCH HANDBOOK

copies made abroad, it was (practically) unanimous in its view that the first-sale doctrine has life beyond the words of Section 109(a).<sup>26</sup>

*Kirtsaeng*, of course, did not involve digital exhaustion, and therefore it does not demonstrate that the court in *ReDigi* erred in its ultimate conclusion. It demonstrates, however, that the *ReDigi* court erred when it assumed that considering any interpretation that is not strictly tied to the language of Section 109(a) would inappropriately encroach on legislative prerogative. If the basis of the first-sale doctrine isn't statutory, as at least eight of the justices in *Kirtsaeng* affirmed,<sup>27</sup> and if, as Justice Ginsburg added, it was appropriate for the Court in *Bobbs-Merrill* to hold that "Congress did not intend to permit copyright owners 'to fasten ... a restriction upon the subsequent alienation of the subject-matter of copyright'"<sup>28</sup> even though the statute then did not include any such explicit limitation, then it would have been equally legitimate for the court in *ReDigi* to do the same, or at least to consider this interpretative option.

## 2. Is every fixation a "reproduction"?

The second pillar of the court's decision in *ReDigi* was the holding that *ReDigi* infringed the reproduction right. *ReDigi*'s service was designed to ensure that the digital file would be transferred without being multiplied. *ReDigi* contended that without multiplication no "reproduction" within the meaning of Section 106(1) occurs. The court disagreed and held that "reproduction" within the meaning of the Act does not require multiplication of copies. Rather:

the reproduction right is necessarily implicated when a copyrighted work is embodied in a new material object, and because digital music files must be embodied in a new material object following their transfer over the Internet, ... the embodiment of a digital music file on a new hard disk is a reproduction within the meaning of the Copyright Act. ... Simply put, it is the creation of a *new* material object and not an *additional* material object that defines the reproduction right.<sup>29</sup>

As a matter of plain language, holding that "reproduction" requires multiplication is just as correct as holding that it does not.<sup>30</sup> The legal meaning of the term, therefore,

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ON INTELLECTUAL PROPERTY EXHAUSTION AND PARALLEL IMPORTS 226, 228 n.4 (Irene Calboli & Edward Lee eds., 2016).

<sup>26</sup> I say "practically unanimous" because Justice Scalia joined Justice Ginsburg's dissent, but did not join this part of her decision. He did not, however, provide any reasons explaining his disagreement.

<sup>27</sup> *Id.*

<sup>28</sup> *Kirtsaeng*, 133 S. Ct. at 1386 (quoting *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339, 349–50 (1908)).

<sup>29</sup> *ReDigi*, 934 F. Supp. 2d at 649–50.

<sup>30</sup> The Oxford English Dictionary includes both definitions that imply multiplication, such as "To produce again in the form of a copy; to replicate (a work of art, picture, drawing, etc.), esp. by means of engraving, photography, scanning, or similar digital or mechanical processes," or "To present again or replicate in writing or print," and others that do not necessarily imply multiplication, such as "To effect or bring about (a phenomenon, occurrence, etc.) again," or "To bring again into material existence; to create or form (a person or thing) again." See OXFORD ENGLISH DICTIONARY, <http://www.oed.com/view/Entry/163098> (definition of "reproduce").

cannot be determined by its dictionary meaning, and requires the court to ascertain what it means for copyright purposes.<sup>31</sup> If, as Justice Ginsburg reasoned, the term “distribute” must be interpreted as including an exhaustion principle to prevent increased control by copyright owners over downstream distribution,<sup>32</sup> then the term “reproduction” could be interpreted to prevent such control as well.<sup>33</sup>

The court’s holding in *ReDigi* can be nicely contrasted with that of the Supreme Court of Canada in *Théberge*.<sup>34</sup> The plaintiff in that case was Claude Théberge, a renowned painter, who had assigned a publisher the right to publish poster reproductions, cards and other stationery products representing certain of his works. The defendant purchased such poster reproductions and then transferred the printed image to canvas, using an ink-transfer process, which involves lifting the ink from the paper poster and transposing it onto canvas substrate. Since this process leaves the poster blank, there was no increase in the total number of copies, and therefore the question was whether that unauthorized transfer of the image from one substrate to another infringed the reproduction right.

The holding in *Théberge* offers several instructive insights. First of all, the Court split precisely on the question that the *ReDigi* court thought was unambiguous, namely, whether “reproduction” requires multiplication or not. The majority held that multiplication is necessary, and therefore the defendant did not infringe the copyright when it used a process that did not increase the number of copies.<sup>35</sup> In contrast, the dissent, like the court in *ReDigi*, held that any fixation of a work in a new material object constitutes reproduction, whether or not multiplication of copies occurs.<sup>36</sup> The split reflects more than disagreement about the *lexical* meaning of the word “reproduction,” and reveals deeper diverging views about the nature of copyright that resulted in different opinions on the *legal* meaning of the word. The dissenting judges adopted an owner-centric approach and favored an expansive interpretation of the reproduction right. According to them, authors asserting their copyright “are not defending a privilege, but the sacred right of all rights to retain ownership of their works.”<sup>37</sup> In contrast, the majority espoused a narrower view of the scope of the reproduction right, emphasizing that the Act presents “a balance between promoting the public interest in

<sup>31</sup> Similarly, linguistically the term “vend,” at issue in *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339 (1908), is not limited to the first authorized sale.

<sup>32</sup> *Kirtsaeng*, 133 S. Ct. at 1387 (Ginsburg, J., dissenting).

<sup>33</sup> Notably, in *Bobbs-Merrill*, 210 U.S. at 350–51, the Court described the reproduction right as the exclusive right to multiply copies. Also, in *Bowman v. Monsanto*, 133 S. Ct. 1761 (2013), the Court held that the exhaustion doctrine in patent law does not permit a farmer to reproduce patented seeds through planting and harvesting without the patent holder’s permission. The Court distinguished this case from other exhaustion cases on the grounds that that case involved multiplication and replication of the patented item, not merely its reuse. At the same time, the Court emphasized that the ruling does not imply a broader rule whereby multiplication would necessarily negate exhaustion.

<sup>34</sup> *Théberge v. Galerie d’Art du Petit Champlain Inc.*, [2002] 2 S.C.R. 336 (Can.).

<sup>35</sup> *Id.* ¶ 50.

<sup>36</sup> *Id.* ¶ 149 (Gonthier, J., dissenting).

<sup>37</sup> *Id.* ¶ 112 (Gonthier, J., dissenting) (quoting M. Pagnol, *Preface*, in J. BONCOMPAIN, LE DROIT D’AUTEUR AU CANADA 9 (1971)).



the encouragement and dissemination of works of the arts and intellect and obtaining a just reward for the creator.”<sup>38</sup>

Justice Binnie, writing for the majority, held that “reproduction” within the meaning of copyright law is “usually defined as the act of producing *additional* or *new* copies of the work *in any material form*. Multiplication of the copies would be a necessary consequence of this physical concept of ‘reproduction.’”<sup>39</sup> In addition to citing earlier Supreme Court of Canada and House of Lords decisions that describe the reproduction right as the right to multiply copies,<sup>40</sup> the majority relied on several legal and policy arguments to reveal a general principle of exhaustion, which in that case justified a narrow reading of the distribution right.

### III. *THÉBERGE* AND THE LOGIC OF EXHAUSTION

The Court in *Théberge* had to define the meaning of the reproduction right, not the meaning of the distribution right.<sup>41</sup> However, as I describe below, in preferring the narrower interpretation of the reproduction right, the majority relied on various policy considerations that are similar to the entire catalogue of arguments offered to justify exhaustion of the distribution right:

- The long-term societal interests that inhere in the limited nature of copyright;
- Concerns about the property rights of owners of lawfully purchased copies;
- Privacy;
- Transactional clarity and administrability of legal rules; and
- Cultural preservation.<sup>42</sup>

Thus, the fact that the Court in *Théberge* relied on the logic of exhaustion in a case involving an allegation of unauthorized reproduction, not unauthorized distribution, illustrates how exhaustion constitutes a broader limiting principle in copyright.<sup>43</sup>

#### A. The Limited Nature of Copyright

The majority in *Théberge* emphasized the goal of maintaining “a balance between promoting the public interest in the encouragement and dissemination of works of the

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<sup>38</sup> *Id.* ¶ 30.

<sup>39</sup> *Id.* ¶ 42.

<sup>40</sup> *Id.* ¶¶ 42–44 (citing *Massie & Renwick, Ltd. v. Underwriters’ Survey Bureau Ltd.*, [1940] S.C.R. 218, 227 (Can.); *Walter v. Lane*, [1900] A.C. 539, 545 (U.K. H.L.)).

<sup>41</sup> In fact, strictly speaking, until 2012 Canada’s Copyright Act did not include a distribution right. *See infra* note 116.

<sup>42</sup> *See, e.g.*, Perzanowski & Schultz, *Digital Exhaustion*, *supra* note 4; Ariel Katz, *The First Sale Doctrine and the Economics of Post-Sale Restraints*, 2014 BYU L. REV. 55 (2014) [hereinafter Katz, *First-Sale*]; Perzanowski & Schultz, *Reconciling*, *supra* note 7.

<sup>43</sup> Jeremy de Beer & Robert Tomkowicz, *Exhaustion of Intellectual Property Rights in Canada*, 25 CANADIAN INTELL. PROP. REV. 3, 12–13 (2009).

arts and intellect and obtaining a just reward for the creator,”<sup>44</sup> adding that “[t]he proper balance... lies not only in recognizing the creator’s rights but in giving due weight to their limited nature.”<sup>45</sup> It stressed that “[e]xcessive control by holders of copyrights and other forms of intellectual property may unduly limit the ability of the public domain to incorporate and embellish creative innovation in the long-term interests of society as a whole, or create practical obstacles to proper utilization.”<sup>46</sup>

Thus, “[o]nce an authorized copy of a work is sold to a member of the public, it is generally for the purchaser, not the author, to determine what happens to it.”<sup>47</sup> This is, of course, a paradigmatic statement of the principle of exhaustion. But the need to prevent “excessive control” manifests itself in other ways. It is also “reflected in the exceptions to copyright infringement enumerated in ss. 29 to 32.2, which seek to protect the public domain in traditional ways such as fair dealing ... and to add new protections to reflect new technology, such as limited computer program reproduction and ‘ephemeral recordings’ in connection with live performances.”<sup>48</sup> Notably, the Court presented the various exceptions to copyright infringement as *protections* of the public domain, protections that also inform the proper construction of the statutory right itself.

## B. Price Discrimination

Justice Binnie reasoned (or assumed) that an expansive interpretation of the scope of the reproduction right might inefficiently overcompensate authors.<sup>49</sup> Critics might point out that without being able to identify what the elusive “optimal” level of compensation is, it is hard to tell whether one interpretation or another may lead to inefficient over- or under-compensation. Indeed, those who oppose a broad first-sale doctrine often argue that allowing copyright owners to control the downstream use of their works would allow them to set different prices for different users. Without the power to price discriminate, they argue, the copyright owner might elect to set a high uniform price, resulting in a lower quantity of distributed copies and the exclusion of consumers with a lower willingness or ability to pay. If so, then greater control over downstream uses could be efficient: efficient in the static sense by reducing the deadweight loss that may result from the grant of copyright, as well as efficient in the dynamic sense by allowing copyright owners to earn a higher profit, which could increase the incentive to create (even without improving static efficiency).<sup>50</sup>

The economic effects of price discrimination, however, are more ambiguous than proponents of expansive copyright acknowledge. Price discrimination does not always result in greater output and lower deadweight loss, but could lead to the opposite. Its contribution to dynamic efficiency is equally ambiguous, and even when efficient,

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<sup>44</sup> *Théberge v. Galerie d’Art du Petit Champlain Inc.*, [2002] 2 S.C.R. 336, ¶ 30 (Can.).

<sup>45</sup> *Id.* ¶ 31.

<sup>46</sup> *Id.* ¶ 32.

<sup>47</sup> *Id.* ¶ 31.

<sup>48</sup> *Id.* ¶ 32.

<sup>49</sup> *Id.* ¶ 31.

<sup>50</sup> *Kirtsaeng v. John Wiley & Sons, Inc.*, 133 S. Ct. 1351, 1390 n.27 (2013) (Ginsburg, J. dissenting); Katz, *First-Sale*, *supra* note 42, at 77; Guy A. Rub, *Rebalancing Copyright Exhaustion*, 64 EMORY L.J. 741, 775 (2015).

copyright owners may, and often do, implement price discrimination even without statutory power to control downstream uses.<sup>51</sup> *Théberge* demonstrates this point. Théberge chose to sell both original paintings (at a high price) and cheaper paper reproductions—a classic form of price discrimination. To maximize profit, he elected not to authorize canvas reproductions, as he was concerned that their presence might decrease the demand for the higher-price originals.<sup>52</sup>

Justice Binnie acknowledged that the artist wished “to stop the appellants from catering to the market for canvas-backed reproductions that apparently exists,” but held that “[t]o do so, however, he must as a litigant demonstrate a statutory right that overrides what the owners of the authorized poster could otherwise do with their tangible property.”<sup>53</sup> Similarly, in *Kirtsaeng*, the majority acknowledged the price discrimination argument, but held that the Copyright Act does not include a right to divide markets or a concomitant right to charge different purchasers different prices and the Constitution does not require granting such a right.<sup>54</sup>

Just as the general welfare implications of price discrimination are ambiguous, the general welfare implication of both high courts’ refusal to be swayed by the price discrimination argument could be ambiguous. However, since there was no evidence that the artist’s inability to prevent canvas reproductions—even if these reproductions could, at the margin, reduce the demand for originals—would cause Théberge to stop painting or stop authorizing paper reproductions,<sup>55</sup> the Court’s ruling in that particular case ensured the legality of a market that the plaintiff sought to extinguish. Therefore, it probably resulted in greater output and net social gain than would exist had the Court adopted a more expansive interpretation of the reproduction right.

### C. Copyright vs. the Rights of Purchasers

The majority in *Théberge* also recognized the tension, commonly associated with exhaustion, “between the holder of the intellectual property in a work and the owner of the tangible property that embodies the copyrighted expressions.”<sup>56</sup> Emphasizing that a purchaser of an authorized copy is generally entitled to determine what happens with that copy,<sup>57</sup> the majority characterized the dissent’s view as “intrusive[],”<sup>58</sup> and

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<sup>51</sup> Ariel Katz, *The Economic Rationale for Exhaustion: Distribution and Post-Sale Restraints*, in RESEARCH HANDBOOK ON INTELLECTUAL PROPERTY EXHAUSTION AND PARALLEL IMPORTS (Irene Calboli & Edward Lee eds., 2016) [hereinafter Katz, *The Economic Rationale for Exhaustion* 23].

<sup>52</sup> He testified that clients who had paid \$8,000 or \$9,000 for originals were enraged when they subsequently discovered canvas reproductions that were available for \$40 to \$120. *Théberge*, [2002] 2 S.C.R. 336, ¶ 20.

<sup>53</sup> *Id.* ¶ 21.

<sup>54</sup> *Kirtsaeng*, 133 S. Ct. at 1371.

<sup>55</sup> Nor does such an outcome seem likely. Claude Théberge died in 2008, but poster reproductions of his paintings appear to be widely available from various reputable sellers. See, e.g., ALLPOSTERS.CA, [http://www.allposters.ca/-st/Claude-Theberge-posters\\_c28716\\_.htm](http://www.allposters.ca/-st/Claude-Theberge-posters_c28716_.htm). One may assume that these poster reproductions are not products of mass copyright infringement.

<sup>56</sup> *Théberge*, ¶ 33.

<sup>57</sup> *Id.* ¶ 31.

reiterated that the defendants, “as owners of the physical posters” were within their rights to transfer the ink from one substrate to another.<sup>59</sup>

The U.S. Supreme Court expressed similar considerations in *Bobbs-Merrill*, when it concluded that as a matter of statutory interpretation the first authorized sale of a book exhausts the exclusive right to “vend” copies. The Court did not assert that the word “vend” compels this conclusion—obviously it does not. Instead, finding no explicit statutory language granting intrusive powers to qualify the title of the future buyers after the first sale, the Court held that a contrary interpretation would extend the statute’s operation, by construction, beyond its meaning.<sup>60</sup>

#### D. Privacy Interests

The majority in *Théberge* was also concerned about intrusion upon the privacy interests of individuals. If any new fixation is reproduction, as the dissent would hold, then liability will not be limited to commercial defendants, but will also apply to an individual who makes a single copy to hang in his own living room.<sup>61</sup> The majority preferred the interpretation that minimizes the potential for intrusion into individuals’ private spheres,<sup>62</sup> just as proponents of the first-sale doctrine often highlight how it protects consumer privacy and anonymity.<sup>63</sup>

#### E. Legal Clarity and Administrability

The *Théberge* majority also rejected the lower court’s solution of distinguishing between infringing and non-infringing types of ink transfers, concluding that “[t]o allow artists to regulate what can or cannot be done with posters in this way would have the public searching for elusive distinctions.”<sup>64</sup> Likewise, the majority in *Kirtsaeng* emphasized that the first-sale doctrine, among other benefits, “also frees courts from the administrative burden of trying to enforce restrictions upon difficult-to-trace, readily movable goods. And it avoids the selective enforcement inherent in any such effort.”<sup>65</sup> The Court also described several “horribles” arising from the uncertainty of the legal status of copies and which the doctrine avoids.<sup>66</sup>

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<sup>58</sup> *Id.* ¶ 34.

<sup>59</sup> *Id.* ¶ 2.

<sup>60</sup> *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339, 350–51 (1908).

<sup>61</sup> *Théberge*, [2002] 2 S.C.R. 336, ¶ 27.

<sup>62</sup> *Cf. Soc’y of Composers, Authors & Music Publishers of Can. v. Canadian Ass’n of Internet Providers*, [2004] 2 S.C.R. 427, ¶ 153 (Can.) (LeBel, J., dissenting) (“Insofar as is possible, this Court should adopt an interpretation of s. 3(1)(f) that respects end users’ privacy interests, and should eschew an interpretation that would encourage the monitoring or collection of personal data gleaned from Internet-related activity within the home.”).

<sup>63</sup> *E.g.*, Perzanowski & Schultz, *Digital Exhaustion*, *supra* note 4, at 896.

<sup>64</sup> *Théberge*, [2002] 2 S.C.R. 336, ¶ 40.

<sup>65</sup> *Kirtsaeng*, 133 S. Ct. at 1363.

<sup>66</sup> *Id.* at 1364–66.

## F. Preservation

The first-sale doctrine safeguards public access to works that are no longer available commercially, and thus contributes to preserving our cultural heritage.<sup>67</sup> In *Kirtsaeng*, Justice Breyer supported exhaustion of the distribution right by discussing several examples that demonstrate how exhaustion benefits libraries, used-books dealers, and museums.<sup>68</sup> In *Théberge*, Justice Binnie mentioned preservation as one of the considerations supporting a narrower construction of the reproduction right.<sup>69</sup>

## G. Disfavoring Restraints on Alienation Under the Common Law

The majority in *Kirtsaeng* explained that the first-sale doctrine reflects the common law's traditional refusal to permit restraints on the alienation of chattels.<sup>70</sup> Since exhaustion constitutes a common law baseline, the Copyright Act has "to be read with a presumption favoring the retention of long-established and familiar principles, except when a statutory purpose to the contrary is evident."<sup>71</sup> Echoing similar considerations, the majority in *Théberge* noted that in some civil law countries, and particularly France, the reproduction right was interpreted to include not only the right to make new copies but also a "right of destination" that gives the author considerable power to control subsequent uses of authorized copies of his or her work. In Justice Binnie's view, the artist was attempting to introduce, without statutory basis, such a backdoor *civiliste* "droit de destination" into Canadian copyright law.<sup>72</sup>

## H. Conclusion

*Théberge*, of course, cannot bind American courts, and the copyright laws of Canada and the United States are not identical. Nevertheless, since the two laws share common

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<sup>67</sup> Perzanowski & Schultz, *Digital Exhaustion*, *supra* note 4, at 895; Katz, *First-Sale*, *supra* note 42, at 110–11.

<sup>68</sup> *Kirtsaeng*, 133 S. Ct. at 1364–65.

<sup>69</sup> *Théberge*, [2002] 2 S.C.R. 336, ¶ 38.

<sup>70</sup> *Kirtsaeng*, 133 S. Ct. at 1363; *see also* Christina M. Mulligan, *Personal Property Servitudes on the Internet of Things*, 50 GA. L. REV. \_\_ (forthcoming 2016), Brooklyn Law School, Legal Studies Paper No. 400, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2465651](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2465651).

<sup>71</sup> *Kirtsaeng*, 133 S. Ct. at 1363 (quoting *Isbrandtsen Co. v. Johnson*, 343 U.S. 779, 783 (1952)).

<sup>72</sup> *Théberge*, [2002] 2 S.C.R. 336, ¶¶ 63–65. It may also be noteworthy that the Court in *Théberge* split along the Anglophone/Francophone lines, where the dissenting judges, all from Quebec, adopted a strongly author-centric approach, while the majority relied on the Anglo-American tradition.

origins<sup>73</sup> and many of their similar features are aptly described as “kissing cousins,”<sup>74</sup> the courts in both jurisdictions may learn from each other.

*Théberge* shows that the English term “reproduce” is capable of different meanings,<sup>75</sup> and demonstrates that the logic of exhaustion and the rationales behind it can be invoked to limit the reproduction right, not only the distribution right. Additionally, *Bobbs-Merrill* and *Kirtsaeng*’s recognition that the first-sale doctrine reflects a common law principle, independent of and broader than its codification in Section 109, gives American courts a mandate to apply this principle beyond the distribution right. The various policy considerations that animated the top Courts’ decisions show that the issues are not as “narrow, technical, and purely legal” as the *ReDigi* court assumed they are.<sup>76</sup>

Lastly, while the *ReDigi* court believed that construing the Act in a way that preserves the rights of users amounts to legislative reform, *Théberge*, *Bobbs-Merrill*, and *Kirtsaeng* show that a clear statutory mandate is required for construing copyright in a way that *interferes* with the common law rights of users, not for preserving them. The top Courts’ holdings followed an established principle of statutory interpretation favoring narrow construction of statutory grants that interfere with the rights of individuals or the public.<sup>77</sup> *ReDigi* deviated from this principle.

#### IV. EXHAUSTION BEYOND THE DISTRIBUTION RIGHT?

ReDigi’s service allowed users to resell their lawfully purchased digital songs without multiplying copies of them. Therefore, *Théberge* suggests that in Canada, transferring the files would not be considered reproductions. But what if ReDigi’s technology, despite its sophistication, involved multiple temporary or incidental reproductions? Would that be fatal?

When I teach *Théberge*, I often ask my students whether the outcome would be different if instead of lifting the ink from the poster and transferring it to canvas (Process 1) the defendants purchased the poster, scanned it, printed the scanned image on canvas and then shredded the poster and deleted the scanned file (Process 2). Some students conclude that Process 2 would constitute infringement, because it involves multiplication of copies: two tangible copies exist before the paper poster is shredded, in addition to one or more digital copies (depending on how the system is configured:

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<sup>73</sup> Ariel Katz, *Fair Use 2.0: The Rebirth of Fair Dealing in Canada*, in *THE COPYRIGHT PENTALOGY: HOW THE SUPREME COURT OF CANADA SHOOK THE FOUNDATIONS OF CANADIAN COPYRIGHT LAW* 93, 96–100 (Michael Geist ed., 2013).

<sup>74</sup> 4 WILLIAM F. PATRY, *PATRY ON COPYRIGHT* § 10:2 (2015) (discussing fair use and fair dealing).

<sup>75</sup> The interpretation that reproduction requires multiplication is also consistent with that of the U.K. House of Lords in *Walter v. Lane*, [1900] A.C. 539, 545 (U.K. H.L.) and the U.S. Supreme Court, which has characterized the reproduction right as “the right of multiplying copies,” *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339, 351 (1908).

<sup>76</sup> *Capitol Records, LLC v. ReDigi Inc.*, 934 F. Supp. 2d 640, 645 (S.D.N.Y. 2013).

<sup>77</sup> Ariel Katz, *Spectre: Canadian Copyright and the Mandatory Tariff—Part II*, 28 *INTELL. PROP. J.* 40, 84 (2015). See also Katz et al., *The Interaction*, *supra* note 6, at 12–13.

whether a copy is saved on a hard disk, whether RAM copies are made and for how long they are retained, etc.), before being deleted. Next, I present Process 3, the “Thébergerator”: an imaginary top-of-the-line all-in-one device that simultaneously scans, prints, and shreds, in such a way that at no point does more than one copy exist. This time, as in the real *Théberge*, most students conclude that there would be no infringement. These hypotheticals then elicit discussion about the proper reading of *Théberge*. We note that *Théberge* stands for the proposition that multiplication of copies is *necessary* for infringing the reproduction right, but that it does not follow that multiplication is also *sufficient*. We also note that many of the rationales behind the majority reasoning could also apply to processes that involve some incidental reproductions. The Supreme Court has not confronted this question directly yet, but a series of other cases suggests that the outcome could be the same even if multiplication did take place.

Recall that rather than banning all reproduction, copyright law institutionalizes a distinction between lawful and unlawful copying.<sup>78</sup> Fair dealing and other exceptions demonstrate this point.<sup>79</sup> But Canadian courts have not relied only on such exceptions to limit the scope of copyright owners’ exclusive rights. In several cases the courts have relied on the logic of exhaustion to circumscribe the scope of both the reproduction right (in cases that, unlike *Théberge*, involved multiplication) and the public performance right. Some of the cases also invoked the principle of technological neutrality, which implies that regulations should emerge and evolve in a way that neither favors nor discriminates against specific technologies.<sup>80</sup> I discuss some of them below.

#### A. Implied License

In *Netupsky v. Dominion Bridge* the Supreme Court of Canada relied on the notion of implied license and prevented a copyright owner from controlling subsequent reproductions by an authorized user. The plaintiff, Boris Netupsky, an engineer, provided plans for the structural design of the Ottawa Civic Centre, pursuant to a contract between him and the architects who acted for the City of Ottawa. The defendant, a steel subcontractor hired by the City, made some cost-saving modifications to the plans, and made copies necessary for its part in the construction. The contract between Netupsky and the architects contemplated modifications to the plans and the basis for payment for them, but Netupsky refused to make the changes, repudiated the contract, and brought an action for copyright infringement against the subcontractor.

The Court held that the City and, through it, its subcontractor, became Netupsky’s licensee. The license carried with it not only an implied consent to make some changes

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<sup>78</sup> ABRAHAM DRASSINOWER, WHAT’S WRONG WITH COPYING? 2 (2015).

<sup>79</sup> *Id.* at 74.

<sup>80</sup> Carys J. Craig, *Technological Neutrality: (Pre)Serving the Purposes of Copyright Law*, in THE COPYRIGHT PENTALOGY: HOW THE SUPREME COURT OF CANADA SHOOK THE FOUNDATIONS OF CANADIAN COPYRIGHT LAW, *supra* note 73, at 271, 272.

to the plans but also an implied consent to reproduce the plans in as many copies as might be necessary for the construction of the work.<sup>81</sup>

The Court also cited with approval an Australian case, *Beck v. Montana Constructions Pty. Ltd.*,<sup>82</sup> involving architects who, at the request of a client, made plans for the construction of a building on the client's land. The land was subsequently sold together with the plans. The first architects alleged that the new owner of the land and another architect he hired to prepare further plans for the construction of the proposed building infringed their copyright. The court disagreed, holding that the first owner, who commissioned the work, had an implied license "to use those sketch plans for the purpose for which they were brought into existence, namely for the purpose of building a building in substantial accordance with them" as well as "for the purpose of preparing any necessary drawings as part of the task of building the building."<sup>83</sup> The court stated that this holding reflected a principle of general application, and further held that the first owner, "having commissioned the sketch plan and having obtained the right to use it for the purpose of erecting on that site a building in substantial accordance with it, should have the right to transfer it to a new owner of the land."<sup>84</sup> Even though the court referred to the principle as implied license, it could have easily described it as exhaustion of the reproduction right. Indeed, while implied license and exhaustion are not identical concepts, courts and commentators often use them interchangeably.<sup>85</sup>

The Court's holding that an implied license existed did not rely on a factual finding that the plaintiff had authorized the reproduction impliedly rather than verbally. Indeed, as a matter of fact, the plaintiff repudiated the contract and explicitly objected to the changes and the reproduction. The Court implied a license as a matter of law, as one of the legal consequences appurtenant to that type of transaction and arising from the copyright owner's initial permission.<sup>86</sup>

This proposition could be restated as exhaustion: the first transaction, wherein the plaintiff authorized the reproduction of his work, exhausted his copyright with respect to subsequent reproductions made in fulfillment of the purpose of the original transaction.

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<sup>81</sup> *Netupsky v. Dominion Bridge Co.*, [1972] S.C.R. 368, 377 (Can.).

<sup>82</sup> *Beck v. Montana Constructions Pty. Ltd.*, [1964–65] NSW 229 (Sup. Ct. of N.S.W.) (Austl.). The *Beck* case was also applied by Lord Denning in *Blair v. Osborne & Tomkins*, [1971] 2 Q.B. 78 (Eng. Ct. of App.).

<sup>83</sup> *Beck*, [1964–65] NSW 229 at 235.

<sup>84</sup> *Id.*

<sup>85</sup> Orit Fischman Afori, *Implied License: An Emerging New Standard in Copyright Law*, 25 SANTA CLARA COMPUTER & HIGH TECH. L.J. 275 (2009). See also de Beer & Tomkowicz, *supra* note 43, at 5.

<sup>86</sup> The distinction is similar to contract law's distinction between an obligation "implied in fact" and an obligation "implied in law." See, e.g., *Auto Glass Express, Inc. v. Hanover Ins. Co.*, 293 Conn. 218, 224 n.7 (2009) ("An implied in fact contract is the same as an express contract, except that assent is not expressed in words, but is implied from the conduct of the parties ... On the other hand, an implied in law contract is not a contract, but an obligation which the law creates out of the circumstances present, even though a party did not assume the obligation.") (quoting *Vertex, Inc. v. Waterbury*, 278 Conn. 557, 573–74 (2006)).



## **B. Exhaustion and the Turducken Problem: Using a Work Inside a Work**

The turducken is a chicken stuffed into a duck that is stuffed into a turkey. It recently appeared in American case law,<sup>87</sup> although copyright law has confronted its own turducken problems for many years. Exhaustion has been one method of avoiding them. Thus, if a sound recording of a song about chicken is lawfully incorporated into a film about poultry, a person who buys a DVD with the movie can resell it freely, even though the DVD is a copyright turducken: a tangible object incorporating a cinematographic work, which, in turn, incorporates a sound recording incorporating a musical composition.

But what happens when copyright owner A authorizes B to incorporate his work in another work, produced by B, and then B authorizes C to reproduce B's work or to publicly perform it? Does the fact that reproducing or performing B's work involves reproducing or performing A's work require C to obtain a license from A in addition to the license from B? We know that the lawful incorporation of Work A exhausts the distribution right in copies made with its owner's permission, but might it also exhaust other rights? Canadian courts have never confronted the question formulated in this way, but in several cases they held that a license from B was sufficient, and applied the logic of exhaustion to limit the scope of the owners' rights and nip the growth of legal turduckens in the bud.

### **1. Exhaustion and the reproduction right**

Consider *Allen v. Toronto Star*,<sup>88</sup> a perfect copyright turducken case: a magazine commissions a photograph of a politician from a professional photographer and incorporates the photo into the magazine cover. Several years later, a newspaper, with the magazine's permission, incorporates the magazine cover into its own article. The newspaper was licensed to reproduce the magazine cover, but it did not obtain the photographer's permission. Has the newspaper infringed the reproduction right of the photographer?

It was accepted that Allen, the photographer, retained ownership in the copyright to his photograph, and that his consent would be required for any subsequent use of the photo itself after its first use by the magazine. Nevertheless, the court held that his copyright was not infringed when the newspaper reproduced the magazine cover because the cover was a separate original artistic work. Allen's photo was an important component in creating the overall expressive effect of the cover, but the copyright in the cover belonged to the magazine, not to Allen. The magazine bargained with Allen for the taking of the photo and obtained his permission to incorporate it in the cover, and therefore Allen's copyright in the photograph was not infringed by the reproduction of the entire magazine cover.<sup>89</sup> Restated in terms of exhaustion: just as the authorized sale of a copy does not terminate the distribution right, but exhausts it with respect to the

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<sup>87</sup> *FTC v. Watson Pharm., Inc.*, 677 F.3d 1298, 1315 (11th Cir. 2012), *rev'd sub nom.* *FTC v. Actavis, Inc.*, 133 S. Ct. 2223 (2013).

<sup>88</sup> *Allen v. Toronto Star Newspapers Ltd.*, 1997 CanLII 16254 (ON SC), 78 C.P.R. (3d) 115 (1997) (Can. Ont. Ct. of Justice).

<sup>89</sup> *Id.* at 121.

sold copy, Allen's reproduction right was not terminated, but as far as the magazine cover was concerned, it was effectively exhausted.

In *Robertson v. Thompson*<sup>90</sup> the Supreme Court of Canada applied this logic when it held that a newspaper publisher did not infringe the copyright of freelance authors who authorized it to publish their articles in the newspaper when it subsequently authorized providers of electronic databases to digitize the newspaper and provide access to electronic versions of the newspaper. The majority and the dissent agreed that the newspaper is a separate original work, a compilation, and therefore the publisher is entitled to reproduce and authorize the reproduction of the compilation without seeking the authors' permission, as long as the publisher's originality is what is being reproduced, even though reproducing the compilation reproduces the component articles.<sup>91</sup> "This continuing right of use of the individual authors' originality creates no unfairness to those authors since... the ability to produce a collective work in the first place depends on the individual authors' authorization to use the materials that form the compilation."<sup>92</sup>

The Court split, however, on the application of this principle to the facts. The majority held that the publisher was only entitled to reproduce the freelance authors' articles in the CD-ROMs, but not in the online databases, because each article in the CD-ROM was presented alongside the other articles from that day's edition appearing in the frame on the right-hand side of the screen.<sup>93</sup> For the majority this meant that the CD-ROMs reproduced the newspaper, a separate original work distinct from the freelance author's article. The online databases, however, displayed each article individually, and were more akin to databases of individual articles rather than reproductions of the newspaper; the online databases reproduced the originality of the freelance articles, not the originality of the newspaper.<sup>94</sup> The dissent disagreed that the different organization and presentation was significant for copyright purposes, because it did not cause the publisher's originality to disappear.<sup>95</sup>

Regardless of the Court's split on the application of the legal principle to the specific facts, the crucial point for this chapter lies in the unanimous view that when the copyright owner of work A authorizes its inclusion in work B (e.g., a compilation), the owner of B is entitled to reproduce and authorize the reproduction of B without seeking A's permission, even though reproducing B will necessarily reproduce A.<sup>96</sup> This does not entitle B to reproduce A apart from B, but with respect to B, the copyright of A has been essentially exhausted.

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<sup>90</sup> *Robertson v. Thomson Corp.*, [2006] 2 S.C.R. 363 (Can.).

<sup>91</sup> *Id.* ¶ 34.

<sup>92</sup> *Id.* ¶ 83 (Abella, J., dissenting).

<sup>93</sup> *Id.* ¶ 52.

<sup>94</sup> *Id.* ¶ 41.

<sup>95</sup> *Id.* ¶¶ 91–92 (Abella, J., dissenting).

<sup>96</sup> *Id.* ¶ 84 (Abella, J., dissenting).

## 2. Exhaustion and the public performance right

The Supreme Court of Canada invoked the logic of exhaustion in two additional recent cases, preferring a narrower interpretation of the public performance right. In *Entertainment Software Association v. SOCAN*<sup>97</sup> the Court considered whether Internet delivery of a permanent copy of a video game containing musical works amounted to a “communication to the public by telecommunication.”<sup>98</sup> The majority held that the communication right was a subset of the public performance right, and that the delivery of a permanent copy implicated the reproduction right, not the communication/performance right.

The first paragraph of the majority opinion framed the issue in the language of exhaustion:

In the video game publishing industry, the royalties for the reproduction of any musical works which are incorporated into the games are currently negotiated before the games are packaged for public sale. Once these rights have been negotiated, the owner of the copyright in the musical work has no further rights when the game is sold. The question in this appeal is whether the rights are nonetheless revived when the work is sold over the Internet instead of in a store. In our view, it makes little sense to distinguish between the two methods of selling the same work.<sup>99</sup>

The rest of the opinion centered on the distinction between reproduction and performance, the legislative and judicial history of the public performance right, and several policy considerations. Arguably the opinion could stand on those grounds regardless of the exhaustion-like concerns, but taken together, the majority opinion signals strong aversion to allowing copyright owners unconstrained power to control downstream uses of works that have been lawfully put on the market. Once these rights have been negotiated and copies of the game are sold, the copyright owner’s rights in the musical work incorporated in the game are exhausted, and the technological differences between online and offline sales do not revive them.

In *Re:Sound v. Motion Picture Theatre Association of Canada*,<sup>100</sup> decided the same day, the Court confronted the question of whether the broadcasting of sound recordings incorporated into the soundtrack of a cinematographic work requires payment of royalties to performers and makers of the sound recordings. The statutory definition of the term “sound recording” “excludes any soundtrack of a cinematographic work where it accompanies the cinematographic work,”<sup>101</sup> but the term “soundtrack” is not defined. Estimating that it could collect \$45 million annually,<sup>102</sup> Re:Sound asked the Copyright Board to approve a tariff, arguing that “excludes” means “includes” (or to put it more charitably, that the definition applies only to commissioned recordings, but “does not

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<sup>97</sup> *Entm’t Software Ass’n v. Soc’y of Composers, Authors and Music Publishers of Canada*, [2012] 2 S.C.R. 231 (Can.).

<sup>98</sup> *Id.* ¶ 12.

<sup>99</sup> *Id.* ¶ 1.

<sup>100</sup> *Re:Sound v. Motion Picture Theatre Ass’ns of Canada*, [2012] 2 S.C.R. 376 (Can.).

<sup>101</sup> Copyright Act, R.S.C. 1985, c. C-42, § 2.

<sup>102</sup> Factum of Appellant ¶ 1, *Re:Sound v. Motion Picture Theatre Ass’ns of Canada*, [2012] 2 S.C.R. 376 (Can.), available at [http://www.scc-csc.gc.ca/WebDocuments-DocumentsWeb/34210/FM010\\_Appellant\\_ReSound.pdf](http://www.scc-csc.gc.ca/WebDocuments-DocumentsWeb/34210/FM010_Appellant_ReSound.pdf).

exclude a pre-existing sound recording that is incorporated into a soundtrack”).<sup>103</sup> The Court disagreed. Among other reasons, it agreed with the Copyright Board, which emphasized:

The performer and maker, having authorized the inclusion of a performance or sound recording in a movie soundtrack, are precluded from exercising both their respective copyright (including the rental right) and their remuneration right, when the soundtrack accompanies the movie. When the soundtrack does not accompany the movie, all their rights continue to exist.<sup>104</sup>

Again, as in the previous Canadian cases, the Court did not say “exhaustion,” but applied the logic of exhaustion: a copyright owner does not lose its copyright when it authorizes certain acts, but the authorization of those acts exhausts its rights with respect to subsequent uses of what had been authorized.

The most recent copyright decision of the Supreme Court of Canada might seem to take a different approach. In *CBC v. SODRAC*,<sup>105</sup> the Court had to decide whether “broadcast-incidental” reproductions constituted reproductions within the meaning of the Copyright Act. “Broadcast-incidental” copies were various copies made by the broadcaster for technical reasons to facilitate the broadcasting of television programs. They included digital copies of television programs loaded into the broadcaster’s digital content management system, as well as additional copies made in the course of communicating the works to the public by broadcast or over the Internet.<sup>106</sup> The majority of the Court accepted the position of SODRAC, a collective society representing copyright owners of French-language musical works, that the “broadcast-incidental” reproductions engaged the reproduction right under Section 3(1)(d) of the Copyright Act.<sup>107</sup>

CBC invited the Court to overturn an earlier decision, *Bishop v. Stevens*.<sup>108</sup> In that case, the Court held that reproduction and public performance were separate rights, and that a license to broadcast a performance of a work did not include the right to make “ephemeral” recordings beforehand for the purpose of facilitating the broadcast.<sup>109</sup> CBC argued that that decision was no longer consistent with the Court’s later case law, including its adoption of technological neutrality as an interpretative principle.<sup>110</sup> The majority, per Justice Rothstein, declined the invitation, for two main reasons: first, the majority held that the plain and ordinary meaning of the words of Section 3(1)(d), granting an exclusive right to the making of a “sound recording, cinematograph film or other contrivance by means of which the work may be mechanically reproduced or performed,” covered the “broadcast-incidental” copies; and second, it concluded that specific statutory exceptions for ephemeral recordings that Parliament enacted after

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<sup>103</sup> *Re:Sound*, [2012] 2 S.C.R. 376, ¶ 7.

<sup>104</sup> *Id.* ¶ 14.

<sup>105</sup> *Canadian Broadcasting Corp. v. SODRAC 2003 Inc.*, [2015] 3 S.C.R. 615 (Can.).

<sup>106</sup> *Id.* ¶¶ 10–11.

<sup>107</sup> *Id.* ¶¶ 1–5.

<sup>108</sup> *Bishop v. Stevens*, [1990] 2 S.C.R. 467 (Can.).

<sup>109</sup> *Id.* at 480.

<sup>110</sup> *CBC v. SODRAC*, ¶¶ 45–46.

*Bishop v. Stevens* confirmed that Parliament intended to include these types of reproductions, unless they fall within the scope of the specific exceptions, within the scope of the reproduction right under Section 3(1)(d).<sup>111</sup> The majority also rejected the argument that the license to synchronize the musical work with the television show implied a license to make the additional “broadcast-incidental” copies.<sup>112</sup>

While Justice Abella’s strong dissent is more in line with the approach that I propose in this chapter, it is too early to tell whether the majority opinion signals a major retreat from the line of cases discussed above. Three main reasons might justify a narrow reading of the *SODRAC* decision: first, the decision is limited to the scope of the specific exclusive right under Section 3(1)(d), rather than applying to the general reproduction right in Section 3(1); second, the majority might have felt the Parliament’s response to the Court’s earlier holding in *Bishop* (the enactment of finely calibrated exceptions to the rule) resulted in a complete code governing this type of reproductions by broadcasters, which precluded the Court from revisiting its own prior interpretation of the rule;<sup>113</sup> and third, the fact that this case involved rate-setting proceedings before the Copyright Board, rather than an action for copyright infringement, might have presented the majority with an opportunity to find a seemingly pragmatic, or rather Solomonic, solution. It affirmed the Copyright Board’s legal determination that “broadcast-incidental” reproductions were “reproductions,” but it also set aside the Board’s valuation of the right to make broadcast-incidental copies at 31.25 percent of the value of the right to broadcast the works, holding that the Board did not take account of the principles of technological neutrality and balance in valuing the license fees.<sup>114</sup>

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This survey shows how Canadian courts have relied on the logic of exhaustion to limit the power of copyright owners who authorize certain acts to control certain additional downstream uses of their works.<sup>115</sup> The courts have not dealt with exhaustion in the context of the distribution right because, until very recently, Canada’s Copyright Act did not grant a distribution right.<sup>116</sup> These cases demonstrate that exhaustion can be

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<sup>111</sup> *Id.* ¶¶ 49–51.

<sup>112</sup> *Id.* ¶¶ 56–64.

<sup>113</sup> In her dissent, Justice Abella argued that a discrete legislative response to a specific judicial interpretation of the Copyright Act should not be mistaken for a Rosetta stone on the scope and meaning of the reproduction right, and does not constitute an express statutory language required to preclude the Court from interpreting the *Act* in light of its fundamental objectives and principles. *Id.* ¶ 174.

<sup>114</sup> *Id.* ¶ 92.

<sup>115</sup> *Cf.* Perzanowski & Schultz, *Digital Exhaustion*, *supra* note 4, at 908–25 (documenting how exhaustion principles have been applied in the United States beyond the distribution right). *See also* Pamela Samuelson, *The Quest for a Sound Conception of Copyright’s Derivative Work Right*, 101 *GEO. L.J.* 1505, 1537 (2013).

<sup>116</sup> Unauthorized distribution could be actionable either as an infringement of the first publication right under Section 3 (in the case of copies of a work that had not been previously published), or under Section 27(2) as a form of secondary infringement in the case of distribution of infringing copies. Since the distribution of a lawfully made copy of a published

understood as an overarching (or underlying) principle, capable of manifesting itself in a variety of contexts. The freedom to resell copies that were made and distributed with the owner's consent may be the most common and obvious example, but as a general principle, it is not limited to this context.

It may be imprudent to prophesize about the outcome of a case like *ReDigi* had it been litigated in Canada, but the Canadian case law makes it possible to envisage an entirely different outcome. Clearly, if, as in *ReDigi*, digital files can be transferred from one user to another without multiplication, then under *Théberge* there would be no reproduction or any other exclusive right that could be infringed. But the case law also suggests that *ReDigi*'s technological sophistication might not even be necessary, and that it could offer a resale service even if it involved some intermediary reproductions. If this possibility is not clear from the case law, or if pursuing it might seem more difficult in the aftermath of *CBC v. SODRAC*, then a recently enacted provision in the Act lends it further support. Section 30.71, enacted in 2012, provides:

It is not an infringement of copyright to make a reproduction of a work or other subject-matter if (a) the reproduction forms an essential part of a technological process; (b) the reproduction's only purpose is to facilitate a use that is not an infringement of copyright; and (c) the reproduction exists only for the duration of the technological process.<sup>117</sup>

Recall that the court in *ReDigi* did not hold that the first-sale doctrine would never apply to works in digital formats: it will apply if a person transfers the tangible medium that embodies the digital file, but won't apply if the transfer involves reproduction in another medium.<sup>118</sup> But if the owner of a copy is entitled to sell or otherwise dispose of the possession of that copy, then the transfer itself is not an infringement of copyright, and it will not be an infringement of copyright to make reproductions that are necessary for the technological process that facilitates the transfer.<sup>119</sup>

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work would not infringe any right, neither the Canadian Copyright Act nor Canadian courts had to include a first-sale or exhaustion rule. In 2012, Parliament added Section 3(1)(j), an exclusive right "in the case of a work that is in the form of a tangible object, to sell or otherwise transfer ownership of the tangible object, as long as that ownership has never previously been transferred in or outside Canada with the authorization of the copyright owner." Copyright Act, R.S.C. 1985, c. C-42, § 3(1)(j). Thus, the new distribution right applies only to the distribution of tangible copies, and it comes with a built-in first-sale limitation.

<sup>117</sup> Copyright Act, R.S.C. 1985, c. C-42, § 30.71. *CBC v. SODRAC* was argued and decided on the basis of the statute as it existed prior to those amendments. The Court did not consider, and the parties made no arguments about, the potential impact of this and other amendments.

<sup>118</sup> *Capitol Records, LLC v. ReDigi Inc.*, 934 F. Supp. 2d 640, 648 (S.D.N.Y. 2013).

<sup>119</sup> In *Soc'y of Composers, Authors & Music Publishers of Can. v. Canadian Ass'n of Internet Providers*, [2004] 2 S.C.R. 427, ¶ 91 (Can.), the Court held, interpreting another exception, that the word "necessary" "is satisfied if the means are reasonably useful and proper to achieve the benefits of enhanced economy and efficiency."

## V. AGAINST COPYRIGHT PRIMITIVISM

The previous Part established that copyright law is entirely capable of envisioning a digital exhaustion doctrine based on an understanding of exhaustion as a general limiting principle. In this Part I argue that the contrary position, viewing exhaustion as restricted to the transfer of a tangible object, reflects a form of primitive legal thinking that ought to be abandoned.

Every first-year law student learns that “the institution of property is not concerned with scarce resources themselves (‘things’), but rather with the rights of persons with respect to such resources.”<sup>120</sup> Ownership is not “that sole and despotic dominion”<sup>121</sup> over a thing, but a complex bundle of rights, privileges, powers, and immunities that a person has, entailing correlative duties, no-rights, liabilities, and disabilities that bind others.<sup>122</sup> Likewise, every student taking copyright law learns that the rights in a work are completely distinct from the right in the tangible medium that embodies the work.<sup>123</sup> Unfortunately, when those students become lawyers or judges and confront a copyright case they get confused, forget these fundamentals, and resort to a primitive preoccupation with “things.”

The ruling in *ReDigi* is imbued with such “thingness.” The court explained that its finding that ReDigi did not transfer a particular copy but reproduced copies was “confirmed by the laws of physics [because] [i]t is simply impossible that the same ‘material object’ can be transferred over the Internet.”<sup>124</sup> This may be true as a matter of physics, but a court of law ought to be less concerned about the laws of physics than with rules of law. Physics determines a realm of practical possibilities, but the law defines which of them are permissible. Physical realities are relevant to determining whether facts that may give rise to certain legal rights or liabilities exist or could exist, but they do not determine those rights or liabilities. For example, acquiring title by adverse possession requires physical presence on the land but title is a legal concept, determined by law, not physics. Likewise, title can be transferred without transferring possession, and possession may transfer without transferring title. I can buy a house in another city and become its owner by complying with all the legal requirements without setting foot in it, and I may complete the transaction by mail or over the Internet. The laws of physics confirm that a house cannot be transferred over the Internet or mailed in an envelope, but this tells very little about the possibility of effectuating a transfer of legal interest by means of mail or online communication. This cornerstone of modern legal thought seems to have been clear a long time ago. Indeed, in his famous discussion against restraints on alienation from the 17th century, Lord Coke discussed how a man who *possessed* a horse and gives or sells his whole *interest* in the horse cannot restrict the buyer from further alienating the buyer’s *interest* in the

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<sup>120</sup> Thomas W. Merrill, *Property and the Right to Exclude*, 77 NEB. L. REV. 730, 731–32 (1998).

<sup>121</sup> 2 WILLIAM BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND 2 (1765–69).

<sup>122</sup> WESLEY N. HOHFELD, FUNDAMENTAL LEGAL CONCEPTIONS AS APPLIED IN JUDICIAL REASONING AND OTHER LEGAL ESSAYS 96 (Walter W. Cook ed., 1923).

<sup>123</sup> *See, e.g.*, 17 U.S.C. § 202.

<sup>124</sup> *ReDigi*, 934 F. Supp. 2d at 649.

horse. The seller cannot restrain the subsequent alienation, not because he lost physical control over the horse, but because by selling the horse with no possibility of reverter, the law determines that he divested himself of his entire legal interest in the horse.<sup>125</sup>

The legal significance of a sale of a horse, a book, an iPod, or any other chattel lies not in the transfer of the physical item, but in the transfer of the seller's legal interest in it. When a person owns a tangible copy of a work she owns the tangible object—not the copyright. What she can do with the copy depends on a combination of the laws of physics (defining a range of actions possible in the physical world to the extent that the law deems them relevant), and property law, copyright law, and other pertinent legal rules (defining what she may be entitled to do). Ownership of the copy will generally entitle her (legally) to possess it (physically), as well as give her the legal power to gain or regain possession from which she has been physically, yet unlawfully, deprived. In turn, this possession may enable her to enjoy the work in certain ways that do not require the copyright owner's permission, such as reading the book or listening to the music as far as the laws of physics make those acts possible.<sup>126</sup> However, owning the copy will not entitle her to publicly perform the work without the copyright owner's consent, even if the laws of physics make it possible. As an owner of the chattel she will be generally entitled to sell it, because the power to sell is one of the incidents of ownership; however, because the chattel incorporates a copyright owner's work this power may be curtailed, depending on whether the copy is an infringing one or not, and the nature of the sale. If the sale is "private," copyright law has nothing to say about it, because Section 106(3) covers only the distribution of copies "to the public." But even if the sale is to the public, the owner can still sell her copies under Section 109, provided the copies were lawfully made. In contrast, if the copies were made unlawfully, distributing them to the public will infringe the copyright owner's rights under Section 106(3), and the court may even interfere with the defendant's property rights in the tangible objects by ordering their impoundment, destruction, or other disposition.<sup>127</sup>

Thus, when A sells a copy to B, A transfers that bundle of rights to B. B then becomes the owner and can exercise all the powers that are incidental to ownership, while A can no longer exercise them. The laws of physics will determine the practical scope of what can be done with the copy, while legal rules will determine which of them will be legally permissible. Therefore, the laws of physics may confirm the impossibility of transferring a particular material object over the Internet, but this trivial observation tells very little about whether, as a legal matter, one is entitled to transfer her lawfully acquired bundle of legal rights to another person.

The view that the first-sale doctrine does not apply to digital files assumes that because Section 109 uses the phrase "a particular copy," and Section 101 defines "copy" as a "material object," the doctrine only applies to the transfer of a particular

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<sup>125</sup> 1 EDWARD COKE, *INSTITUTES OF THE LAWS OF ENGLAND* § 360, at 223 (1628), *cited in* *Kirtsaeng v. John Wiley & Sons, Inc.*, 133 S. Ct. 1351, 1363 (2013).

<sup>126</sup> For example, reading the book may require a suitable level of lighting, and listening to a song embedded in a digital file will require using a compatible functioning and powered electronic player.

<sup>127</sup> 17 U.S.C. § 503.



material object, and could not possibly apply when transferring a digital file involves its reproduction. Under this view, when one “buys” a song from iTunes or an eBook from Amazon’s Kindle store, the buyer does not purchase any material object that she can later sell under the first-sale doctrine. Instead, the buyer pays for and receives a bundle of certain privileges that allow her to do certain things with the work. Rather than buying a thing, those transactions merely entail a license to perform certain acts that otherwise would constitute infringement, for example, permission to reproduce the digital file on five devices.<sup>128</sup> The differences between selling a copy and licensing its use, and between selling a tangible object and licensing a user to reproduce a digital file (by downloading and installing it on her devices), are supposed to prove the inapplicability of the doctrine.

But these differences can only serve as a useful starting point for discussion, not its conclusion. If, as codified in Section 109, the American first-sale doctrine applies only to the sale or disposal of “material objects” and may not apply to the transfer of digital files (apart from transferring the medium in which they are embedded), then Section 106(3) cannot apply either, because Section 106(3) grants an exclusive right “to distribute copies [i.e., material objects] ... to the public by sale or other transfer of ownership.” If transferring a digital file online does not count as a sale of a material object for the purpose of Section 109, then it is hard to see why it would nonetheless constitute a sale of a material object for the purpose of Section 106(3).<sup>129</sup> In other words, the very reason that would prevent the defendant from relying on Section 109’s limitation on the distribution right should also preclude the plaintiff from claiming infringement of that right.

This observation might seem like the ultimate proof that there is no such thing as digital first-sale, and that digital sales aren’t really sales but acts of reproduction to which the doctrine does not apply. But before rushing to this conclusion consider the following. Interpreting the Copyright Act in such a way would call into play the *expressio unius* canon of statutory construction: since the statute mentions only exhaustion of the distribution right, it impliedly excludes exhaustion of all other rights. However, this maxim is held not to be of universal application,<sup>130</sup> and it is also not the

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<sup>128</sup> The Apple iTunes store includes among its terms and conditions: “(i) You shall be authorized to use iTunes Products only for personal, noncommercial use. (ii) You shall be authorized to use iTunes Products on five iTunes-authorized devices at any time ... iTunes Store, *Terms and Conditions*, APPLE, <http://www.apple.com/legal/internet-services/itunes/us/terms.html#SERVICE>.

<sup>129</sup> In *Elektra Entm’t Grp., Inc. v. Barker*, 551 F. Supp. 2d 234 (S.D.N.Y. 2008), a case involving peer-to-peer file-sharing, the Electronic Frontier Foundation, as amicus curiae, argued that file-sharing could not implicate the distribution right under Section 106(3) because the right only applies to the distribution of “material objects.” The court declined to address this argument because the defendant had not raised it in her brief. *Id.* at 240 n.6.

<sup>130</sup>

The maxim, *expressio unius est exclusio alterius*, enunciates a principle ... in the construction of statutes ... [W]hile it is often a valuable servant, it is a dangerous master to follow. Much depends upon the context. One has to realize that a general rule of interpretation is not always in the mind of a draughtsman; that accidents occur; that there may be inadvertence; that sometimes unnecessary expressions are introduced, *ex abundanti cautela*, by way of least

only relevant canon of construction. As discussed earlier, *Kirtsaeng*, relying on other accepted canons of interpretation,<sup>131</sup> affirms that the doctrine neither originates in the statute, nor is restricted by its codification.<sup>132</sup> If the Court in *Bobbs-Merrill* could legitimately adopt a limiting construction of the distribution right to prevent copyright owners from “fasten[ing] ... a restriction upon the subsequent alienation of the subject-matter of copyright,”<sup>133</sup> there is no a priori reason why courts could not rely on the same considerations for limiting the reproduction right. The Canadian cases discussed earlier illustrate how the principles of exhaustion could be applied across the board.

Exhaustion in patent law provides another instructive analogy. In *Henry v. A.B. Dick Co.*,<sup>134</sup> the U.S. Supreme Court had initially declined to extend its holding from *Bobbs-Merrill* to the area of patent law in light of differences in the terms of the copyright and patent statutes: the copyright statute only grants an exclusive right to multiply and sell, whereas the patent statute provides more extensive rights “to make, use, and vend the invention or discovery.”<sup>135</sup> But this holding was short lived. The following year, in *Bauer & Cie. v. O’Donnell*,<sup>136</sup> the Court distinguished the holding in *A.B. Dick* and limited it to its particular facts. The Court first held that the exclusive right to vend had the same meaning under the patent and the copyright statutes, and that the scope of the right was the same; if the sale of a book exhausts the right to vend it, so does the sale of a patented machine.<sup>137</sup> The Court then rejected the patentee’s contention that the transaction was not a sale but a license to use, and extended the *Bobbs-Merrill* holding to patent law.<sup>138</sup> Shortly thereafter, the Court overruled *A.B. Dick* and applied the exhaustion principle not only to the exclusive right to “vend” the patented article but also to the right to “use” it.<sup>139</sup> Taken together, those decisions support the following propositions: (a) there are no major differences between exhaustion of copyrights and patents; (b) exhaustion of a patent is not limited to the right to sell it; (c) therefore, exhaustion of copyright may also not be limited to the distribution right; and (d) the IP owner’s characterization of the transaction as a license and not a sale may be of little importance.

Moreover, once we recall that the legal significance of a sale lies in the transfer of legal entitlements, not in the physical transfer of an object, conceiving a digital exhaustion doctrine becomes quite easy. Digital exhaustion simply means that a person

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resistance, to satisfy an insistent interest, without any thought of limiting the general provision; and so the axiom is held not to be of universal application.

Turgeon v. Dominion Bank, [1930] S.C.R. 67, 70–71 (Can.). See also AHARON BARAK, PURPOSIVE INTERPRETATION IN LAW 108–09 (2005).

<sup>131</sup> See *supra* Part II(B)(1).

<sup>132</sup> *Id.*

<sup>133</sup> *Kirtsaeng v. John Wiley & Sons, Inc.*, 133 S. Ct. 1351, 1386 (Ginsburg, J., dissenting) (quoting *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339, 349–50 (1908)).

<sup>134</sup> *Henry v. A.B. Dick Co.*, 224 U.S. 1 (1912).

<sup>135</sup> *Id.* at 46.

<sup>136</sup> *Bauer & Cie. v. O’Donnell*, 229 U.S. 1 (1913).

<sup>137</sup> *Id.* at 13.

<sup>138</sup> *Id.* at 16.

<sup>139</sup> *Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 243 U.S. 502, 516 (1917).

who lawfully obtains a bundle of rights that includes certain privileges to use a work is entitled to transfer that bundle of rights to another person, and thereby deprives herself thereof. Like a reseller of a book, who transfers her *interest* in the particular copy to another person, the reseller of a digital song transfers her use privileges to another. Focusing on the transfer of one's *rights* with respect to a resource (be it a horse or an iTunes song) instead of the transfer of the resource-thing, renders the difference between the book and the e-book insignificant.

The argument that digital works are licensed and not sold and therefore not subject to the first-sale doctrine may have some currency only if it pertains to terminological accuracy of the word "sale." But once we substitute "exhaustion" for "first-sale," the argument becomes less determinative than it initially seems. Section 109 may have codified the exhaustion doctrine as applied to the *sale* of particular copies that one owns, but this codification does not mean that a licensee cannot assign her rights under the license to another person and that exhaustion, as a legal principle, cannot secure her right to do so. Digital exhaustion simply means that the buyer has the power to alienate the bundle of rights that she obtained under the license (e.g., the right to reproduce the file on five devices) to another person. The bundle of rights associated with the ownership of a tangible object might be different from the bundle associated with the purchase of a digital copy, but those differences, on their own, do not imply that only the first bundle is transferable while the second is not.

The no-digital-first-sale argument assumes that a licensee lacks the power to transfer the set of legal entitlements obtained under a license to another person, or that a copyright owner has an unfettered power to decide whether to allow or restrict such transfers. None of these assumptions is a foregone conclusion. The copyright statutes (in the United States or in Canada) provide little guidance on the question of the transferability of copyright licenses, and the case law indicates that it remains an open question.<sup>140</sup> In *Netupsky*, the Supreme Court of Canada recognized not only that a user who paid for a work may have implied license to make necessary reproductions of it, but also that the user could transfer those rights to another person.<sup>141</sup> An Australian court held that license agreements that involve no personal content are assignable.<sup>142</sup> According to David Vaver, where the identity of the licensee matters to the licensor or where the licensee has further obligations to the licensor, the license may be considered personal, and may not be validly transferred or sub-licensed unless transfer or sub-licensing is permitted or implied from the circumstances.<sup>143</sup> Such permission may be implied, however, where the identity of the licensor or licensee is unimportant.<sup>144</sup> Most published books, recorded songs, movies, television shows, and mass-market software products would appear to fall into this category easily. Likewise, Christopher Newman argues that the key concern animating non-assignability of licenses in the

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<sup>140</sup> Christopher M. Newman, "What Exactly Are You Implying?": *The Elusive Nature of the Implied Copyright License*, 32 CARDOZO ARTS & ENT. L.J. 501, 546–47 (2013).

<sup>141</sup> See *supra* Part IV(A).

<sup>142</sup> *JWH Group Pty Ltd v. Kimpura Pty Ltd*, [2004] WASC 39, ¶ 74 (Sup. Ct. of West. Austl.) (Austl.).

<sup>143</sup> DAVID VAVER, *INTELLECTUAL PROPERTY LAW* 575 (2d ed. 2011).

<sup>144</sup> *Id.*

United States has been protecting the IP owner's right to control the identity of the licensee, and that when those interests are not harmed, refusing to infer such permission might increase transaction costs unproductively.<sup>145</sup>

The notion that the transferability of a license depends on the copyright owner's permission, explicit or implied, may suggest that a copyright owner could simply prohibit the transfer by disallowing it explicitly. This, however, was precisely what IP owners in the United States tried to do, and what the Court, in a line of cases beginning with *Bobbs-Merrill*, consistently disallowed. The Court frowned upon the myriad techniques that IP owners employed in order to extend their powers and limit the use or alienability of intellectual goods,<sup>146</sup> and it was not impressed by attempts to characterize transactions as licenses and not sales.<sup>147</sup> There might be some circumstances where limiting such transfers by valid contracts or other means might be consistent with the underlying policies of IP law, but identifying those circumstances cannot be left entirely to the discretion of IP owners.<sup>148</sup> Therefore, distinctions between selling and reproducing, or between owning an object or being merely licensed to use the intellectual good embodied therein, carry less weight than opponents of digital exhaustion tend to assume.

## VI. IS DIGITAL DIFFERENT?

Copyright law has traditionally assumed that its public policy goals require limiting copyright owners' power to prevent buyers from transferring their interest in their copies to others. Therefore, it is hard to see why in principle transferring one's bundle of rights under a license should be treated differently. In *Rogers Communications v. SOCAN*, the Supreme Court of Canada held that copyright law's balance of public and private interests requires that liability should not depend "merely on the business model" where "the end result is the same,"<sup>149</sup> and concluded that communicating musical works via on-demand streaming services is no less public than traditional broadcasting.<sup>150</sup> In *ABC v. Aereo*, the majority of the U.S. Supreme Court employed a similar logic when it held that Aereo performed the plaintiffs' works publicly, and concluded that the technological differences differentiating Aereo's service from the services of cable television operators were legally insignificant.<sup>151</sup> In these cases the courts rejected arguments seeking to rely on technological differences to narrow the

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<sup>145</sup> Newman, *supra* note 140, at 547–48.

<sup>146</sup> See *Boston Store of Chicago v. Am. Graphophone Co.*, 246 U.S. 8 (1918) (surveying the line of cases).

<sup>147</sup> *Id.* at 24–25. See also *Quanta Computer, Inc. v. LG Electronics, Inc.*, 553 U.S. 617, 626 (2008) (describing how in *Motion Picture Patents* the Court disapproved of "the 'increasing frequency' with which patent holders were using ... licenses to limit the use of their products").

<sup>148</sup> Katz, *The Economic Rationale for Exhaustion*, *supra* note 51, at 41–42. Katz et al., *The Interaction*, *supra* note 6, at 17–18.

<sup>149</sup> *Rogers Commc'ns Inc. v. Soc'y of Composers, Authors & Music Publishers of Can.*, [2012] 2 S.C.R. 283, ¶ 40 (Can.).

<sup>150</sup> *Id.*

<sup>151</sup> *Am. Broadcasting Cos. v. Aereo, Inc.*, 134 S. Ct. 2498 (2014).

scope of copyright owners' rights. But in *Entertainment Software Association v. SOCAN*,<sup>152</sup> the Supreme Court of Canada employed the same reasoning in declining to expand the scope of copyright owners' rights to the detriment of users. The majority held that "[t]he traditional balance between authors and users should be preserved in the digital environment."<sup>153</sup> It held that online delivery of video games implicates only the reproduction right and rejected the argument that it also implicates the public performance right: "a 'download' is merely an additional, more efficient way to deliver copies of the games to customers,"<sup>154</sup> and "there is no practical difference between buying a durable copy of the work in a store, receiving a copy in the mail, or downloading an identical copy using the Internet. The Internet is simply a technological taxi that delivers a durable copy of the same work to the end user."<sup>155</sup> It instructed courts to interpret the Act "in a way that avoids imposing an additional layer of protections and fees based solely on the *method of delivery* of the work to the end user."<sup>156</sup> This logic strongly suggests that if users are free to resell the tangible copies they purchase, they should be, in principle, entitled to resell their digital copies.

Opponents of digital exhaustion argue, however, that it threatens to undermine copyright's traditional balance because digital exhaustion will be detrimental to copyright owners. It would chill the initial distribution of digital work and reduce the incentives to create in the first place.<sup>157</sup> The threat comes from a combination of two factors. Unlike used tangible copies that ordinarily wear out through use and as they pass from one user to another, digital copies remain identical to the original, and thus serve as a perfect substitute. They can also be transmitted easily and cheaply and almost instantaneously anywhere in the world, which facilitates arbitrage, and makes price discrimination more difficult to implement. As a result, allowing digital exhaustion might threaten copyright owners' profit on a level not experienced before.<sup>158</sup> Moreover, digital exhaustion could mask piracy because nothing prevents people who sell their digital copies from simultaneously retaining them.<sup>159</sup>

The first argument ignores a crucial point about exhaustion: it does not affect the copyright owner's ability to control the volume of units entering the market; it only limits the owner's power to rely on copyright to control their secondary and successive redistribution.<sup>160</sup> The owner still controls the total quantity of units, new and used, and indirectly, their respective prices. Moreover, while exhaustion may affect an owner's

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<sup>152</sup> *Entm't Software Ass'n v. Soc'y of Composers, Authors & Music Publishers of Canada*, [2012] 2 S.C.R. 231 (Can.).

<sup>153</sup> *Id.* ¶ 8.

<sup>154</sup> *Id.* ¶ 4.

<sup>155</sup> *Id.* ¶ 5.

<sup>156</sup> *Id.* ¶ 9.

<sup>157</sup> See, e.g., Rub, *supra* note 50, at 803–04; Wolfgang Kerber, *Exhaustion of Digital Goods: An Economic Perspective*, MAGKS, Joint Discussion Paper Series in Economics, No. 14-2016, ZEITSCHRIFT FÜR GEISTIGES EIGENTUM (ZGE)/INTELLECTUAL PROPERTY JOURNAL (IPJ) (forthcoming 2016), available at <http://ssrn.com/abstract=2777459>.

<sup>158</sup> U.S. COPYRIGHT OFFICE, DMCA SECTION 104 REPORT 78–105 (2001), available at <http://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf>.

<sup>159</sup> Rub, *supra* note 50, at 803.

<sup>160</sup> *London-Sire Records, Inc. v. Doe 1*, 542 F. Supp. 2d 153, 174 (D. Mass. 2008).

ability to exercise downstream control over the use of her works, it should not categorically prevent owners from imposing reasonable post-sale contractual “sticks” to discourage resale of copies,<sup>161</sup> or offering “carrots” to induce their retention if the speed and ease of digital resale proves detrimental. Furthermore, publishers can develop various strategies to compete with resellers of used copies that are not available to those resellers. For example, they can offer price-match guarantees, or they can discourage resellers by threatening to increase supply of new copies, or offer bundles of work, and so on. Large and sophisticated resellers might offer their own inducements, but the copyright owner’s control over the release of new copies provides it a strategic advantage over the reseller, whose supply of used copies will be affected by the actions of the copyright owner.

The argument that digital exhaustion could be used to launder piracy ignores that as a matter of law a person who sells his copy but makes and retains another may still infringe copyright, and that as a practical reality, people who wish to evade the law do not need to masquerade as complying with first-sale rules when they can obtain illegal copies much more easily elsewhere. In addition, the dire predictions on the effect of digital exhaustion also rely on several strong but untested assumptions about how consumers behave, how producers respond, and how markets and technologies evolve.<sup>162</sup> The shortcomings in the arguments predicting dire consequences from allowing digital exhaustion do not mean that they don’t pass the threshold of plausibility. However, the history of copyright teaches us that dire predictions about the devastating effects of digital and other technologies are frequently raised but have rarely materialized.<sup>163</sup> In many cases the sky has actually risen.<sup>164</sup> The fact that the sky hasn’t fallen before doesn’t mean that it may not fall in the future, but the pattern of those arguments justifies close scrutiny.

But more importantly, like many of the arguments favoring no or very weak exhaustion rules, the “digital exhaustion is different” argument focuses on the short-term benefits that may accrue to copyright owners if the doctrine could be eliminated or the challenges facing them if maintained, while ignoring the long-term harms and benefit to the public. Digital exhaustion might be challenging for copyright owners, but it is far from obvious that those challenges are insurmountable to the point of justifying

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<sup>161</sup> Katz, *The Economic Rationale for Exhaustion*, *supra* note 51, at 41–42. Katz et al., *The Interaction*, *supra* note 6, at 17–18.

<sup>162</sup> For example, a “used” digital copy is not always a functional equivalent to an original. People often buy books, movies, or music albums as gifts. But giving another person a “used” copy may look cheap and undermine the social significance of the gift giving. Likewise, an iTunes gift card might serve as a socially acceptable gift in a way that a ReDigi gift card might not. Furthermore, the assumption that digital copies may serve as durable perfect copies ignores the fact that so far digital copies are often shorter-lived than analog ones. File formats, software, and hardware all change rapidly and can leave digital copies inaccessible and practically worthless quite quickly. I thank Aaron Perzanowski for reminding me of this point.

<sup>163</sup> *Am. Broadcasting Cos. v. Aereo, Inc.*, 134 S. Ct. 2498, 2517–18 (2014) (Scalia, J., dissenting).

<sup>164</sup> *The Sky Is Rising!*, TECHDIRT, <https://www.techdirt.com/skyisrising/>; Clark Asay, *Kirtsaeng and the First-Sale Doctrine’s Digital Problem*, 66 STAN. L. REV. ONLINE 17, 22 (2013).

the doctrine's abolition.<sup>165</sup> Whatever those challenges are, they do not justify burdening digital works with restraints on their alienation lasting the entire duration of the copyright. At most they might justify some reasonable short-term contractual restrictions, as long as they do not undermine the broad and long-term benefits that the first-sale doctrine confers on society.<sup>166</sup>

To illustrate the long-term harms that may result from treating digital works as not subject to exhaustion rules consider the problem of orphan works. The problem of orphan works is serious enough even with respect to works that were sold in tangible form,<sup>167</sup> but as much as high transaction costs may prohibit many beneficial uses of such works that may involve their reproduction or public performance, used copies of them can still be freely resold, read, listened to, or watched. The notion that exhaustion is inapplicable to digital works, and that transferring them from one person to another requires the copyright owner's permission, means that the orphan works problem will be compounded.

## VII. CONCLUSION

Until recently we have only encountered works embedded in discrete tangible copies. This combination of the tangible object and the intangible work created a tension between the property rules governing the use and disposition of chattels, and the copyright rules regulating the use of the work they embody. The first-sale doctrine has served to mediate this conflict<sup>168</sup> by giving precedence to the rights of the buyer who purchased a lawful copy. The owner of the copy was given precedence not because the scrap value of the chattel was assumed to be greater than that of the work embedded therein, but because allowing the copyright owner to exercise downstream control was considered unnecessary and harmful. This may have worked well, but it has also conditioned us to think about the first-sale doctrine in terms of tangible objects that are owned and sold and ignore the more general principle of exhaustion that underlies it.

Digital technologies untie the enjoyment of a work from any particular physical object, but rather than rendering exhaustion obsolete, it allows us to conceive of the doctrine in its unexciting simplicity: a species of the general rule that people are generally free to transfer their legal entitlements to others.

The general rule in favor of free alienability has some exceptions, but it is one of the ground rules allowing "Trade and Traffic, and bargaining and contracting between man and man."<sup>169</sup>

This chapter has shown that as a general principle, exhaustion does not have to be limited to the distribution right, nor does it have to be confined to sales or enjoyed by

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<sup>165</sup> Katz, *First-Sale*, *supra* note 42, at 136.

<sup>166</sup> Katz, *The Economic Rationale for Exhaustion*, *supra* note 51, at 41; Katz, *First-Sale*, *supra* note 42, at 116–17.

<sup>167</sup> See generally Ariel Katz, *The Orphans, the Market, and the Copyright Dogma: A Modest Solution for a Grand Problem*, 27 BERKELEY TECH. L.J. 1285 (2012).

<sup>168</sup> Newman, *supra* note 140, at 524.

<sup>169</sup> COKE, *supra* note 125.

those who own particular tangible copies. It also demonstrated, through the example of several Canadian cases, how principles of exhaustion have been applied as a limit on copyright owners' power in a variety of cases involving both the reproduction right and the public performance right. There is no a priori reason why the principle of exhaustion could not and should not apply to works in digital form.

Digital exhaustion presents challenges, and the recognition of a principle does not automatically translate into operative rules. This chapter did not endeavor to provide such operative rules; my main goal was to shed light on and emphasize the principle. More time and experimentation will be required before good rules defining its precise contours could be formulated, but recognizing the principles animating them is a crucial starting point.<sup>170</sup>

The first-sale doctrine might be in crisis. Like others (rules, business models, individuals), it finds the transition to digital challenging. The rumors about its death, however, are premature.

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<sup>170</sup> For some proposals see Perzanowski & Schultz, *supra* note 1.