# REBALANCING AT RESALE: *REDIGI*, ROYALTIES, AND THE DIGITAL SECONDARY MARKET

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*This Note explores the various legal and policy considerations underlying resale of digital works against the backdrop of the* ReDigi *litigation. It considers the history and evolution of the first sale exception, the provision of copyright law that traditionally permits owners of lawfully acquired copies to resell them without first seeking the copyright holder's permission. This Note analyzes the conflicting conclusions drawn by courts and commentators with respect to digital resale. The* ReDigi *court, for example, held squarely that digital resale is impermissible, in part because the first sale exception is inapplicable to digital works. Some scholars, on the other hand, insist that digital resale is decidedly permissible as a matter of public policy and common law precedent. Finding both viewpoints inadequate, this Note concludes that the secondary markets enabled by the first sale exception continue to serve important purposes in the digital world and they must be preserved. To do so, Congress must rebalance the interests of copyright holders and consumers – that is to say, the public – by amending the Copyright Act to incorporate a resale royalty. The digital environment presents unique risks to copyright holders. A resale royalty can offset those risks and compensate copyright holders for the continued exploitation of their digital works. This Note then proposes a model for such a resale royalty scheme, looking both to proposed and existing resale royalties in the visual art context and to current royalties assessed and collected for digital performances of sound recordings. It concludes that a digital resale royalty, as part of a larger goal of preserving secondary markets and broadening the first sale exception to encompass digital works, effectively and fairly balances the novel and legitimate concerns of copyright holders with the traditional and important consumer ability to dispense with unwanted property, albeit digital.*

## INTRODUCTION

On February 6, 2012, an attorney for Capitol Records stood before the Honorable Judge Richard Sullivan of the United States District Court for the Southern District of New York and accused an upstart technology company of "opening up . . . Pandora's box."[1] Just one month before, Capitol Records filed suit against ReDigi, Inc. (ReDigi), a newcomer seeking to create an online resale marketplace for digital versions of music and books.[2] The lawsuit followed a cease-and-desist demand sent to ReDigi by the Recording Industry

[1] Transcript of Oral Argument at 6, Capitol Records, LLC v. ReDigi, Inc., No. 12-95, 2013 WL 1286134 (S.D.N.Y. Mar. 30, 2013).

[2] *See* Complaint, *ReDigi*, No. 12-95. ReDigi currently resells only digital music but plans to begin sales of digital books (also known as "e-books") in the near future. *See* Judith Rosen, *ReDigi Plans to Sell Used e-Books*, PUBLISHER'S WKLY. (July 27, 2012), http://www.publishersweekly.com/pw/by-topic/digital/retailing/article/53334-redigi-plans-to-sell-used-e-books.html.

Association of America (RIAA), a trade group of which Capitol Records is a member,[3] claiming that ReDigi's practices "constitute[] willful copyright infringement."[4] ReDigi's efforts to create a resale market for digital versions of legally purchased works aim only to bring a privilege that consumers frequently exercise offline – namely, the ability to resell books, CDs, DVDs, etc. – to the online environment. Given the recording industry's history of resistance to new technologies and business models,[5] it is perhaps unsurprising that the industry might feel threatened by ReDigi. In likening ReDigi's efforts to the opening of Pandora's Box, however, Capitol suggests that the emergence of secondary markets for digital works spells chaos for the recording industry. Together with RIAA, Capitol appears determined to keep consumers out of the used record shop of the future.

This Note explores the various legal and policy considerations underlying resale of digital works[6] against the backdrop of the *ReDigi* litigation. It considers the history and evolution of the first sale exception, the provision of copyright law that traditionally permits owners of lawfully acquired copies to resell them without first seeking the copyright holder's permission.[7] This Note analyzes the conflicting conclusions drawn by courts and commentators with respect to digital resale. The *ReDigi* court, for example, held squarely that digital resale is impermissible, in part, because the first sale exception is inapplicable to digital works.[8] Some scholars, on the other hand, insist that

[3] *See RIAA Members*, RECORDING INDUS. ASS'N AM., http://www.riaa.com/aboutus.php?content_selector=aboutus_members&f=c (last visited June 23, 2013).

[4] Letter from Jennifer L. Pariser, Senior Vice President of Litig., RIAA, to John Ossenmacher, CEO, ReDigi, Inc. (Nov. 10, 2011) (on file with author).

[5] As recently as August 2007, for instance, RIAA touted the value of CDs, even while acknowledging new music distribution technologies. *See* RECORDING INDUS. ASS'N OF AM., THE CD: A BETTER VALUE THAN EVER 2-3 (2007).

[6] Throughout this Note the term "digital works" refers to works of authorship, legally acquired, in digital file formats. In this way, the term will encompass works of text, music, recordings, and visual and audiovisual art saved across a panoply of common formats such as MP3, AIFF/WAV, JPG, ePub, iBooks, AZW, and PDF, along with other less common formats and those yet to be developed. The terms "digital resale" and "digital resale market" refer to online secondary markets that specialize in reselling lawfully acquired digital works.

[7] The first sale exception, as it exists today, is codified in the Copyright Act of 1976. Section 106(3) of the Copyright Act grants to copyright holders – initially authors who later may transfer their copyrights – the exclusive right to distribute copies of their works. 17 U.S.C. § 106(3) (2012). At the same time, however, the statute allows owners of lawfully owned *individual* copies to resell, give away, or donate them without the permission of the copyright holder. *Id.* § 109(a). It thus operates as an exception to the copyright holders' exclusive right to distribute their works. *Id.*; *see also infra* notes 76-77 and accompanying text.

[8] Capitol Records, LLC v. ReDigi, Inc., No. 12-95, 2013 WL 1286134, at *3 (S.D.N.Y. Mar. 30, 2013) ("The novel question presented in this action is whether a digital music file, lawfully-made and purchased, may be resold by its owner through ReDigi under the first sale doctrine. The Court determines that it cannot."). The *ReDigi* court further identified, as

digital resale is decidedly permissible as a matter of public policy and common law precedent. Finding both viewpoints inadequate, this Note argues that the secondary markets enabled by the first sale exception continue to serve important purposes in the digital world and they must be preserved. To do so, Congress must rebalance the interests of copyright holders[9] and consumers[10] – that is to say, the public – by amending the Copyright Act to incorporate a resale royalty. The digital environment presents unique risks to copyright holders. A resale royalty can offset those risks, compensating copyright holders for the continued exploitation of their digital works. This Note then proposes a model for such a resale royalty scheme, looking both to proposed and existing resale royalties in the visual art context and to current royalties assessed and collected for digital performances of sound recordings. It concludes that a digital resale royalty, as part of a larger goal of preserving secondary markets and broadening the first sale exception to encompass digital works, effectively and fairly balances the novel and legitimate concerns of copyright holders with the traditional and important consumer ability to dispense with unwanted property, albeit digital.

## I. REDIGI AND ITS MARKET

Launched in the fall of 2011, ReDigi serves as an online marketplace that "gives digital goods 'physicality,' [thereby] bringing the familiar process of selling a physical good (CD, vinyl, book, etc.) into the digital age."[11] Founded

a cause for concern about digital resale, that "the first sale doctrine was enacted in a world where the ease and speed of data transfer could not have been imagined." *Id.* at *11.

[9] This Note uses the term "copyright holder" to refer to those individuals or entities that are current owners of copyright(s) in a work and are thus able to assert any of the exclusive rights outlined in § 106. The term *holder* – as opposed to the term *owner* – avoids confusion during comparisons to owners of individual copies and reflects the notion that copyrights are frequently sold and transferred. Section 201 specifies that copyright in an eligible work "vests initially in the author or authors of the work," but later may be transferred "in whole or in part by any means of conveyance or by operation of law." 17 U.S.C. § 201(a), (d) (2012). Copyright transfers are a frequent occurrence in the music industry as *ReDigi* illustrates, wherein a record label seeks to enforce copyrights it holds vis-à-vis assignments and agreements with performers and other authors (assuming the record label does not hold copyright as the employer for hire, about which there is some debate). Thus, the term "copyright holder" is inclusive of a variety of interested parties over the term of a copyright, including authors, employers, companies, heirs, and the like.

[10] This Note uses the term "consumers" to refer to individuals and entities that use and rely on copyrighted works. Consumers are owners of particular copies of works – as opposed to copyright holders – and they represent the purchasing party in sales transactions involving copyrighted works. Consumers use copies of works in their possession. In this way, the term consumers, as defined, encompasses the public at large and effectively any party that is not the author or copyright holder of a given work.

[11] *Is ReDigi Legal? Yes!*, REDIGI, http://www.studiolegaleclipeo.it/blog/wp-content/uploads/2013/03/DOCUMENTO_Is-ReDigi-Legal-Yes.pdf (last visited Oct. 2, 2013) (hosting a

by CEO John Ossenmacher and former Massachusetts Institute of Technology researcher Larry Rudolph, ReDigi enables users to buy and sell preowned digital files in the same way that a traditional used book or record shop allows customers to purchase or trade in unwanted copies of works from their personal libraries.[12] Just like a brick-and-mortar secondhand shop, ReDigi resells only legally owned, lawfully purchased digital works and rejects pirated or unauthorized versions.[13] Using proprietary technology called the "Verification Engine," ReDigi uses metadata indicators to identify a digital work's source and confirm its eligibility for resale.[14] Once verified, the file is transferred to ReDigi's cloud-based system and a desktop client combs through the seller's computer and any synced devices to remove remaining duplicates.[15] When designated for sale by the user, the file appears as "in stock," allowing buyers to purchase it at an effective price of $0.59.[16] ReDigi claims the transfer process from the seller's computer to ReDigi's server ostensibly occurs by "atomic transaction" technology that "'migrat[es] a user's file, packet by packet[,] analogous to a train," without copying it.[17] Moreover, ReDigi asserts that any associated licenses transfer from seller to buyer as part of a sale by virtue of the atomic transaction.[18] The company takes a five to fifteen percent share of the sale price.[19]

copy of the webpage, which is no longer available on the ReDigi website).

[12] Brian Boyd, *For Sale: MP3's, One Careful Owner*, IRISH TIMES, Oct. 12, 2012, at 15; Jessica Leber, *A Startup Asks: Why Can't You Resell Old Digital Songs?*, MIT TECH. REV. (Aug. 15, 2012), http://www.technologyreview.com/news/428792/a-startup-asks-why-cant-you-resell-old-digital-songs.

[13] Leber, *supra* note 12 ("'You buy it, and you own it. You should be able to sell it,' says ReDigi chief technology officer Larry Rudolph . . . . 'If you steal it, you shouldn't be able to sell it. It's very simple.'").

[14] *Is ReDigi Legal? Yes!*, *supra* note 11; *see also* Ben Sisario, *Site to Resell Music Files Has Critics*, N.Y. TIMES, Nov. 15, 2011, at B1, *available at* http://www.nytimes.com/2011/11/15/business/media/reselling-of-music-files-is-contested.html.

[15] *See Is ReDigi Legal? Yes!*, *supra* note 11. Judge Sullivan colorfully characterized ReDigi's "Cloud" system as "an ethereal moniker for what is, in fact, merely a remote server in Arizona." Capitol Records, LLC v. ReDigi, Inc., No. 12-95, 2013 WL 1286134, at *1 (S.D.N.Y. Mar. 30, 2013).

[16] ReDigi generally prices works at $0.79 each, subject to $0.20 "ReDigi Coupons" that users receive upon offering works for sale. *See, e.g.*, *RIAA Goes After ReDigi for Selling "Used" iTunes Tracks*, ELECTRONISTA (Nov. 15, 2011, 10:25 PM), http://www.electronista.com/articles/11/11/15/trade.group.demands.access.to.sales.records. Thus, the effective price for most files is usually $0.59. *See id.*

[17] *ReDigi*, 2013 WL 1286134, at *1. The court found the various metaphors the company relied on to describe its technology to be amusing but unconvincing. *Id.* at n.2 ("A train was . . . one of the many analogies used to describe ReDigi's service. At oral argument, [it] was likened to the Star Trek transporter – 'Beam me up, Scotty' – and Willy Wonka's teleportation device, Wonkavision.").

[18] *Is ReDigi Legal? Yes!*, *supra* note 11.

[19] Sisario, *supra* note 14.

Notwithstanding all of ReDigi's technological innovations, ReDigi is not the first company to jump into the digital secondary market. In 2008, Bopaboo, a company based in Washington, D.C., built a similar online marketplace for audio files lacking digital rights management (DRM) protections.[20] Unlike ReDigi, however, Bopaboo had no mechanism in place to ensure that its members were not retaining copies of files they put up for sale.[21] Instead, Bopaboo simply asked its members to adhere to a user agreement specifying that only lawfully acquired files were eligible for resale and that all remaining copies must be deleted after the sale.[22] Bopaboo ultimately abandoned its efforts after fierce opposition from copyright holders and after failing to secure licenses or revenue-sharing agreements.[23]

Bopaboo's failure reflects, in part, the persistent paranoia of copyright holders regarding the ease of copying and transferring digital works.[24] Haunted by the online-piracy culture unleashed by Napster – the recording industry's original Pandora's Box – copyright holders are justifiably wary of any online efforts to facilitate sales or sharing that are beyond their reach.[25] They worry further that the availability of identical, albeit preowned, digital works at lower prices will cannibalize sales on the primary market.[26] But, for over a century consumers have enjoyed the benefits associated with a thriving secondary

[20] Nakimuli Davis, *Reselling Digital Music: Is There a Digital First Sale Doctrine?*, 29 LOY. L.A. ENT. L. REV. 363, 368 (2009). Presumably, Bopaboo focused on DRM-free files to avoid violations of the anticircumvention measures of the Digital Millennium Copyright Act (DMCA). *See* 17 U.S.C. § 1201 (2012) ("No person shall circumvent a technological measure that effectively controls access to a work protected under this title.").

[21] *See* Davis, *supra* note 20, at 368.

[22] Matthias Marcus Glathaar, Resale of Digital Music: *Capitol Records v. ReDigi* 12 (Apr. 30, 2012) (unpublished LL.M. thesis, Harvard University), *available at* http://ssrn.com/abstract=2172403; Greg Sandoval, *Reselling MP3s: The Music Industry's New Battleground?*, CNET NEWS (Dec. 11, 2008, 4:00 AM), http://news.cnet.com/8301-1023_3-10120951-93.html.

[23] Glathaar, *supra* note 22, at 12; Sisario, *supra* note 14. In what seemed to serve as a farewell tweet to members and fans, Bopaboo acknowledged that while its quest to launch a digital secondary market may have ended, the stage was set for others to follow in its footsteps: "[W]e are quietly bopaboo'ing away. [Y]'all just sit tight." Bopaboo, TWITTER (Apr. 28, 2009, 5:57 PM), https://twitter.com/bopaboo/status/1643484483.

[24] *See, e.g.*, Transcript of Oral Argument, *supra* note 1, at 30-31 ("There's a lot of effort to sell infringing copies, and asking [Capitol] against that backdrop and decades of litigation and experience to take it at face value that people are going to do the right thing, I don't think that's something that [it has] to do . . . .").

[25] *See id.* at 6 ("[T]here's a real risk that . . . infringement is going to be very widespread and Capitol will lose control of its assets, its copyrights, its most valuable assets.").

[26] *See* Keith Kupferschmid, *Lost in Cyberspace: The Digital Demise of the First-Sale Doctrine*, 16 J. MARSHALL J. COMPUTER & INFO. L. 825, 848 (1998) ("A digitized book or digital audiotape . . . will not degrade in quality, and thus the resale market for these products will compete with the market for the copyright owner's products.").

market, including improved affordability and enhanced availability.[27] In an increasingly digital world, will those benefits survive fierce industry opposition and legal scrutiny by skeptical courts? Even if ReDigi, in the wake of its loss to Capitol Records, also "bopaboo's away," other resellers are poised to jump into the fray. Both Apple and Amazon have recently sought patents on technologies to permit resale of digital works.[28] With further attempts to jump into the digital secondary market on the horizon, whether and how the first sale exception applies to digital works is likely to remain an important question of law and policy.

## II. JUMPING INTO THE DIGITAL SECONDARY MARKET: THREE HURDLES

Any aspiring purveyor of preowned digital works must clear three major hurdles before creating an effective and legal digital resale market. These obstacles include the frequent use of licenses in the "sale" of digital files; the fact that computer systems necessarily copy digital files when "moving" them; and uncertainty as to whether the first sale exception, which permits resale in the physical world, applies in the digital one. Though ReDigi claimed that its business model addressed each of these issues, Judge Sullivan thought otherwise.

### A. *Licensing and Ownership of Digital Works*

Unlike the sale of a CD or textbook, the sale of a digital work does not offer to the purchaser any physical property interest. When a consumer purchases an album on CD, for instance, he acquires an article of personal property along with all of the prerogatives associated with it; he is the owner of that CD.[29] In part because of their ease of duplication and distribution, digital works are often offered to consumers pursuant to license agreements. Before purchasing a digital song, for example, a consumer agrees to a lengthy and sometimes opaque licensing agreement that specifies that he is not purchasing a song in the traditional sense, but merely acquiring a license for its use.[30] Frequently,

[27] *See* discussion *infra* Part III.C.

[28] *See* Ben Lovejoy, *Apple Patent Applications Address User-to-User Resale and Lending of iTunes Store Content*, MACRUMORS (Mar. 7, 2013, 6:33 AM), http://www.macrumors.com/2013/03/07/apple-patent-applications-address-user-to-user-resale-and-lending-of-itunes-store-content; David Streitfeld, *Imagining a Swap Meet for E-Books and Music*, N.Y. TIMES (Mar. 7, 2013), http://www.nytimes.com/2013/03/08/technology/revolution-in-the-resale-of-digital-books-and-music.html.

[29] Lawrence J. Glusman, Comment, *It's My Copy, Right? Music Industry Power to Control Growing Resale Markets in Used Digital Audio Recordings*, 1995 WIS. L. REV. 709, 713. The CD embodies the copyrighted work contained therein. *See infra* notes 76-77 and accompanying text.

[30] Brian W. Carver, *Why License Agreements Do Not Control Copy Ownership: First Sales and Essential Copies*, 25 BERKELEY TECH. L.J. 1887, 1896 (2010) (describing how copyright holders "use the word 'license' to describe a permanent transfer of a copy of a

the license terms prohibit not only resale but also *any* subsequent transfer.[31] In such cases, the consumer can neither sell the song outright, since he does not have title to the file, nor sell the license. In effect, resale is foreclosed.[32]

copyrighted work in which the transferor purportedly retains full title to and ownership of the transferred copy" in the digital context, and how "[n]o other type of transfer of a tangible good is comparable").

[31] Amazon, for instance, requires its digital music customers to adhere to terms of use that do not allow customers to "assign, sell, broadcast, rent, share, lend, . . . license or otherwise transfer" any audio recordings. *Amazon MP3 Store: Terms of Use*, AMAZON, http://www.amazon.com/gp/help/customer/display.html?nodeId=200154280 (last visited June 23, 2013). Such expansive terms even seem to prohibit transfers from beyond the grave. *See* Quentin Fottrell, *Who Inherits Your iTunes Library? Why Your Digital Books and Music May Go to the Grave*, WALL ST. J. MARKETWATCH (Aug. 23, 2012, 4:57 PM), http://articles.marketwatch.com/2012-08-23/finance/33336852_1_digital-content-digital-files-apple-andamazon.

[32] Recently, a loophole has emerged in the licensing model. Amazon, which purports to license all of its digital content rather than sell it to purchasers, has introduced a service called AutoRip. *See Learn More About AutoRip*, AMAZON, http://www.amazon.com/gp/help/customer/display.html/?nodeId=200997290 (last visited June 23, 2013). The moniker "AutoRip" evokes images of the (arguably) infringing practice of "ripping" music from a CD to a computer (that is, from a physical to a digital format). More importantly, the service offers a way for purchasers to navigate around Amazon's own digital content license terms. When a consumer purchases an album on CD that is in the AutoRip program, "a free MP3 version of that album is [included for use on a] PC or Mac computer, or other connected device." *Id.* Presumably, the Amazon MP3 version is subject to the regular Amazon MP3 license, though the AutoRip terms do not specifically address this issue. *See AutoRip Terms and Conditions*, AMAZON, http://www.amazon.com/gp/help/customer/display.html/?nodeId=201114300#tandc (last visited June 23, 2013). If so, then the general Amazon MP3 license limits the consumer's ability to sell his MP3 version. *See supra* note 31 and accompanying text. But the AutoRip terms, which specify that a consumer will be charged the MP3 price if he downloads the MP3 version and then returns the CD or cancels the order, do not prevent a consumer from later reselling the CD but retaining the digital album. *Id.* As a result, a consumer can purchase a CD, also receive the digital version courtesy of AutoRip, and then resell the CD to recoup most of the purchase price. To illustrate, the recent album from the band The Strokes, released on March 26, 2013, is available from Amazon for $9.99, for both the CD (with AutoRip) and the MP3 version alone. *Comedown Machine*, AMAZON, http://www.amazon.com/Comedown-Machine-TheStrokes/dp/B00B9LNLTQ/ref=ntt_mus_dp_dpt_1 (last visited June 23, 2013). If a consumer purchases the MP3 version, he can never resell it, per both Amazon's license terms and the decision in *ReDigi* that the first sale exception does not apply to digital works. But, for the same price, the consumer can purchase the CD, which comes with the AutoRip MP3 version, on the primary market, and resell that CD, unopened, on the traditional secondary market. He can do this without infringing any copyrights or violating any licenses because the § 109(a) first sale exception, as construed by *ReDigi*, permits the resale of the physical CD but not the digital album. Capitol Records, LLC v. ReDigi, Inc., No. 12-95, 2013 WL 1286134, at *11 (S.D.N.Y. Mar. 30, 2013) (distinguishing physical from digital audio records to hold that the "first sale defense does not permit sales of digital music files on ReDigi's website").

Given such expansive – and indeed, draconian – restrictions, licenses are unsurprisingly generating controversy. In a world that increasingly relies on digital files to exchange works of authorship, whether music, movies, or e-books, the proliferation of licensed-only works presages a world in which consumers can never truly "own" copies of their favorite works.[33] As some scholars have opined, these licenses "attempt to give consumers the *appearance* of ownership, while legally restricting the transfer of title to the physical copy."[34] Such a world clearly presents novel questions that are particular to copyright and secondary markets.

Perhaps envisioning a world without ownership, observers and even some courts are starting to explore its implications. Courts may begin to look beyond the existence of a license or its terms to determine whether any transfer of a work to a consumer constitutes a sale that transfers title.[35] The Ninth Circuit, for instance, has suggested that the characterization of a transfer as a license rather than a sale may *indicate* that the transaction does not transfer title, but that a label alone is not dispositive.[36] The Ninth Circuit deploys a three-part test to ascertain when a consumer is a licensee rather than an owner, at least in the software context.[37] That approach has prompted some to conclude the Ninth Circuit, at least, is open to the notion that "the right to perpetual possession of a copy is indicative of ownership" regardless of any purported license agreement.[38] Even as it enforces licenses, the Ninth Circuit has voiced concerns about the licensing model generally, observing that license agreements often resemble contracts of adhesion and have potential to reach all species of works.[39] In addition, some scholars have argued that the licenses,

[33] Aaron Perzanowski, Assistant Professor, Wayne State Univ., Remarks at the New York Law School In re Books Symposium: In re Readers (Oct. 26, 2012) (urging courts and scholars to "resist the conclusion that everyone's a mere licensee").

[34] Aaron Perzanowski & Jason Schultz, *Digital Exhaustion*, 58 UCLA L. REV. 889, 902 (2011) (emphasis added).

[35] R. Anthony Reese, *The First Sale Doctrine in the Era of Digital Networks*, 44 B.C. L. REV. 577, 645 (2003) ("Courts might be especially cautious in characterizing a copyright owner's transaction with a consumer as a license rather than a sale, giving careful scrutiny to the actual reality of the transaction rather than to any labels used by the copyright owner.").

[36] UMG Recordings, Inc. v. Augusto, 628 F.3d 1175, 1180 (9th Cir. 2011) ("[T]he mere labeling of an arrangement as a license rather than a sale, although it was a factor to be considered, was not by itself dispositive of the issue.").

[37] Vernor v. Autodesk, Inc., 621 F.3d 1102, 1111 (9th Cir. 2010) ("[A] software user is a licensee rather than an owner of a copy where the copyright owner (1) specifies that the user is granted a license; (2) significantly restricts the user's ability to transfer the software; and (3) imposes notable use restrictions.").

[38] Sarah Abelson, *An Emerging Secondary Market for Digital Music: The Legality of ReDigi and the Extent of the First Sale Doctrine*, 29 ENT. & SPORTS LAW. 8, 9 (2012) (citing Carver, *supra* note 30, at 1920-25).

[39] *Vernor*, 621 F.3d at 1115.

often a matter of state contract law, are preempted by federal copyright law and are therefore unenforceable.[40] Still others insist that even if such licenses are valid under the Copyright Act, they remain subject to certain basic common law principles that would permit resale.[41] Thus, while licenses restricting digital resale remain valid and enforceable today, it is far from certain they will remain so permanently or unconditionally. In the meantime, resellers like ReDigi exclude licensed content from their resale portfolios.[42]

While the Ninth Circuit criticizes licenses, yet upholds them, these license arrangements have faced tougher scrutiny in Europe. Recently, the Court of Justice of the European Union issued a landmark decision in *UsedSoft GmbH v. Oracle International Corp.*[43] UsedSoft enabled companies or other entities to resell software licenses they had purchased but did not use or need.[44] Holding that content licenses may not prohibit further transfer or resale, the court found that downloading a copy of a copyright holder's software coupled with the execution of a license for its use "form an indivisible whole which . . . must be classified as a sale."[45] The court justified its holding with compelling policy reasoning; the court feared that proprietors would label transactions as licenses rather than sales "in order to circumvent the rule of exhaustion and divest it of all scope."[46] Echoing the concerns of copyright holders, the court warned that when a work is resold in this manner, the seller must make his copy "unusable at the time of resale" in order to avoid infringement.[47]

After *UsedSoft*, with licenses subject to limitations in Europe, pressure may increase for courts in the United States to follow suit. Regardless, the *UsedSoft* decision must serve as a welcome development for ReDigi and other entrepreneurs seeking to build a digital secondary market. Indeed, ReDigi has recently announced plans to move into the European market.[48] For now, in the

[40] Reese, *supra* note 35, at 646.

[41] Perzanowski & Schultz, *supra* note 34, at 904 ("Copyright owners who exchange perpetual possession of a copy for a payment . . . remain bound by copyright's exhaustion rules.").

[42] *See infra* note 49 and accompanying text (discussing how ReDigi bypasses the licensing issue).

[43] Case C-128/11, UsedSoft GmbH v. Oracle Int'l Corp. (July 3, 2012), http://curia.europa.eu/juris/document/document.jsf?text=&docid=124564&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=887724.

[44] *Id.* para. 24 ("UsedSoft markets used software licenses . . . . For that purpose UsedSoft acquires from customers of Oracle such user licenses, or parts of them, where the original licenses relate to a greater number of users than required by the first acquirer.").

[45] *Id.* para. 84.

[46] *Id.* para. 49. Exhaustion refers to the set of rights that pass to the buyer as part of a traditional sale of a work, allowing that buyer a bundle of rights including a right of resale.

[47] *Id.* para. 78.

[48] ReDigi announced its plan to make preowned music available to "European music lovers" on its website. *See* REDIGI, http://archive.is/5PZE (last visited Oct. 2, 2013) (hosting a copy of the webpage, which is no longer available on the ReDigi website).

United States at least, ReDigi largely bypasses the licensing issue by deploying its "Verification Engine" to render eligible only those files that are owned rather than licensed.[49]

### B. *Intermediate Copying, Fair Use, and "Atomic Transaction" Technology*

Technology uniquely affects digital secondary markets. In a world of physical goods, when the owner of a paperback book, for instance, resells it to a buyer, the transferred article is the exact one put up for sale. Under Supreme Court precedent and the Copyright Act's first sale exception, codified at 17 U.S.C. § 109 (2012), the copyright holder cannot prohibit such further *distribution* of a work via resale.[50] But the transfer of a digital work implicates the copyright holder's exclusive *reproduction* right as well.[51] In other words, moving a file from one digital location to another necessarily reproduces it.[52] Unlike the paperback, a digital work cannot simply be carried to the new location; the work is copied to it instead.[53]

This copying, a byproduct of technology, is a major hurdle for would-be resellers. In 1993, the Ninth Circuit held in *MAI Systems Corp. v. Peak*

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[49] Rosen, *supra* note 2 (reporting that ReDigi resells iTunes files but cannot accept files from Amazon because it purports to license them); Rick Sanders, *ReDigi: A Digital Secondary Market*, AARON SANDERS PLLC L. BLOG, (Oct. 19, 2011), http://www.aaronsanderslaw.com/blog/redigi-a-digital-secondary-market-part-15-of-our-online-music-services-series (discussing how the iTunes end-user license agreement does not term its purchases "licenses" and therefore arguably transfers title); *see also* Transcript of Oral Argument, *supra* note 1, at 46 ("One of the reasons that we started out this business model with iTunes is because iTunes sells the title to the MP3."). *But see Is ReDigi Legal? Yes!*, *supra* note 11 (explaining that ReDigi's technology transfers both the file and the corresponding license).

[50] *See* discussion *infra* Part II.C.

[51] *See* 17 U.S.C. § 106(1) (2012) (giving the copyright holder the "exclusive rights . . . to reproduce the copyrighted work"); Kupferschmid, *supra* note 26, at 839 ("When a work is transmitted from one computer to another, a temporary copy of the work is made in the RAM of the 'receiving' computer. Although this RAM copy is a temporary copy, it is a copy nonetheless and therefore implicates the copyright owner's reproduction right." (citation omitted)).

[52] *See infra* note 57 (discussing how copies made during a computing process can infringe a copyright holder's reproduction rights); *see also* WORKING GRP. ON INTELLECTUAL PROP. RIGHTS, INTELLECTUAL PROPERTY AND THE NATIONAL INFORMATION INFRASTRUCTURE 66 (1995) [hereinafter WHITE PAPER], *available at* http://www.uspto.gov/web/offices/com/doc/ipnii/ipnii.pdf ("When a file is transferred from one computer network user to another, multiple copies generally are made.").

[53] *See* Capitol Records, LLC v. ReDigi, Inc., No. 12-95, 2013 WL 1286134, at *5 (S.D.N.Y. Mar. 30, 2013) ("Because 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 Court determines that the embodiment of a digital music file on a new hard disk is a reproduction within the meaning of the Copyright Act.").

*Computer, Inc.* that copies of software made in a computer's random access memory (RAM) during a program's use were sufficiently fixed to be considered "copies" under § 101, thereby implicating the copyright holder's § 106(1) reproduction right.[54] In 1995, the Clinton Administration issued a white paper reinforcing this interpretation.[55] Later, Congress effectively ratified this view by adding an exception to § 117 to allow computer repair technicians to make such RAM copies.[56] Outside § 117, copies made in RAM or elsewhere during a computing process can infringe a copyright holder's exclusive reproduction rights under § 106(1).[57] Consequently, when copying occurs in the transfer process at resale, such as during uploading and downloading from the ReDigi cloud, infringement also occurs.[58] Moreover, after resale, additional infringement may occur vis-à-vis the purchaser's use of the preowned digital works, when creation of further RAM copies is necessary in order to access, read, watch, or listen to these works.[59] Finally, while both *MAI* and the § 117 amendment specifically concerned software, courts have not shown reluctance to apply the same principles to other species of digital works.[60]

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[54] MAI Sys. Corp. v. Peak Computer, Inc., 991 F.2d 511, 518-19 (9th Cir. 1993), *cert. dismissed*, 510 U.S. 1033 (1994).

[55] Joseph P. Liu, *Owning Digital Copies: Copyright Law and the Incidents of Copy Ownership*, 42 WM. & MARY L. REV. 1245, 1261 (2001) (quoting WHITE PAPER, *supra* note 52, at 17, 64, 211-20). Indeed, Professor Liu has criticized "the Clinton administration's wholesale adoption of the *MAI* decision as settled law." *Id.*

[56] *Id.* at 1261-62. Section 117(c) provides, in relevant part:

> Notwithstanding the provisions of section 106, it is not an infringement for the owner or lessee of a machine to make or authorize the making of a copy of a computer program if such copy is made solely by virtue of the activation of a machine that lawfully contains an authorized copy of the computer program, for purposes only of maintenance or repair . . . .

17 U.S.C. § 117(c) (2012); *see also* Kupferschmid, *supra* note 26, at 843-44 (arguing that the broadness of § 117 indicates that Congress believes copies created in RAM are sufficiently fixed to be infringing).

[57] *See* Liu, *supra* note 55, at 1265 ("When a digital work is sent over the Internet, numerous temporary copies are made in the many computers on the Internet through which the work passes. So, if I send a copy of a work to a friend, temporary copies will be made on the computers of my Internet service provider (ISP), on various routers on the Internet, on my friend's service provider, and [ultimately] on my friend's computer. Each of these copies could potentially result in infringement under *MAI*.").

[58] Of course, this conclusion assumes the copying is not excused by some other exception in the Copyright Act, such as fair use. *See infra* notes 61-69 and accompanying text.

[59] Eurie Hayes Smith IV, Comment, *Digital First Sale: Friend or Foe?*, 22 CARDOZO ARTS & ENT. L.J. 853, 857 (2005).

[60] Liu, *supra* note 55, at 1263 ("[N]othing in the reasoning [of *MAI*] prevents it from being extended from computer software to any and all works stored in digital form, such as images, text documents, sound recordings, and motion pictures. Indeed, several federal

Some have argued that intermediary copies created during the resale of a digital file are defensible under § 107, the doctrine of fair use.[61] The *ReDigi* court, however, unequivocally rejected that defense.[62] The court determined that "[e]ach of the statutory factors counsels against a finding of fair use."[63] It deemed ReDigi's use of copyrighted works nontransformative and "undoubtedly commercial."[64] Moreover, Judge Sullivan found that ReDigi copied works "in their entirety."[65] Finally, Redigi's resales were detrimental to copyright holders because ReDigi's sales "divert buyers away from the primary market."[66]

In finding against ReDigi, Judge Sullivan rejected ReDigi's argument that analogized the transfer of a file from one electronic locale to another, "space shifting," to the fair use recognized by the Supreme Court in *Sony Corp. of America v. Universal City Studios, Inc.*, "time shifting."[67] In *Sony*, the Court held that recording a broadcast program on a home VCR for viewing at a time other than its airtime was permissible fair use.[68] ReDigi argued that copying a file in order to move it from one storage area to another, as in from a seller's computer to ReDigi's cloud, was likewise permissible.[69] But unlike in *Sony*,

courts have extended the rule in *MAI* to just such digital works."); Perzanowski & Schultz, *supra* note 34, at 935 (discussing how the rationales underlying RAM copies of software programs apply to all digital works).

[61] *See* Smith IV, *supra* note 59, at 857; *cf.* 17 U.S.C. § 107 (2012) ("In determining whether the use made of a work in any particular case is a fair use the factors to be considered shall include – (1) the purpose and character of the use, including whether such use is of a commercial nature or is for nonprofit educational purposes; (2) the nature of the copyrighted work; (3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and (4) the effect of the use upon the potential market for or value of the copyrighted work.").

[62] *See* Capitol Records, LLC v. ReDigi, Inc., No. 12-95, 2013 WL 1286134, at *9 (S.D.N.Y. Mar. 30, 2013) ("ReDigi facilitates and profits from the sale of copyrighted commercial recordings, transferred in their entirety, with a likely detrimental impact on the primary market for these goods. Accordingly, the Court concludes that the fair use defense does not permit ReDigi's users to upload and download files to and from [ReDigi's server] incident to sale.").

[63] *Id.* at *8.

[64] *Id.*

[65] *Id.* at *9.

[66] *Id.*

[67] *See* Defendant's Memorandum of Law in Opposition to Plaintiff's Motion for a Preliminary Injunction at 9-10, *ReDigi*, 2013 WL 1286134 (No. 12-95) (citing, e.g., Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417, 429 (1984)).

[68] *Sony Corp. of Am.*, 464 U.S. at 454-55 ("[W]e must conclude that this record amply supports the District Court's conclusion that home time-shifting is fair use.").

[69] *See* Defendant's Memorandum of Law, *supra* note 67, at 10 (citing Recording Indus. Ass'n of Am. v. Diamond Multimedia Sys., 180 F.3d 1072, 1079 (9th Cir. 1999)). *Diamond* involved a dispute between copyright holders and the manufacturer of the Rio, a portable digital music device that enabled users to copy music from their computer hard drives for

ReDigi's space shifting is not for personal use, but rather to aid a commercial transaction. As the *ReDigi* court recognized, fair use provides an unconvincing defense to the copying necessary to effectuate digital resale.

ReDigi's space-shifting arguments, as well as its assertions that the resale of any particular file simultaneously transfers any associated licenses,[70] seem to implicitly acknowledge that copying does indeed occur during the resale process. Nevertheless, ReDigi has insisted at other times that copying does *not* occur when customers use its service because of its "patent-pending Atomic Transaction technology."[71] Indeed, ReDigi's technology was characterized as follows in the *MIT Technology Review*: "While [ReDigi] can't literally move a file's digital bits from one place to another, it has adopted methods originally developed in the banking industry to ensure that a digital song or book, just like digital money, is never in two places at once."[72] Echoing this characterization at oral argument, ReDigi's counsel asserted that no copies are made during the use of ReDigi's service.[73] The *ReDigi* court rejected that argument.[74] Even if ReDigi's technology worked as claimed and, just like electronic funds, two digital files – or even portions thereof – could never be in two different places, does copying truly occur? The *ReDigi* court said yes, because it is the very creation of a new copy that violates the copyright holder's exclusive reproduction right; a new copy does not evince an additional copy.[75] From this perspective, technology is a significant hurdle to digital resale, one that calls for a legislative fix authorizing intermediary copies in order to enable digital secondary markets.

on-the-go listening. *Diamond*, 180 F.3d at 1073. Citing *Sony*, the Ninth Circuit found such a use to be permissible, remarking: "The Rio merely makes copies in order to render portable, or 'space-shift,' those files that already reside on a user's hard drive. Such copying is paradigmatic noncommercial personal use . . . ." *Id.* at 1079 (citing *Sony Corp. of Am.*, 464 U.S. at 455).

[70] *See supra* note 49 and accompanying text.

[71] *Is ReDigi Legal? Yes!*, *supra* note 11.

[72] Leber, *supra* note 12.

[73] ReDigi's counsel, however, did not take a position on uploads to ReDigi by resellers at the outset, indicating only that once digital works are received by ReDigi, no copying occurs. Transcript of Oral Argument, *supra* note 1, at 13 ("[T]here is no copy made. The sale transaction which take[s] place is done without copying, it's done with the exact file that's uploaded.").

[74] *See* discussion *infra* Part II.C.2.

[75] Capitol Records, LLC v. ReDigi, Inc., No. 12-95, 2013 WL 1286134, at *5-6 (S.D.N.Y. Mar. 30, 2013) ("Simply put, it is the creation of a *new* [copy] and not an *additional* [copy] that defines the reproduction right. . . . It is beside the point that the original phonorecord no longer exists. It matters only that a new phonorecord has been created."); *see also* discussion *infra* Part II.C.2.

### C. *First Sale in a Digital World*

To resell digital works lawfully, consumers must rely on the Copyright Act's first sale exception as allowing the further distribution of their legally acquired copies or phonorecords. The exception's applicability to digital works, however, remains contentious. This uncertainty presents a significant hurdle to the development of a digital secondary market. Returning to the common law roots of the first sale exception demonstrates that the Copyright Act's text alone is insufficient to evaluate the exception's applicability to digital works.

#### 1. The Statutory Language and Its Origins

Section 109 of the Copyright Act of 1976 contains the provision commonly known as the "first sale" exception.[76] This provision serves as a limitation on the exclusive right of copyright holders to distribute copies of works, as conferred by § 106(3).[77] For over a century, that provision and its predecessors have legally sanctioned resale of works at neighborhood used book and record shops, yard and estate sales, library and school surplus sales, and online book resellers at web marketplaces such as Amazon, eBay, or Half.com. In addition, first sale permits the exchange of works among friends and family members via borrowing or trade as well as the gifting of works between individuals.

[76] 17 U.S.C. § 109(a) (2012) ("Notwithstanding the provisions of section 106(3), the owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord."). The Copyright Act specifies that "copies" and "phonorecords" are mutually exclusive. The term "phonorecord" refers specifically to the embodiments of sound recordings, such as CDs or cassette tapes, while the term "copies" refers to everything else, including books, sheet music, paintings, sculptures, and the like. *Id.* § 101. Section 101 further specifies that embodiments of audiovisual works, such as films and movies, are *not* phonorecords; thus, movie DVDs and VHS tapes must be copies. *Id.*

[77] Section 106(3) grants copyright owners the exclusive right "to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending," and absent § 109, suggests that copyright holders could control or forbid subsequent sales of such copies. *Id.* § 106(3). The Supreme Court recently explained the interaction between the two statutory provisions as follows:

> [E]ven though § 106(3) forbids distribution of a copy of, say the copyrighted novel Herzog without the copyright owner's permission, § 109(a) adds that, once a copy of Herzog has been lawfully sold (or its ownership otherwise lawfully transferred), the buyer of *that copy* and subsequent owners are free to dispose of it as they wish. In copyright jargon, the "first sale" has "exhausted" the copyright owner's § 106(3) distribution right.

Kirtsaeng v. John Wiley & Sons, Inc., 133 S. Ct. 1351, 1355 (2013). As the Court's example suggests, § 109(a)'s first sale exception applies only to the distribution right in § 106(3), and not to any other exclusive right delineated in that section. *See* Kupferschmid, *supra* note 26, at 832.

This aspect of copy ownership is a manifestation of a broader right, endogenous to property ownership, of alienation.[78]

In 1908, the Supreme Court in *Bobbs-Merrill Co. v. Straus* expressly recognized a limit on a copyright holder's control over a particular copy after its initial sale.[79] The Court held that the owner of copyright in a novel, after selling it to retailer Macy's, could not impose restrictions on the retail price Macy's offered to consumers, at least not by sheer notice or demand.[80] The Court emphasized that copyright law vested the copyright holder with "the sole right to vend copies," but that right had already been exercised when copies were sold to the retailer in the first instance; any further control beyond that first sale was outside the language of the statute as well as the intent of Congress.[81] The following year, the *Bobbs-Merrill* holding was incorporated into section 41 of the Copyright Act of 1909, which provided that "the copyright is distinct from the property in the material object copyrighted" and that "nothing in this Act shall be deemed to forbid, prevent, or restrict the transfer of any copy of a copyrighted work the possession of which has been lawfully obtained."[82]

The statutory first sale provisions have always included (or presumed) copy physicality. The 1909 Act differentiates copyright in a work from the "material object" in which the work is embodied.[83] The "material object" wording was dropped from the 1976 Act's first sale provision, which recognized the right of

[78] *See, e.g.*, John D. Park & Sons Co. v. Hartman, 153 F. 24, 39 (6th Cir. 1907) ("The right of alienation is one of the essential incidents of a right of general property in movables, and restraints upon alienation have been generally regarded as obnoxious to public policy, which is best subserved by great freedom of traffic in such things as pass from hand to hand.").

[79] 210 U.S. 339, 350-51 (1908).

[80] *Id.* ("[T]he copyright statutes, while protecting the owner of the copyright in his right to multiply and sell his production, do not create the right to impose, by notice . . . a limitation at which the book shall be sold at retail by future purchasers . . . ."). Interestingly, the inclusion of the phrase "by notice," along with the Court's recognition that "[t]here is no claim in this case of contract limitation, no license agreement controlling the subsequent sales of the book," suggests that equivalent contractual restrictions can be permissible. *See id.* Indeed, such restrictions have since been upheld, particularly in the software context. *See* ProCD, Inc. v. Zeidenberg, 86 F.3d 1447, 1449 (7th Cir. 1996) ("Shrinkwrap licenses are enforceable unless their terms are objectionable on grounds applicable to contracts in general."). An early recognition in *Bobbs-Merrill* that sanctions restrictive licenses could present further difficulties for digital resellers, at least insofar as resellers seek to challenge restrictions in the licenses attached to digital works.

[81] *Bobbs-Merrill*, 210 U.S. at 351 ("To add to the right of exclusive sale the authority to control all future retail sales . . . would give a right not included in the terms of the statute, and, in our view extend its operation . . . beyond its meaning, when interpreted with a view to ascertaining the legislative intent in its enactment.").

[82] Copyright Act of 1909, ch. 320, 35 Stat. 1075, 1084, *repealed and superseded by* Copyright Act of 1976, Pub. L. No. 94-553, 90 Stat. 2541.

[83] *Id.*

a lawful owner "to sell or otherwise dispose of the possession of [a] copy or phonorecord."[84] But the wording reappeared in § 101, which defines both copies and phonorecords as "material objects."[85] Indeed, the Supreme Court's use of the word "book," as opposed to "work," in *Bobbs-Merrill* highlights how the Court foresaw only physical works.

Textually, then, because § 101 defines copies and phonorecords as material objects, and because the first sale exception in § 109 applies only to copies and phonorecords, the exception is inapplicable to digital works, which are not material objects.[86] Or alternatively, the exception is inapplicable for all practical purposes.[87] If so, resale of a digital music file or e-book by ReDigi or a similar merchant would violate the copyright holder's distribution right under § 106(3). An exclusively textual or formalistic reading of the first sale exception thus suggests that § 109 will wither as consumers shift from physical textbooks, paperback novels, CDs, and the like, toward digital works.[88] Therefore, the statutory text alone, a relic from another era, offers an inadequate approach to first sale in the modern age of digital works.

2. Fixed on Fixation

At the outset, for a work to be eligible for copyright protection, it must first be "fixed" under § 102.[89] Section 101 defines "fixed" in such a way that points back to the "material objects" definitional language of "copies" and

[84] Copyright Act of 1976 § 109(a) (codified as amended at 17 U.S.C. § 109 (2012)).

[85] *Id.* § 101 (codified as amended at 17 U.S.C. § 101 (2012)).

[86] Judge Sullivan analyzed ReDigi's technology from a perspective informed by the statutory text and reminiscent of the *MAI* decision, concluding that the digital works at issue were fixed in portions of the computer hard drives and other components housing them. *See infra* notes 92-97 and accompanying text. As I define them, however, digital works are fixed in digital file formats, not in tangible mediums. *See supra* note 6.

[87] Capitol Records, LLC v. ReDigi, Inc., No. 12-95, 2013 WL 1286134, at *11 (S.D.N.Y. Mar. 30, 2013) (determining that the first sale exception shields consumers who resell a physical component housing a digital work, "be it a computer hard disk, iPod, or other memory device onto which the file was originally downloaded"). Naturally, such a resale is impractical should a consumer wish to sell only a particular digital work, or even a particular series of digital works.

[88] Reese, *supra* note 35, at 579 ("The first sale doctrine may remain on the books, authorizing copy owners to resell, rent, or lend their [physical] copies, but if few or no copies of copyrighted works exist, then the doctrine will essentially be a dead letter."); *see* Kirtsaeng v. John Wiley & Sons, Inc., 133 S. Ct. 1351, 1387 (2013) (Ginsburg, J., dissenting) ("Section 109(a) . . . serve[s] as a statutory bulwark against courts deviating from *Bobbs-Merrill* in a way that increases copyright owners' control over downstream distribution, and legislative history indicates that is precisely the role Congress intended § 109(a) to play.").

[89] 17 U.S.C. § 102(a) (2012) ("Copyright protection subsists . . . in original works of authorship fixed in any tangible medium of expression, now known or later developed . . . .").

"phonorecords" while including a "tangible medium" dimension as well.[90] In *MAI*, the Ninth Circuit determined that "copies" created in RAM were "fixed" under § 101, with the RAM microchip serving as the "copy" of the work.[91] As courts have confronted the question of how digital works can qualify as "fixed" and thus be eligible for copyright protection, they have looked to *MAI*'s logic. *ReDigi* demonstrates the inadequacy of that logic and how, if adhered to literally and without any considerations of policy and technology, it produces nonsensical and absurd results.[92] The notion that a microchip is the true "copy" of a digital work suggests that the requirement of physicality underlying the Copyright Act has already been stretched past the point of practicality; *ReDigi* only furthers the reach.

The Copyright Act defines two mutually exclusive and necessarily physical embodiments in which works can be fixed: copies and phonorecords.[93] Where works are fixed in RAM microchips, so too can they be fixed in hard drives, flash memory, or other computer components in which they are hosted or through which they pass. Such components lend the physicality necessary to label the works within them "copies." But the notion that a computer hard drive is the "copy" of a novelist's work as opposed to the actual, digital file she typed and saved, simply because the hard drive is a tangible object, is at best artificial, if not outright bizarre. Likewise, when a teenager's band records a performance using a laptop equipped with a microphone, the notion that the laptop or its hard drive is the true "phonorecord," as opposed to the sound file it contains, seems outlandish. In addition, if copies and phonorecords are distinct and mutually exclusive under § 101, then what becomes of a microchip

[90] *Id.* § 101 ("A work is 'fixed' in a tangible medium of expression when its embodiment in a copy or phonorecord, by or under the authority of the author, is sufficiently permanent or stable to permit it to be perceived, reproduced, or otherwise communicated for a period of more than a transitory duration.").

[91] MAI Sys. Corp. v. Peak Computer, Inc., 991 F.2d 511, 518-19 (9th Cir. 1993), *cert. dismissed*, 510 U.S. 1033 (1994); *see also* discussion *supra* Part II.B.

[92] *See ReDigi*, 2013 WL 1286134, at *5 ("[W]hen a user downloads a digital music file . . . to his 'hard disk,' the file is 'reproduce[d]' on a new phonorecord within the meaning of the Copyright Act. This understanding is, of course, confirmed by the laws of physics. It is simply impossible that the same 'material object' can be transferred over the Internet." (second alteration in original) (citation omitted)); James Grimmelmann, *ReDigi, Digital First Sale . . . and Star Trek*, PUBLISHER'S WKLY. (Apr. 2, 2013), http://www.publishersweekly.com/pw/by-topic/digital/copyright/article/56646-grimmelmann-redigi-digital-first-sale-and-star-trek.html (characterizing the court's line-drawing in *ReDigi* as "quite literally metaphysical, and a sign that we're getting away from the more pragmatic questions of real-world consequences that ought to drive copyright policy").

[93] 17 U.S.C. §§ 101, 102(a) (specifying that the interacting definitions of "fixed," "copies," and "phonorecords" indicate that the universe of material objects in which a work could be fixed consists exclusively of copies and phonorecords, as defined).

that simultaneously houses a literary work and a wholly separate sound recording, since it cannot be both?[94]

Underneath Judge Sullivan's *ReDigi* opinion lurks the requirement that true "copies" and "phonorecords" must be physical to be eligible for copyright protection. The court rejected ReDigi's technology because it concluded that the transfer of digital works from users to ReDigi's server fixes a new copy or phonorecord on the server's hard drive.[95] To skirt the mutual exclusivity of copies and phonorecords, the court adopted a distinction from a case decided by another federal district court that defined the relevant copy or phonorecord not as the component in its entirety, but rather as the "appropriate segment of the hard disk."[96] This idea, while perhaps formalistically or textually precise, borders on ludicrous. It suggests that if a consumer removes the hard drive from his computer, identifies the exact piece upon which a digital work is stored, excises it, and then mails the chunk to a buyer, resale is permissible. But to resell through a service like ReDigi is unlawful because digital works can never be sent over the Internet without a new "fixation" occurring.[97]

Clearly, the construct of physicality set up by the text of the 1976 Act with respect to fixation, copies, and phonorecords, like a well-worn paperback, is tattered and falling apart at the seams. It offers little perspective and no pragmatic solution to the role of first sale in the twenty-first century.

3. Exhausting All Options

After *Bobbs-Merrill*, Congress incorporated the Supreme Court's first sale doctrine into the 1909 general revision of the Copyright Act.[98] Today, that provision has evolved into the first sale exception in § 109. The Court, however, did not simply conjure up a first sale limitation in *Bobbs-Merrill*.[99] Instead, it rooted its holding in a traditional, common law principle of exhaustion, reflecting the notion that personal property should not be unduly encumbered.[100] As Professors Perzanowski and Schultz define it, exhaustion represents "a fundamental set of user rights or privileges [that] flows from lawful ownership of a copy of a work," allowing "activities incidental to the use and enjoyment of copies by their owners."[101] Such rights extend beyond mere authorization to resell or otherwise distribute a particular copy and

[94] *See supra* notes 76, 89-93, and accompanying text.

[95] *ReDigi*, 2013 WL 1286134, at *5 ("[T]he Court determines that the embodiment of a digital music file on a new hard disk is a reproduction within the meaning of the Copyright Act.").

[96] *Id.* (citing London-Sire Records, Inc. v. Doe 1, 542 F. Supp. 2d 153, 166 & n.16, 171 (D. Mass. 2008)).

[97] *Id.*

[98] *See* discussion *supra* Part II.C.1.

[99] Perzanowski, *supra* note 33.

[100] *Id.*

[101] Perzanowski & Schultz, *supra* note 34, at 912.

encompass the full catalog of exclusive rights conferred by copyright.[102] In light of the exhaustion principle, notwithstanding § 109, a copyright holder's exclusive rights with respect to a *particular* copy of a work are exhausted under common law after the first authorized sale.[103] Under the auspices of the exhaustion principle, digital first sale becomes permissible not only in principle but also in effect since the activities necessary to digitally resell, such as intermediate copying and transfer, likewise become lawful.

A parade of cases predating *Bobbs-Merrill* reflects the exhaustion principle that Professors Perzanowski and Schultz describe. For example, in *Doan v. American Book Co.*, the Seventh Circuit recognized a bookseller's right not only to resell textbooks but also to repair them beforehand, even when the repairs "appear[ed] perilously close to acts of reproduction."[104] In effect, the court endorsed further distribution of a particular copy (that is, first sale) as well as necessary alteration or reproduction in furtherance of doing so (that is, intermediary copying).[105] Today, such actions would implicate not only § 106(3)'s distribution right, the right for which § 109(a) provides a first sale exception, but also § 106(2)'s derivative work right and § 106(1)'s reproduction right, for which first sale provides no exception.[106]

Other cases support the notion that the first sale exception constitutes only one aspect of a broader exhaustion principle. For instance, in *Bureau of National Literature v. Sells*, a federal district court found a former employee's reconstruction and revision of anthologies published by his former employer to be permissible, in effect recognizing an exhaustion-rooted repair right distinct from the right to resell.[107] In *Kipling v. G.P. Putnam's Sons*, author Rudyard Kipling sued a publisher that was purchasing individual, unbound copies of his works, compiling and combining them with others, including a biography of Kipling, and rebinding them into a uniform series for resale.[108] The Second Circuit found that the creation of the compilation series and its index was lawful and did not violate Kipling's copyrights.[109] Similarly, in *Fawcett*

[102] *Id.*

[103] *Id.*

[104] *Id.* at 913-14 (citing Doan v. Am. Book Co., 105 F. 772, 776-77 (7th Cir. 1901)). The reproduction-like acts in *Doan* involved the reseller's creation of new covers identical in design to the damaged or destroyed ones. *Id.* at 914 (citing *Doan*, 105 F. at 777).

[105] *Id.* at 913 ("[T]he Seventh Circuit endorsed not only the familiar notion that the sale of a copy exhausts the exclusive right to vend, but that copy ownership also implies a right to renew or repair, even if repair entails altering or copying the underlying work.").

[106] *See* 17 U.S.C. § 106 (2012).

[107] Bureau of Nat'l Literature v. Sells, 211 F. 379, 381-82 (W.D. Wash. 1914).

[108] Kipling v. G.P. Putnam's Sons, 120 F. 631, 632 (2d Cir. 1903).

[109] *Id.* at 634. While the 1909 Act did not provide for a general, exclusive right to create derivative works in the mold of the 1976 Act's § 106(2), there existed an exclusive right to create adaptations which courts often applied in situations similar to those in *Kipling*. Perzanowski & Schultz, *supra* note 34, at 916 n.143. The court thus determined that such a right had not been violated by the publisher. *Id.* at 916.

*Publications, Inc. v. Elliot Publishing Co.*, a federal district court denied summary judgment to a copyright holder's suit against a defendant who produced compilations of its comic books and resold them to fans.[110] The court noted that the defendant did not reproduce any of the copyrightable material and found that the copyright holder could not prohibit the comic compilations, even if they constituted new, derivative works.[111]

This collection of early-twentieth-century cases suggests not only that a common law basis undergirds the first sale exception, but also that the rights that inhere with individual copy ownership are more extensive than § 109(a)'s authorization to resell. Drawing from the exhaustion principle, courts sanctioned efforts of copy owners "to renew, repair, preserve, and adapt their copies, sometimes in the name of enabling continued use and enjoyment and other times to facilitate resale."[112] Translated to the digital realm, the same principle would allow owners of digital works to copy and transfer them as part of the resale process, in addition to allowing the resale itself.[113] Exhaustion thus provides a potential basis to clear the hurdles posed by intermediary copying and the statutory first sale exception's limitation to physical works.

Jumping into the digital secondary marketplace is an exhausting exercise for any merchant seeking to resell digital works. As ReDigi's experience reveals, entrants must clear several hurdles, navigating around licenses with problematic restrictions, technology that lends itself to infringing uses and copying processes, and leaping over a first sale exception cloaked in terms that seemingly exclude digital works. These hurdles may be high, but they are not necessarily insurmountable. Where licenses do exist, they may not be automatically and unconditionally enforceable. Computer technology evolves, and the law should and must adapt to it. And past legal principles guide novel legal questions. ReDigi claimed to have cleared these hurdles by seeking to vend digital works that are owned rather than licensed, developing technology to avoid impermissible copying, and relying on a statutory exception whose common law underpinnings are more flexible than its language alone suggests. Although Judge Sullivan thought otherwise, ReDigi boldly attempted to jerry-rig a predigital legal framework to twenty-first-century commerce. In so doing,

[110] Fawcett Publ'ns, Inc. v. Elliot Publ'g Co., 46 F. Supp. 717, 717-18 (S.D.N.Y. 1942); Perzanowski & Schultz, *supra* note 34, at 916-17.

[111] *Fawcett Publ'ns*, 46 F. Supp. at 717-18.

[112] Perzanowski & Schultz, *supra* note 34, at 935.

[113] *Id.* at 936-37 ("Informed by exhaustion's traditional focus on use and alienability, the basic rule courts should adopt is one that entitles copy owners to reproduce or prepare derivative works based on that copy to the extent necessary to enable the use, preservation, or alienation of that copy or any lawful reproduction of it. This rule, in conjunction with the existing first sale doctrine, would give copy owners a set of privileges for digital works functionally equivalent to the privileges they have traditionally enjoyed in the analog context.").

ReDigi's story has drawn attention to the necessity of revisiting the first sale exception and its continued importance in modern copyright topography.

## III. A PROVISION WITH A PURPOSE

Aside from the common law basis of the first sale exception, the purposes and policies underlying the exception compel its extension to digital works. The consequences of allowing the "digital demise of the first-sale doctrine," as some have advocated, are too dire to tolerate.[114] Justification for consumer ability to resell digital works extends far beyond the right to alienate property or recoup funds from unwanted digital purchases.[115] The traditional secondary market for works of literature, textbooks, music, films, and other copyrightable works, enabled by the first sale exception, safeguards extremely important public interests, and does so with minimal imposition to copyright holders. Perhaps the three most significant such interests protected by robust secondary markets – and thus by the first sale exception enabling them – are innovation, consumer privacy and welfare, and accessibility.

### A. *Promoting Innovation*

Professors Perzanowski and Schultz argue that since secondary markets bolster innovation, the first sale exception is a crucial driver of innovation.[116] Beyond the reach of copyright holders, entrepreneurs are free to experiment, develop, and refine new business models for disposition of works on the secondary market.[117] Services such as Redbox, Netflix, and even ReDigi itself, represent efforts empowered by the first sale exception, innovative upstarts that successfully responded to a market demand they identified and cultivated.[118] Similarly, copyright holders also innovate in response to competition by the secondary market, often by adding value to new editions, such as extra or bonus features or other new content.[119] In these ways, and perhaps others, the existence of a secondary market opens doors to innovation, in furtherance of copyright's goal of incentivizing creative efforts.

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[114] *See generally* Kupferschmid, *supra* note 26.

[115] *See* Kirtsaeng v. John Wiley & Sons, Inc., 133 S. Ct. 1351, 1363 (2013) (citing Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 886 (2007)) (acknowledging the historical "importance of leaving buyers of goods free to compete with each other when reselling or otherwise disposing of those goods" and how "American law . . . has generally thought that competition, including freedom to resell, can work to the advantage of the consumer").

[116] Perzanowski & Schultz, *supra* note 34, at 897-901.

[117] *Id.*

[118] *Id.* On its website, ReDigi specifically identifies the first sale doctrine as enabling its business model and technology. *See Is ReDigi Legal? Yes!*, *supra* note 11.

[119] Perzanowski & Schultz, *supra* note 34, at 897.

B. *Safeguarding Privacy and Consumer Welfare*

In various ways, the existence of a healthy secondary market for copyrighted works supports consumer welfare interests, including privacy interests. A first sale exception obviates the need for consumers to seek permission from copyright holders for certain activities. For example, a digital secondary market, empowered by the first sale exception, aids in "reducing consumer lock-in" to specific technologies, formats, or platforms.[120] If consumers can resell past digital purchases, their costs of switching to new technologies decrease because they can recoup at least a portion of their past investments.[121] Moreover, the ability to resell reduces the likelihood that a consumer might feel frustrated at having already purchased a work, albeit in a different format, and thus seek an illegal avenue to obtain the same work in a new format.[122] Allowing consumers to resell digital works in older or unwanted formats when switching to newer technologies is simply the digital analog of the common practice of reselling cassette tapes when switching to CDs or reselling videocassettes when switching to DVDs.

Another, more salient aspect of consumer welfare is consumer privacy. An effective secondary market provides an avenue for consumers to acquire copies of a specific work without a copyright holder's knowledge.[123] Digital technology already presents novel privacy issues, but in a world where works are primarily or exclusively digital, copyright holders could glean very specific information on individual customers through online sales. If there are no options other than to purchase a work on the primary market, there is no way a consumer can avoid sharing personally identifying information with the vendor, who is either the copyright holder or a proxy.[124] Consumer identification may prove problematic in situations where works contain

[120] *Id.* at 900.

[121] *Id.*

[122] Abelson, *supra* note 38, at 10 (indicating that increased legal avenues for the exchange of digital works might discourage consumers from seeking illegal or pirated content sources, an effect especially important for the "Napster generation" already exhibiting "[c]asual attitudes about piracy").

[123] Perzanowski & Schultz, *supra* note 34, at 896 ("[F]irst sale protects consumer privacy. Under the doctrine, consumers can transfer works without permission of the copyright holder, thereby allowing them to do so privately and anonymously."); Reese, *supra* note 35, at 584 (observing that the alienability of physical works, sanctioned by the first sale exception, historically has permitted consumers to "access . . . works while maintaining their privacy or anonymity from the copyright owner").

[124] Of course for certain works, it may be possible to continue to purchase or otherwise access physical copies, thereby preserving anonymity. That option, however, may disappear as more works are published exclusively in digital formats. *See* John D. Sutter, *Self-Published e-Book Author: "Most of My Months Are Six-Figure Months,"* CNN (Sept. 7, 2012, 1:08 PM), http://www.cnn.com/2012/09/07/tech/mobile/kindle-direct-publish (discussing Amazon's digital self-publishing service, Kindle Direct Publishing, which allows authors to digitally self-publish directly through Amazon).

politically unpopular, controversial, or stigmatizing material.[125] In addition, anonymity is important in various other contexts, such as when works are sought in connection with investigations, competition, reverse engineering, reviews, or evaluations.[126] A digital secondary market can restore at least some privacy or anonymity, since a customer shares information necessary for the online sale only with an intermediary such as ReDigi, rather than with a copyright holder (or agent thereof) directly. Given the nature of digital transactions, there will certainly be some erosion of anonymity; there simply is no digital analog to walking into a bookshop and purchasing a paperback with cash. But a digital secondary market, enabled by the first sale exception, is one way to preserve some level of privacy, both for personal and business-related reasons.

### C. *Ensuring Accessibility*

In supporting a secondary market for copyrighted works, the first sale exception serves its most important purpose: promoting accessibility.[127] It accomplishes this in two distinct ways: by enhancing the affordability of works and furthering their availability to the public.[128]

#### 1. Affordability

Secondary markets lead to greater affordability of works, thereby placing books, music, and other works within reach of more consumers.[129] In the digital context, a reseller like ReDigi helps exert downward pressure on the prices sought by copyright holders in the primary markets.[130] In effect, a secondary market introduces some competition to a marketplace otherwise controlled exclusively by the copyright holder.[131] Moreover, the prospect of resale lowers the effective prices consumers pay on the primary market because they later are able to recoup a portion of their outlays.[132] In its suit, Capitol Records complained that ReDigi's "delivery of pristine digital recordings at 'used' prices supplants the market for legitimate digital distribution."[133] That argument demonstrates that even opponents of digital

[125] Perzanowski & Schultz, *supra* note 34, at 896.

[126] *Id.* at n.30.

[127] Reese, *supra* note 35, at 577 (emphasizing that first sale constitutes "a major bulwark in providing public access" to works).

[128] *See id.* at 584.

[129] *Id.* at 587.

[130] Perzanowski & Schultz, *supra* note 34, at 894.

[131] *Id.*

[132] *Id.*; Reese, *supra* note 35, at 587.

[133] *See* Reply Memorandum in Further Support of Plaintiff's Motion for Preliminary Injunction at 3, Capitol Records, LLC v. ReDigi, Inc., No. 12-95, 2013 WL 1286134 (S.D.N.Y. Mar. 30, 2013).

first sale recognize its potential to enhance the affordability and thus availability of works to the public.

Enhanced affordability of works resulting from secondary markets need not, however, run counter to the interest of copyright holders, as Capitol Records implies. A secondary market, though digital, remains second best. New releases, which often constitute the greatest portion of a copyright holder's earnings, seldom appear on the secondary market until after their novelty and popularity have ebbed.[134] Enthusiastic customers purchase new titles when they are released, but the works generally are not put up for resale until much later, after a significant portion of their value has already been extracted by the copyright holder.[135] This pattern can be readily observed in the thriving used book and used CD markets. As Sarah Abelson has remarked, "CD's don't traditionally show up at a used CD store while they are still on top of the charts; rather it takes years for [them] to enter the secondary market."[136] Similarly, digital works will not make their way to the secondary market until some significant period of time has elapsed.[137] Consequently, even with a robust secondary market present, a copyright holder will retain the ability to capture the lion's share of revenues from initial sales to customers seeking access to the work sooner rather than later.[138]

Secondary markets offer additional benefits to copyright holders. The same ability of consumers to recapture a portion of their expenditures through resale may also motivate them to purchase digital works initially.[139] And digital first sale may allow a copyright holder to actually raise prices on the primary market, knowing that consumers can later recoup some costs at resale, and that less interested consumers will remain on the sidelines until the work appears in the secondary market anyway.[140] Increasing prices in this manner would still

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[134] *See* Abelson, *supra* note 38, at 10.

[135] *Id.*

[136] *Id.*

[137] Sarah Abelson provides the following example:

> [P]op music fans buy a new Katy Perry song shortly after its release, likely after hearing it on the radio. The song will probably be played over and over while still "new" on laptops, iPhones, or MP3 players. It is highly unlikely that a Katy Perry fan would turn around and sell this song on a secondary market while it is still "new" and relevant.

*Id.*

[138] Reese, *supra* note 35, at 591 (discussing how copyright holders often segment markets for their works chronologically, charging higher prices initially and gradually lowering them as works age).

[139] Glusman, *supra* note 29, at 716 ("The fact that a market does exist in which to liquidate [digital works later] provides an incentive to invest in the first instance.").

[140] At its core, this approach reflects price discrimination. A copyright holder knows that consumers in the primary market at the release of a long-awaited book or album will pay more for immediate access to the work. Later on, some consumers may put up their copies for resale where more patient consumers, who were unwilling to pay more earlier on, can

further affordability inasmuch as it would result in more efficient price discrimination among consumers, thus placing works within better reach of those consumers who are especially price sensitive.[141] Finally, owners of copyrights in music and sound recordings, such as Capitol Records, may benefit indirectly by the operation of a digital secondary market because it reinforces the traditional and profitable model by which consumers traditionally have interacted with such works: through purchase.[142] Where a secondary market offers another avenue to acquire musical works, it may draw consumers away from streaming services such as Pandora, Rhapsody, or Spotify.[143] That may, on the one hand, decrease the performance royalties that the copyright holder receives from those services pursuant to § 106(4) or § 106(6).[144] But to the extent that those services serve as substitutes for the traditional purchase-and-download business model, any loss of performance royalties may be offset by royalties from sales.[145] In other words, if copyright holders are finding the iTunes-like sales model profitable, a secondary market will serve to support that model and enhance its longevity.[146] A vibrant digital secondary market, driven by the first sale exception, increases affordability and therefore consumer accessibility to works without harming the interests of copyright holders; indeed, it may benefit them as well.

purchase the works on the secondary market at lower prices. *Compare* Perzanowski & Schultz, *supra* note 34, at 895 ("[E]vidence suggests that secondary markets are better at price discrimination and at maximizing social welfare than copyright owners."), *with* Reese, *supra* note 35, at 590 (discussing how lack of ability to capture downstream revenues because of a digital first sale exception may induce a copyright owner to charge higher prices initially).

[141] Perzanowski & Schultz, *supra* note 34, at 895.

[142] *Contra* Abelson, *supra* note 38, at 10 n.32.

[143] *See id.*; Derek Thompson, *Music Sales Are Growing for the First Time This Century: Here's Why*, ATLANTIC (Feb. 26, 2013, 10:51 AM), http://www.theatlantic.com/business/archive/2013/02/music-sales-are-growing-for-the-first-time-this-century-heres-why/273512 (discussing how music sales are falling in the United States even while subscription and streaming services have experienced impressive growth).

[144] Section 106 offers an exclusive performance right to copyright holders of musical works and sound recordings delivered digitally. 17 U.S.C. § 106 (2012). Royalties are collected by various collective rights organizations and paid out to copyright holders periodically. For a discussion of the sound recording performance right for digital transmissions, see discussion *infra* Part IV.C.4.

[145] A resale royalty, such as that suggested *infra* Part IV.C, would further alter the calculus in favor of copyright holders since they may collect as much (if not more) revenue through resale royalties as through digital performances.

[146] Evidence suggests that the purchase and download model is finally recovering from the piracy epidemic of the last decade. *See* Thompson, *supra* note 143 ("Global music sales rose by 0.3 percent to $16.5 billion in 2012. . . . [T]his marks the first good year for the industry since 1999.").

2. Availability

In the absence of digital secondary markets, copyright holders retain complete control over the distribution of their works. A digital first sale exception safeguards access to works that a copyright holder no longer makes available.[147] If a paperback book, for instance, goes out of print during its copyright term, dog-eared copies may still be available on the secondary market.[148] By comparison, while a digital book will not go out of print in the conventional sense, there remain personal, commercial, political, and cultural reasons why a copyright holder may cease distributing a work.[149] Where a work is published exclusively online, "a copyright owner's decision to discontinue any further transmissions of the work could well be effective to deny all access to the work."[150] Consequently, where economic reasons why physical works go out of print are not pertinent to digital works, situations in which a copyright holder decides to stop selling a work or even to actively suppress it take center stage. An author or other copyright holder may cease distributing or strive to suppress a previously available work out of personal embarrassment,[151] in response to political pressure,[152] or out of social

[147] Perzanowski & Schultz, *supra* note 34, at 895.

[148] *See* Reese, *supra* note 35, at 592-94 ("[T]he decision to allow a work to go out of print is generally an economically rational one for the publisher, who presumably perceives insufficient demand for copies of the work to justify the expenses involved in creating, storing, transporting, and marketing copies in the quantity needed to make a profit. . . . The first sale doctrine thus helps ensure that even when demand for a work falls below the point at which it is profitable for the copyright owner to continue to sell copies of the work, the work may remain available to the public."); *see also infra* note 183 and accompanying text.

[149] Perzanowski & Schultz, *supra* note 34, at 895.

[150] Reese, *supra* note 35, at 630. The Supreme Court has acknowledged a copyright owner's prerogative to refuse to share his work with the public during its copyright term:

> [A]lthough dissemination of creative works is a goal of the Copyright Act, the Act creates a balance between the artist's right to control the work during the term of the copyright protection and the public's need for access to creative works. The copyright term is limited so that the public will not be permanently deprived of the fruits of an artist's labors. But nothing in the copyright statutes would prevent an author from hoarding all of his works during the term of the copyright.

Stewart v. Abend, 495 U.S. 207, 228-29 (1990).

[151] The actress Mary Pickford, for instance, was reportedly so embarrassed about her early films that she later refused to make them available for television or theater audiences, even threatening to destroy them. *See* Reese, *supra* note 35, at 595; Christel Schmidt, *Mary Pickford: Queen of the Movies*, 2 LIBR. CONGRESS MAG. 10, 13 (2013), *available at* http://www.loc.gov/lcm/pdf/LCM_2013_0304.pdf.

[152] In 1987, the band 10,000 Maniacs included its performance of the Cat Stevens song *Peace Train* on its album *In My Tribe*, which subsequently went multiplatinum. Reese, *supra* note 35, at 595. Two years later, when Cat Stevens became embroiled in a political controversy, the band dropped the track from the album as well as from its live repertoire. *Id.*

sensitivities.[153] As copyright terms have increased, currently extending for the duration of the author's life plus seventy years, "it may not be unusual for attitudes to change significantly during a work's copyright term, such that a copyright owner might choose to shelve a work entirely for fear of offending some segment of the public."[154] In such cases, the secondary market may be the exclusive avenue by which a previously published work may remain available to the public.[155] Libraries, absent the first sale exception, are also at the mercy of the controlling hand of copyright holders, resulting in a growing public access problem.[156] Without authorization to resell digital works, no lawful digital secondary market can emerge, thus allowing copyright holders to retain control over the distribution of all copies of their works and presenting risks that the public may later be barred from accessing works it previously enjoyed.[157] Granting a copyright holder the power to abrogate access to previously available works conflicts with the delicate balance that the copyright law has struck between copyright holders and the public. Ensuring availability is a compelling reason to preserve first sale in the digital world.

The purposes served by secondary markets, enabled by the first sale exception, are critical to the copyright balancing act.[158] Secondary markets

[153] It is widely speculated that Disney has sought to suppress its 1946 feature film, *Song of the South*, which won an Oscar for best song and featured Oscar-winning actress Hattie McDaniel, because of its controversial race-related content. *See* JASON SPERB, DISNEY'S MOST NOTORIOUS FILM: RACE, CONVERGENCE, AND THE HIDDEN HISTORIES OF *SONG OF THE SOUTH* 2, 6, 11 (2012) ("Even the ideologically conservative Disney Corporation – never one to pass up a chance at exploiting older properties in its vault – has refused to rerelease [*Song of the South*] to American audiences for nearly three decades."). Sperb also observes, however, that Disney has had only limited success – or alternatively, has taken only limited enforcement actions – in quashing pirated clips of the film that have appeared online. *See id.* at 216-17.

[154] Reese, *supra* note 35, at 597; *see also* 17 U.S.C. § 302(a) (2012).

[155] As Professor Reese explains, "Continued public access to a work, even in the face of a copyright owner's desire to suppress the work, is generally a salutary effect of the first sale doctrine. Copyright law seeks to encourage the creation and dissemination of works of authorship, and some dissemination is better than none." Reese, *supra* note 35, at 599.

[156] *See* Streitfeld, *supra* note 28 ("Libraries cannot buy from Apple's iTunes [because they cannot lend digital works without copyright holder authorization] . . . . And so, for example, Pixar's Oscar-winning soundtrack for the movie 'Up' is not available in any public collection. An Apple spokesman confirmed this.").

[157] Section 407 of the Copyright Act mandates that two copies of the best edition of any work published in the United States be deposited with the Library of Congress whether or not the copyright owner has elected to register under § 408. *See* 17 U.S.C. §§ 407, 408. Technically then, there could remain a shred of public access preserved insofar as the Library, whose holdings are generally available to the public, may have copies available, assuming that the author complied with § 407 and the Library retained the copies deposited. Even if so, accessing the work would involve traveling to the Library in person, and use of the work would be confined to the designated reading room or viewing area.

[158] *See infra* notes 175-77 and accompanying text.

promote innovation, safeguard consumer welfare and privacy interests, and ensure accessibility by promoting affordability and availability of copyrighted works once they are shared with the public. These interests are too important to leave behind in the twenty-first century. There is an important need for robust secondary markets in books, music, and other works of authorship, even if such works are digital in form. Thus, the first sale exception cannot simply be jettisoned as a relic of the predigital era. And extending it to reach digital works need not open Pandora's Box. The exception should not be blind to the unique risks the digital environment presents to copyright holders. It needs adjustment to restore the appropriate copyright balance and thrive in the twenty-first century.

## IV. REBALANCING AT RESALE: A DIGITAL FIRST SALE SOLUTION

Given the benefits flowing from secondary markets, only the most ardent supporter of copyright holders would advocate for a future media landscape devoid of the first sale exception, the driving force behind them. Indeed, as the market shares of digital books, music, and movies continue to grow, a world in which works are predominantly nonphysical is emerging. If the first sale exception outlined in § 109(a) remains confined to the physical world and beyond the reach of digital works, then it will ultimately become a vestige of history, or at least an archaic doctrine applicable only to the small class of physically formatted works remaining in the new media landscape. Likewise, if copyright holders are free to dictate nonnegotiable license terms and resellers are barred from making necessary intermediary copies, secondary markets – along with their important benefits – will remain confined to the physical world.

Alternatively, if the first sale exception is retooled for digital works, it will remain an important balancing force within copyright law. In fact, Register of Copyrights Maria Pallante, in calling for Congress to consider a general revision of the Copyright Act in the coming years, suggested that it might be appropriate to revisit the issue of digital first sale as part of the revision process.[159] Given the first sale exception's many salutary effects, preserving it in some form, and thereby preserving secondary markets, is the better policy choice.

This Section proceeds first by examining previous legislative efforts to expand the first sale exception to incorporate digital works and thereby allow digital resale. It then discusses how the Internet has amounted to a Pandora's Box for copyright holders, exposing them to unique risks and unprecedented levels of piracy and infringement, threats that persist and warrant consideration in any proposal to permit digital resale. Finally, it proposes the use of a resale royalty as the means to balance consumer interests in reselling digital works against the risks borne by copyright holders in allowing such resale.

[159] *See* Maria A. Pallante, *The Next Great Copyright Act*, 36 COLUM. J.L. & ARTS 315, 331-32 (2013).

A. *Previous Legislative Efforts*

Since enactment of the Digital Millennium Copyright Act (DMCA) in 1998, which did not bring first sale into the digital arena,[160] three bills have appeared in Congress to clarify the relationship between digital works and the first sale exception. All three were introduced in 2003 during the first session of the 108th Congress: two in the Senate, and one in the House of Representatives.[161] The bills appear to have emerged in the context of increasing development and use of technological protection measures (TPMs) by copyright holders to protect and control digital works after their sale.[162] Though Congress enacted none of these bills, they provide a glimpse into previous, unsuccessful efforts to address the digital first sale question and are therefore instructive.

The first of the two Senate bills, Senate Bill 692, emphasized disclosure, requiring only that copyright holders, before a sale, inform consumers of any applicable TPMs that would bar the consumer from subsequently "engaging in the secondhand transfer or sale of legally acquired content to another consumer."[163] By contrast, House Bill 1066 and Senate Bill 1621 went further, expanding the first sale exception to incorporate digital works specifically.[164] Senate Bill 1621, introduced by Republican Senator Sam Brownback of Kansas, observed that use of "access or redistribution control technologies to limit the existence of legitimate secondary markets for digital media products" ran counter to "our Nation's economy, marketplace innovation, [and] consumer, educational institution, and library welfare."[165] Characterizing lawful resale of works on the secondary market as "a traditional form of commerce that is founded in our Nation's economic traditions," Senate Bill

[160] In fact, in a subsequent report to Congress evaluating the impact of the DMCA, Register of Copyrights Marybeth Peters recommended that § 109 remain unchanged, finding there was no compelling reason to bring the first sale exception into the digital arena. *Digital Millennium Copyright Act (DMCA) Section 104 Report: Hearing Before the Subcomm. on Courts, the Internet, and Intellectual Prop. of the H. Comm. on the Judiciary*, 107th Cong. (2001) (statement of Marybeth Peters, Register of Copyrights, U.S. Copyright Office), *available at* http://www.copyright.gov/docs/regstat121201.html ("The benefits to further expansion simply do not outweigh the likelihood of increased harm."); *see also* U.S. COPYRIGHT OFFICE, DMCA SECTION 104 REPORT 96-101 (2001), *available at* http://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf.

[161] *See* Consumer, Schools, and Libraries Digital Rights Management Awareness Act of 2003, S. 1621, 108th Cong. (2003); Digital Consumer Right to Know Act, S. 692, 108th Cong. (2003); Benefit Authors Without Limiting Advancement or Net Consumer Expectations (BALANCE) Act of 2003, H.R. 1066, 108th Cong. (2003).

[162] The BALANCE Act (House Bill 1066), for example, bemoans the fact that § 1201 of the Copyright Act, added by the DMCA just five years earlier, barred even a lawful consumer from "circumvent[ing] technological restrictions, even if he or she is simply trying to exercise a fair use . . . ." H.R. 1066 § 2(7).

[163] S. 692 § 3(c)(5).

[164] *See* S. 1621 § 6; H.R. 1066 § 4.

[165] S. 1621 § 2.

1621 endorsed the resale of digital works by consumers when the technology used to effectuate the sale "automatically" and "contemporaneously" deleted the original.[166] Moreover, the bill seemingly applied to licensed digital works as well as to ones where title was transferred to the consumer.[167] House Bill 1066 even more explicitly abrogated licenses that limit the resale of digital works by consumers.[168] Sponsored by Republicans and Democrats alike, House Bill 1066 was the only bill to grant a digital first sale exception by directly amending § 109, as opposed to adding a separate provision to the Copyright Act.[169] Like Senate Bill 1621, House Bill 1066 added the condition that the exception applied only if the seller did not retain "retrievable" copies after the sale; unlike Senate Bill 1621, however, there was no requirement that the original copy's removal process be automated.[170]

Even with bipartisan interest, all three pieces of legislation languished in their respective committees – the Senate bills in the Committee on Commerce, Science, and Transportation, and the House bill in the Judiciary Committee's Subcommittee on Courts, the Internet, and Intellectual Property. Perhaps the bills simply went too far. While Senate Bill 1621 may arguably have sanctioned transfers of licenses as well as owned copies, like those transfers sanctioned in *UsedSoft GmbH v. Oracle International Corp.*, House Bill 1066 left no such ambiguity, explicitly holding unenforceable license terms restricting the digital first sale provision it created.[171] Indeed, House Bill 1066

[166] *Id.* §§ 2(8), 6. The bill essentially adopts what has become known as the "forward and delete" view of digital resale, explored in the Clinton Administration White Paper, but adds a twist by requiring deletion to be automated, as opposed to manually completed by the seller. *See* WHITE PAPER, *supra* note 52, at 93-94 (rejecting the view that the first sale exception can apply to digital works "as long as the transmitter destroys or deletes from his or her computer the original copy from which the reproduction in the receiving computer was made"). Interestingly, the bill explicitly prohibits a copyright holder from employing a TPM that would later hinder a consumer from donating the purchased digital work to a library or other educational institution. *See* S. 1621 § 6.

[167] Section 9 of Senate Bill 1621 defines "digital media product" – the term employed throughout the bill to refer to digital works – to include works "licensed on nonnegotiable terms" in addition to those sold outright. S. 1621 § 9(3). Thus, when § 6 authorizes the "lawful owner of a digital media product" to "transmit a copy of that product," there is a credible argument that the provision applies to works that were licensed to consumers at the first instance in addition to purchases where title to digital works was transferred. *Id.* §§ 6, 9.

[168] H.R. 1066 § 3 ("When a digital work is distributed to the public subject to nonnegotiable license terms, such terms shall not be enforceable under the common laws or statutes of any State to the extent that they restrict or limit any of the limitations on exclusive rights under this title.").

[169] *Id.* § 4.

[170] *Compare* S. 1621 § 6, *with* H.R. 1066 § 3.

[171] S. 1621 §§ 6, 9; H.R. 1066 § 3; *see also* discussion *supra* Part II.A (analyzing the Court of Justice of the European Union's decision in *UsedSoft GmbH v. Oracle International Corp.*).

may have identified its own fatal flaw when it observed: "[D]igital technology threatens the rights of copyright holders. Perfect digital copies of songs and movies can be publicly transmitted, without authorization, to thousands of people at little or no cost."[172] Even after identifying this threat, as well as observing how the Internet and technology have once again "altered the balance" that copyright seeks, the bill proceeded to ignore the interests of copyright holders entirely, directly amending § 109 to create an unfettered digital first sale exception coupled with restrictions on licenses and an enumeration of new, permissible uses of digital works by copy owners.[173] In effect, House Bill 1066 and its peers offered consumers the privilege to resell digital works while simultaneously offering nothing to the copyright holders of those works. Thus, while the proposals may have drawn support from both sides of the aisle, they failed to balance both sides of the copyright equation, favoring consumers even while acknowledging the unique challenges digital works present to copyright holders.[174]

The failure of these legislative efforts suggests that any efforts to foster digital secondary markets by broadening the first sale exception to digital works must heed what Register of Copyrights Maria Pallante has termed "the copyright balancing act."[175] The Register emphasized that copyright must balance the protection offered to creators and copyright holders against the interests of the public.[176] She lamented that parties are not "in the mood to discuss exceptions and limitations" but that "exceptions need to be updated in response to technological change."[177] First sale is one such exception. Expanding the first sale exception to encompass digital works must address not only the growing needs and desires of consumers, but must also reflect the novel risks presented by technology to copyright holders. Any proposal that ignores copyright holders will fail to restore the appropriate copyright balance and therefore will fail to serve the public interest. Moreover, such an unbalanced proposal would likely encounter fierce resistance from interest groups, and thus would face the same premature demise as House Bill 1066 and its peers.

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[172] H.R. 1066 § 2.

[173] *Id.* §§ 3, 4.

[174] As introduced, House Bill 1066 was sponsored by Representative Zoe Lofgren, a California Democrat, and cosponsored by four other Democrats and two Republicans. *See Bill Summary & Status*, THOMAS, http://thomas.loc.gov/cgi-bin/bdquery/z?d108:HR01066:@@@P (last visited June 23, 2013).

[175] *See generally* Maria A. Pallante, *The Copyright Balancing Act*, COPYRIGHT NOTICES, June-July 2012.

[176] *Id.* at 1 ("[B]alance is a tricky proposition. As a matter of law, we seek balance between exclusive rights and public access, both of which are in the public interest.").

[177] *Id.* at 13. Register Pallante continues: "Exceptions are part of the balancing act, and they are part of the package that drives innovation. But such nuance is lost if as a nation, or a world, we fail to understand and respect the role of authors." *Id.*

B. *The Balance Shifts*

The first sale exception is integral to the balance between authors and the public that lies at the heart of American copyright law. Copyright strives to balance the incentive to create with the public's interest to access and enjoy works.[178] If the first sale exception seeks further to balance a copyright holder's exclusive rights and a copy owner's interest in personal property, then any proposal to adjust or revise the first sale exception must carefully consider its impact on that balance.[179] The three bills introduced in Congress in 2003 patently failed to achieve this balance, or at least assumed that the balance had tilted in favor of copyright holders and a bevy of consumer-friendly measures was necessary to restore it. That assumption is overly simplistic. As Keith Kupferschmid has observed, "[i]f decided wrongly, the first-sale issue has the potential to . . . destroy the delicate balance between copyright owners and users of copyrighted material."[180]

Digital works differ from physically embodied works in several ways, differences that should be reflected in any limitation on the exclusive rights of copyright holders, including the first sale exception. First, digital works maintain their quality level over time, such that "the quality of the first copy of a digitized work is no different than the thousandth copy."[181] In theory, there is no limit to the number of times a digital work may be resold since it can withstand limitless iterations of copying while maintaining the same quality as when purchased new. In comparison, a traditional, physical copy or phonorecord is necessarily limited by its physical lifespan.[182] This distinction impacts not just usability or functionality, but also desirability. At a certain point, would-be buyers on the secondary market may jump to the primary market because a particular preowned copy is unusable or simply undesirable. For example, a book offered for sale on the secondary market may be perfectly readable, yet display signs of wear and tear to such an extent that a prospective buyer declines to purchase the copy in favor of a new edition.[183] In this way,

[178] Perzanowski & Schultz, *supra* note 34, at 921.

[179] *See* Kupferschmid, *supra* note 26, at 847.

[180] *Id.* at 827.

[181] *Id.* at 848.

[182] *Id.*

[183] The Register has referred to such preowned works as "dog-eared copies," a term that this Note adopts. *See* Pallante, *supra* note 159, at 332. Such conditions could include worn or yellowed pages, a musty smell, or a dated cover or preface. While a buyer may not be able to "judge a book by its cover" as far as literary or artistic value of a work, he may very well rely on the cover as an indicator as to whether he would like to purchase that particular dog-eared copy. In fact, many prominent online resellers rely on a detailed rating system designed to assist buyers in evaluating the condition of preowned works. *See, e.g.*, *Condition Guidelines*, AMAZON, http://www.amazon.com/gp/help/customer/display.html?nodeId=1161242 (last visited June 23, 2013) (outlining a comprehensive rubric sellers must adhere to when reselling works).

deterioration and decay impose at least some limit on – if not an endpoint to – resale of physical works such as paperback and hardcover books, vinyl records, and even CDs. Digital works have no such constraint and their resale is thus unfettered.[184] As a result, secondhand copies of digital works may constitute identical substitutes for their brand new counterparts and thus cannibalize sales on the primary market for an extended period of time.[185]

Second, digital files are intertwined with a novel distribution system, one that uniquely threatens copyright holders.[186] Apart from sheer resistance to competition, copyright holders have cause to fear any Internet-driven-distribution or -sales system outside their control. Still haunted by the scourge of the Napster-era file-sharing epidemic, the music and recording industries fear that even legal and well-intentioned digital first sale could rapidly spin out of control, heralding a new era of piracy where consumers unlawfully share and profit from files.[187] Their fear that consumers may retain digital copies despite reselling the original ones they purchased, or copy and resell the same digital file repeatedly, is legitimate and warrants consideration. Such consideration, however, does not invariably lead to the conclusion that the first sale exception must be confined to the physical world, as Keith Kupferschmid has argued.[188] Nor should it lead to an unconditional endorsement of a digital

[184] Some observers challenge the notion that digital works have unlimited lifespans, speculating that digital works, like technology generally, may experience their own mode of degradation via obsolescence. *See* Smith IV, *supra* note 59, at 859 ("Over time, [digital] files will become increasingly obsolete as technology continues to advance. Eventually the digital copies will become unusable and owners will be forced to purchase new digital copies in a more current format."). They further suggest that digital works are coming to exhibit "quasi-tangible" attributes inasmuch as their lifespans may be limited by technological evolution. *See id.* at 856. That may be a valid observation, even if it ignores the possibility that a work may later be converted to operate on newer technology, but it does not resolve the important question of whether and how consumers may resell their digital purchases before they become obsolete.

[185] *See* Kupferschmid, *supra* note 26, at 848 ("A digitized book or digital audiotape . . . will not degrade in quality, and thus the resale market for these products will compete with the market for the copyright owner's products.").

[186] *Id.* at 828-29 ("All it takes is a mere stroke of a key . . . and a person can send a work to virtually anyone in the world. . . . Never before has any technology offered such a perfect reproduction and delivery system.").

[187] Indeed, counsel for Capitol Records expressed such a fear at oral argument in *ReDigi*:

> [T]he problem in the digital area is particular because of the ease with which [digital] files can be reproduced because the whole history of [illegal file sharing]. We're dealing with decades of cases that in this area the problem is particularly acute, and I think that the risk . . . is too great to bear . . . . [W]e think there are real questions about [ReDigi's verification] technology, because there are ways around it so easily.

Transcript of Oral Argument, *supra* note 1, at 58; *see also* Kupferschmid, *supra* note 26, at 845-46 (observing that it is impossible to ensure that resellers do not retain digital copies for personal use or additional resale instances).

[188] Kupferschmid, *supra* note 26, at 856 (concluding that a digital first sale exception,

first sale exception, either by lawmakers proposing one[189] or by courts relying on the common law principle of exhaustion to recognize one.[190] Instead, there must be a middle ground that takes into account the uniqueness of digital technology and balances the concerns of copyright holders with the interests of consumers – policymakers simply cannot avoid "the copyright balancing act."[191]

### C. *Resale Royalties: A Balanced Approach?*

Perhaps surprisingly, an idea originating in the visual-art context in early-twentieth-century France may hold the key to restoring the balance necessary for successful and fair operation of secondary markets in a digital world. Resale royalties provide an avenue to compensate copyright holders for the resale of their digital works. These royalties have recently been the subject of renewed interest from Congress.[192] By remitting a portion of the resale price to copyright holders, consumers can compensate holders for the added risks associated with digital resale. This section examines the history of resale royalties and refashions their rationale to apply to digital works; discusses how a resale royalty rate should be set, collected, and enforced; and identifies a model to emulate in implementation. It concludes by recommending the creation of such a resale royalty regime by Congress as the central component of legislation to foster digital secondary markets.

#### 1. History and Evolution of the Resale Royalty Right

In 1920, France recognized droit de suite and offered visual artists a right to share in the proceeds of subsequent sales of their works.[193] That right reflected both a desire to offer artists an additional opportunity to profit after the initial sale of their works as well as recognition of an artist's inalienable, moral rights vis-à-vis his creations.[194] The use of a resale royalty as a mechanism to confer

even one authorized by Congress, "would be extremely harmful to the legitimate interest of copyright owners and would not serve the long-term interests of the public").

[189] *See* discussion *supra* Part IV.A.

[190] *See* Perzanowski & Schultz, *supra* note 34, at 892 (recommending that courts, relying on the exhaustion principle at common law, should recognize and endorse the rule that owners of digital works may permissibly reproduce or create derivative ones when necessary for use, preservation, or alienation).

[191] *See* Pallante, *supra* note 175, at 1.

[192] *See infra* notes 195-96 and accompanying text.

[193] U.S. COPYRIGHT OFFICE, *DROIT DE SUITE*: THE ARTIST'S RESALE ROYALTY 10-11 (1992), *available at* http://www.copyright.gov/history/droit_de_suite.pdf. The concept of droit de suite has roots in the French law of real property, which permitted individuals in certain situations to retain rights over real property despite subsequent ownership transfers. *Id.* at 7. The term droit de suite is commonly used in Europe, while the term resale royalty has been the favored term in the United States.

[194] The moral rights aspect of droit de suite was reflected in the French law's recognition

added financial benefits on artists as well as safeguard their moral rights is increasingly common, existing in some form in sixty countries.[195] In the fall of 2012, the U.S. Copyright Office published a Notice of Inquiry in the Federal Register soliciting comments on a proposal to join those countries in adopting a resale royalty right for works of visual art.[196] There are, of course, numerous ways in which resale royalties regimes differ by country, such as the class of eligible works, the way in which the royalty is calculated, and the administrative mechanisms enabling it.[197] Thus, while straightforward in principle, a resale royalty right presents numerous, complex policy choices regarding creation and implementation.

Resale royalties arose in the context of visual art because of visual art's unique economics.[198] Editions matter in visual art. Individual sculptures or limited edition prints, for example, are unique and valuable in a way that a specific instance of a CD or a paperback ordinarily is not.[199] In part because of that uniqueness, a work of visual art often increases in value over time, usually

that the resale right was inalienable and that the work in question was not only original but also a "personal creation" of the artist. *See id.* at 11. In the United States, the constitutional basis for copyright protection is understood to have the principal goal of incentivizing innovation and creation. *See* U.S. CONST. art. I, § 8, cl. 8. Moral rights, such as rights of attribution, reputation, or integrity, stand apart from such an incentive structure, and are instead focused on the relationship between the creator and the creation. *See generally* Wendy J. Gordon, *A Property Right in Self-Expression: Equality and Individualism in the Natural Law of Intellectual Property*, 102 YALE L.J. 1533 (1993). Despite its focus on incentivizing creation, copyright law in the United States reflects some moral-rights-related principles. For example, it allows termination of copyright transfers, thereby permitting creators to renegotiate contractual terms for use of their works, and it offers certain rights of attribution to visual artists. *See* 17 U.S.C. §§ 106A, 203 (2012).

[195] Resale Royalty Right, 77 Fed. Reg. 58,175, 58,177 (Sept. 19, 2012).

[196] *Id.* at 58,177-79. Most recently, with the conclusion of the comment phase, the U.S. Copyright Office has announced public hearings on the proposed resale royalty for visual artists. *See* Resale Royalty Right; Public Hearing, 78 Fed. Reg. 19,326, 19,327-28 (Mar. 29, 2013) (posing a number of discussion issues and drawing from comments received in soliciting testimony on "[t]o what extent, if any, are the first sale doctrine and a resale royalty right incompatible").

[197] In 2001, a European Union directive sought to harmonize the differing resale royalty schemes in place throughout its member states. *See* Council Directive 2001/84, 2001 O.J. (L 272) 32, 32 (EC) ("The resale right is currently provided for by the domestic legislation of a majority of Member States. Such laws, where they exist, display certain differences, notably as regards the works covered, those entitled to receive royalties, the rate applied, the transactions subject to payment of a royalty and the basis on which these are calculated.").

[198] U.S. COPYRIGHT OFFICE, *supra* note 193, at 5-6 (observing that "[t]raditional copyright law seems to discriminate against visual artists" because the law's "rights of reproduction and distribution are better suited to exploitation of literary or musical works" and characterizing the "impetus" of droit de suite as "largely economic").

[199] *Id.* at 5 ("A visual artist's expression [unlike that of musical or literary authors] is usually embodied in an end product, sold to a single purchaser.").

on the coattails of the artist's subsequent work and enhanced reputation in the field.[200] For example, a fledgling visual artist creates and sells a work to an art enthusiast for a pittance. Later, as the artist builds a name for himself and grows in prestige, that work soars in value. The enthusiast could then resell the work and realize an enormous – and arguably unjust – profit.[201] A resale royalty thus offers a mechanism to rebalance that equity, allowing the artist to realize a portion of the increase in value of the work due presumably in part to his efforts since its sale.

While resale royalties emerged in the context of visual art, they need not be limited to that single context.[202] In fact, just as a resale royalty emerged as an effective solution to the unique challenges of the market for visual art nearly a century ago, a resale royalty presents an innovative opportunity to address the unique challenges of the market for digital works. Such a royalty would allow consumers to control digital purchases once the copyright holder exhausted the first sale, while simultaneously acknowledging and compensating copyright holders for the risks they bear at the hands of modern technology. As an instrument of rebalance, the resale royalty is uniquely suited to navigate the competing interests of consumers and copyright holders in the era of digital works. In fact, by offering a revenue stream to copyright holders, it presents perhaps the most feasible legislative solution to the digital first sale issue. Resale royalties have precedent in international copyright law, even if their application to digital works would be novel. And implementing a resale royalty scheme that applies to digital books, music, and films is a practical and pragmatic approach to retooling the first sale exception for use in the twenty-first century.

2. Revisiting the Rationale for Resale Royalties

While resale royalties for visual art may reflect at least some aspects of a moral rights approach to copyright,[203] any moral rights analysis is inapplicable in the case of digital works. Authors of digital works continue to be compensated – and thus incentivized to create – as new copies continue to sell. They are not being deprived of the benefits of subsequent creative labors since

[200] *Id.* at 6 ("An artist is entitled to participate in the increased value of earlier work as a matter of equity, not as a matter of welfare, because the increase results from the artist's continued work; otherwise the original purchaser is unjustly enriched from the artist's continued evolution.").

[201] Apart from copyright, an additional basis for resale royalties can be found in the law of restitution. *See id.* The enthusiast or collector can realize enormous profits at resale, at least in part due to efforts of the artist subsequent to his purchase. For example, Belgium created its resale royalty based heavily on the "civil law concept of 'enrichment sans cause,' or unjust enrichment." *Id.* at 31.

[202] *See* Ken Lovern, Comment, *Evaluating Resale Royalties for Used CDs*, 4 KAN. J.L. & PUB. POL'Y 113, 117 (1994) ("There is no evidence that the *droit de suite* has ever been applied to anything other than visual art.").

[203] *See* U.S. COPYRIGHT OFFICE, *supra* note 193, at 11.

digital works do not appreciate the way works of visual art do. Instead, the creation of a digital secondary market offers additional sales opportunities for their works, albeit not without risk. As a result, the purpose of a digital resale royalty is not to protect moral rights of creators but rather rebalance economic interests between copyright holders – who may not even be the creators[204] – and consumers.

An economic rationale for a resale royalty was proposed once before, with the technological advent of the CD in the mid-1990s. Unlike predecessor formats such as records and cassettes, CDs do not routinely degrade with proper care.[205] Because they offer pristine quality even when used and resold, copyright holders protested that resellers would capture a "windfall" of revenues, supplant sales on the primary market, and divert revenues from copyright holders to secondary market middlemen.[206] Those concerns prompted some to revisit the first sale exception and conclude that while it may have been appropriate "during the era of more volatile recording media," the ability of CDs to retain their quality indefinitely barred copyright holders' "participation in a substantial future income stream generated by resales."[207]

Subsequent proposals emerged for a resale royalty on CDs.[208] As Carla Miller has explained:

> [T]here is a parallel between droit de suite protection for visual art and providing resale royalties for copyrighted musical creations delivered on nonvolatile media. Just as droit de suite protection assumes the saleable condition of an original work of art in order to realize profits "into infinity," the durable nature of the compact disc guarantees this saleable condition for musical creations.[209]

She concluded that a resale royalty would rebalance "the distinct interests of copyright owners, retailers, and consumers."[210] A royalty imposed on the

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[204] Since moral rights are not the rationale for a digital resale royalty, and since appreciation does not occur, a digital resale royalty need not focus on compensating authors and creators specifically so much as copyright holders, who bear the unique risks of the Internet distribution system.

[205] Glusman, *supra* note 29, at 709 (describing CDs as "virtually indestructible" and adding that "there is effectively no difference between a new and a used compact disc"); Carla M. Miller, Note, *New Technology and Old Protection: The Case for Resale Royalties on the Retail Sale of Used CDs*, 46 HASTINGS L.J. 217, 220 (1994) (contrasting CDs to books and records, which degrade more rapidly, and concluding that CDs can remain in "pristine condition" for a very long time).

[206] Miller, *supra* note 205, at 220.

[207] *Id.*

[208] *See* Glusman, *supra* note 29, at 739 (characterizing a resale royalty on CDs as an "equitable 'tax'" and concluding that a resale royalty offered a "promising legislative remedy").

[209] Miller, *supra* note 205, at 240.

[210] *Id.* at 241.

resale of CDs, an idea attributed by some to country singer Garth Brooks,[211] would provide additional revenues to copyright holders from resale and advance the Copyright Act's purpose of incentivizing creation.[212]

Similarly, a resale royalty on digital works – which share the major characteristic that make CDs so disruptive, namely that they do not degrade in quality over time[213] – would offer additional revenue to copyright holders, which in turn would enhance the incentives of creators.[214] Moreover, since digital works are also easily replicated and connected to the vast and unprecedented distribution system of the Internet, the incentive of an additional revenue stream is likely even more effective than for CDs. Thus, while resale royalties might have some roots in moral rights, they also have a significant impact on incentives, and therefore present an independent economic justification suitable for consideration in situations, as with digital first sale, where moral rights are not a concern.

3. Designing a Digital Resale Royalty

Resale royalties are neither new nor revolutionary. Although the United States has been reluctant to join its European peers in offering a resale royalty to visual artists, it has seriously considered doing so in the past.[215] In a 1992 study, the U.S. Copyright Office advised against the creation of a resale royalty right even while acknowledging its growing prominence overseas.[216] Congress recently requested that the Office revisit its 1992 analysis and determine whether there is now a greater need for a resale royalty for visual artists.[217] In the preceding decades, California forged ahead, creating its own resale royalty scheme in 1976 with the passage of the California Resale Royalty Act

[211] *See* Lovern, *supra* note 202, at 113.

[212] *Id.* at 119 (acknowledging that although the benefits remain speculative, "granting a resale royalty for used CDs would . . . provide additional economic rewards and hence an increased incentive to create"). Even in situations where an author has transferred his copyright to a nonauthor party who subsequently benefits from the resale royalties, the value added by the resale royalty would presumably be reflected in the terms of the transfer by the author in the first instance.

[213] *See supra* notes 184, 205, and accompanying text.

[214] *See supra* note 212 and accompanying text.

[215] U.S. COPYRIGHT OFFICE, *supra* note 193, at 88-93 (chronicling the efforts of Senator Edward Kennedy and Representative Edward Markey, both of Massachusetts, together with tepid support of Register of Copyrights Ralph Oman, to include a resale royalty in the precursor to the Visual Artists Rights Act of 1990).

[216] *Id.* at 149.

[217] *See* Resale Royalty Right, 77 Fed. Reg. 58,175, 58,175 (Sept. 19, 2012) ("The U.S. Copyright Office is undertaking an inquiry at the request of Congress to review . . . how a federal resale royalty right for visual artists would affect current and future practices of groups or individuals involved in the creation, licensing, sale, exhibition, dissemination, and preservation of works of visual art.").

(CRRA).[218] The CRRA set up a system for the collection and remittance of monies collected at resale to artists.[219] In 1988, Puerto Rico implemented a similar resale royalty.[220] Both statutes, as the lone examples of U.S.-styled resale royalty rights, can serve as templates for a federal digital resale royalty right.

a. *At What Cost? Setting Resale Royalty Rates*

The CRRA required that the seller of a work of visual art pay five percent of the sale price to the artist, regardless of the forum at which the sale took place.[221] The statute made clear that the seller, or his agent, had the duty of locating and paying the artist.[222] If, after ninety days, the artist could not be located, the seller was required to forward the proceeds to the California Arts Council, a state agency tasked with supporting the arts in California.[223] The Council was then required to "attempt to locate" the artist; if it could not do so and the artist did not step forward within seven years, the funds could be used by the Council to acquire artwork for public buildings.[224] The resale royalty persisted for the life of the artist plus twenty years, thereby permitting the artist's heirs to benefit as well.[225] The statute categorically exempted all sales of artwork under $1000 as well as sales when the value of the work had decreased from its prior purchase price.[226] Puerto Rico's statute is extremely similar, providing a 5% resale royalty that sellers must remit to artists directly, or, when they cannot be found, deposit the funds with Puerto Rico's Copyright

[218] CAL. CIV. CODE § 986 (West 2007), *invalidated by* Estate of Graham v. Sotheby's, Inc., 860 F. Supp. 2d 1117, 1126 (C.D. Cal. 2012); *see also* Resale Royalty Right, 77 Fed. Reg. at 58,177.

[219] Remarkably, and unfortunately for artist beneficiaries or resale royalty supporters, the nearly forty-year-old law was recently struck down by the U.S. District Court for the Central District of California. *See Estate of Graham*, 860 F. Supp. 2d at 1126 ("[T]he Court finds that the California Resale Royalties Act, Cal. Civ. Code § 986, violates the Commerce Clause of the United States Constitution. Because the Court finds that the offending provisions cannot be severed, the entire statute is struck down."). Relying on a dormant Commerce Clause analysis, the court ruled that the CRRA was unconstitutional after finding that it had substantial effects on interstate commerce. *Id.* at 1122-23. Consequently, the court never reached the question of whether the law was preempted by § 301 of the Copyright Act. *Id.* at 1120.

[220] P.R. LAWS ANN. tit. 31, § 1401(h) (1993). Unlike the CRRA, the Puerto Rican law has not been invalidated on constitutional grounds.

[221] CIV. § 986(a).

[222] *Id.* § 986(a)(1).

[223] *Id.* § 986(a)(2); *see also What Is the California Arts Council?*, CAL. ARTS COUNCIL, http://www.cac.ca.gov/aboutus/whatisthecac.php (last visited June 23, 2013) (describing the Council's mission to "advance the state through the Arts and creativity").

[224] CIV. § 986(a)(5).

[225] *Id.* § 986(a)(7).

[226] *Id.* § 986(b).

Registrar.[227] Unlike California, which calculated its royalty based on the overall sale price but excluded works that decreased in value, Puerto Rico calculates its resale royalty based only upon the work's increase in value.[228]

While these two laws provide a framework for a digital resale royalty, adaptations would be necessary to refashion a system developed for visual art in a physical context to literary and musical works in a digital context. Puerto Rico's 5% amount and California's $1000 threshold reflect the expectation that sales would generate large sums, 5% of which would offer a generous payday for artists. With digital works, resale would involve sale prices at far smaller amounts, as low as $0.59 per work.[229] To be sure, volume of sales, even coupled with low prices, could over time yield a significant payout to copyright holders. Five percent, however, still seems low, especially when compared to other rates that pertain to statutory licenses provided by the Copyright Act.[230] Unlike California or Puerto Rico, which statutorily fixed their resale royalty rates, Congress would likely vest rate-setting authority in the Copyright Royalty Board, a body upon which it has already conferred rate-setting authority for most other statutory licenses.[231] And if Congress so authorizes, the Copyright Royalty Judges could further determine that resale royalties should be stratified by type of digital work, with resale rates for digital books set at one rate and digital recordings another. Congress may also require that the Board periodically reassess the rates so that they remain responsive to market conditions.[232] Lastly, Congress would have to determine the duration of the resale royalty and could very well decide that life of the author plus twenty years, the term specified by the CRRA, is simply too long for digital works.

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[227] P.R. LAWS ANN. tit. 31, § 1401(h) (1993).

[228] *Id.*

[229] *See* Capitol Records, LLC v. ReDigi, Inc., No. 12-95, 2013 WL 1286134, at *2 (S.D.N.Y. Mar. 30, 2013) ("ReDigi's website prices digital music files at fifty-nine to seventy-nine cents each.").

[230] The Copyright Royalty Board, which is responsible for setting the royalty rates for statutory licenses associated with the digital transmission of sound recordings (such as by SiriusXM satellite radio or Pandora Internet radio), recently announced increased rates for the years 2013 through 2017, all of which range from 8% to 11%. *See* Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services, 78 Fed. Reg. 23,054, 23,054 (Copyright Royalty Bd. Apr. 17, 2013) (to be codified at 37 C.F.R. pt. 382).

[231] *See* 17 U.S.C. § 801(b) (2012); U.S. COPYRIGHT OFFICE, LEGAL ISSUES IN MASS DIGITIZATION: A PRELIMINARY ANALYSIS AND DISCUSSION DOCUMENT app. G (2011), *available at* http://www.copyright.gov/docs/massdigitization/USCOMassDigitization_October2011.pdf (listing the rate-setting mechanisms for each statutory license provided by the Copyright Act).

[232] Currently, for example, the Copyright Royalty Board sets rates for the digital transmission of sound recordings in five-year increments. *See* 17 U.S.C. § 114(f).

b. *Collecting and Enforcing a Digital Resale Royalty*

With rates set, how to administer them – the question of how to collect and remit payments – presents another design challenge. In the context of visual art, California imposed a duty on sellers to pay resale royalties directly to copyright holders and permitted copyright holders to sue sellers that failed to comply.[233] The Copyright Office characterized this approach as "fraught with problems."[234] Among other challenges, the Office found that artists were ill equipped to monitor every sale of their work and hesitant to incur the costs and negative publicity of legal action to pursue a seller who did not remit a royalty.[235] Instead, the Office recommended that collective rights organizations (CROs) be the primary avenue by which resale royalties are collected and distributed.[236] In other words, a private entity representing copyright holders would collect all the royalties, monitor resellers for compliance, and distribute the earnings to members. The Office clearly envisioned a structure similar to the groups that collect the performance royalties for musical works, the American Society of Composers, Authors and Publishers (ASCAP) and Broadcast Music, Inc. (BMI).[237] While this model is instructive, there are reasons to be cautious in translating this structure to a resale royalty, particularly in a digital context.

In managing musical performance rights, ASCAP and BMI sell blanket licenses for use of their members' works, either at a flat rate or on a sliding scale based on customer revenues.[238] Historically, that model has led to antitrust scrutiny by both the U.S. Department of Justice and courts, in part because ASCAP and BMI jointly set prices among copyright owners who otherwise might compete.[239] Even today, ASCAP and BMI operate pursuant to consent decrees, modified in 2001 and 1994, respectively.[240] Instead, a statutory digital resale royalty, as proposed here, would be computed on a per-work basis rather than via a collective license.[241] In addition, enforcement

[233] U.S. COPYRIGHT OFFICE, *supra* note 193, at 117.

[234] *Id.*

[235] *Id.*

[236] *Id.* at 118 ("Only those countries with active and efficient national authors' societies . . . have effectively implemented the *droit de suite*.").

[237] *Id.* at 118-20.

[238] *See* Broad. Music, Inc. v. Columbia Broad. Sys., 441 U.S. 1, 5 (1979).

[239] *Id.* at 10-16.

[240] *See generally* United States v. Am. Soc'y of Composers, Authors & Publishers, No. 41-1395, 2001 WL 1589999 (S.D.N.Y. June 11, 2001); United States v. Broad. Music, Inc., No. 64-3787, 1994 WL 901652 (S.D.N.Y. Nov. 18, 1994).

[241] Because a digital resale royalty would apply to a variety of different types of works, from books to recordings, it is less likely that an entity such as ASCAP would emerge that spans the entire class of potentially covered works. Furthermore, focusing on the royalties due to individual copyright holders rather than encouraging collective action avoids antitrust issues that have long pursued ASCAP and BMI.

would be simpler in a digital resale setting than in either the visual-art or the musical-performance context since enforcement is likely to be limited to a handful of specialized, ReDigi-like online resellers.[242] Low margins on individual resales, coupled with high transaction costs, suggest there will be few, if any, resales of digital works between individual parties directly. With only a handful of entities to keep track of, copyright holders could more easily monitor for compliance. And even where occasional one-off resales occur, the aggregate amount lost will likely be low. Any risk of occasional noncompliance is no reason to abandon the greater scheme. As Carol Sky has observed, "Surely, a royalty on the direct sale of [a work] is less of a challenge to collect than a royalty for music played on the radio, which has been done for many years. If there were no risk of non-compliance, we would not need most of our laws."[243]

California left it to individual artists to enforce their right to a resale royalty when sellers failed to fulfill their duty to remit it.[244] Enforcement problems would be less acute in the case of digital resale royalties, since large copyright holders would have the incentives, resources, and economies of scale to police resale of their works. Even so, the efficiencies of CROs are hard to ignore, despite their drawbacks. Dedicated exclusively to collecting, enforcing, and paying out royalties, such entities can handle a high volume of transactions and develop better technology to match resold works with their respective copyright holders. In short, the Copyright Office's 1992 recommendation that CROs administer a resale royalty for visual artists, while clearly never envisioned for a digital resale royalty, remains an apt prescription for a collective rights middleman.

[242] While visual art may be sold at countless auctions, galleries, or even private transactions, and music may be played or performed publicly at a seemingly endless number of events and businesses, most sales of digital works are likely to be channeled through an online reseller. Earnings on each digital sale are likely to be small and the transaction costs associated with selling them comparatively high. It seems likely that a few major platforms that benefit from economies of scale, such as ReDigi, will emerge and dominate the market. For example, given the technology necessary to resell an electronic work and the small returns on a per work basis, there are not likely to be small resellers or individuals in the market hawking used e-books or individual MP3s. The amount of effort and resources it would cost to do so on an ad hoc basis would not be profitable. The sale of visual art, in contrast, could be very fragmented, with works being sold at garage and estate sales, auctions, and galleries, and so on, such that monitoring to ensure compliance with a resale royalty scheme is far more challenging.

[243] Carol Sky, *Report of the Register of Copyrights Concerning* Droit de Suite*, the Artist's Resale Royalty: A Response*, 40 J. COPYRIGHT SOC'Y U.S. 315, 321 (1992).

[244] *See supra* note 233 and accompanying text.

4. Implementing the Royalty: A Modern Collective Rights Organization Model

A better CRO model has emerged since the Copyright Office made its 1992 recommendation, one that also leaves room for a California-like duty on the part of resellers. In 1995, Congress created a digital performance right for sound recordings.[245] Entities that "perform"[246] sound recordings digitally, including webcasters such as Pandora Internet Radio and satellite radio providers, such as Sirius XM Radio, must pay copyright holders for use of their recordings in their services.[247] At the same time, Congress set up a statutory license to ensure that entities that relied on digital recordings would be able to license them.[248] How payments for those licenses are collected and distributed to copyright holders perfectly exemplifies how a digital resale royalty could function, effectively and efficiently, in practice.

Royalties for statutory licenses pertaining to the performance of digital recordings are collected and distributed by SoundExchange, a nonprofit CRO.[249] Unlike ASCAP and BMI, SoundExchange has no price-setting ability and instead relies on rates set by the Copyright Royalty Board.[250] Thus, it acts exclusively as a middleman between copyright holders and users of copyrightable works. A company that wishes to perform digital recordings pursuant to the statutory license first files a notice with the U.S. Copyright

[245] *See generally* Digital Performance Right in Sound Recordings Act of 1995, Pub. L. No. 104-39, 109 Stat. 336 (codified as amended at 17 U.S.C. §§ 106, 114 (2012)) (amending the Copyright Act to offer to copyright holders of sound recordings exclusive performance rights for digital audio transmissions as well as creating a statutory license by which users may seek licenses to perform such works).

[246] Under the Copyright Act, the term "perform" is a technical one and not limited to "live" performances as commonly understood. *See* 17 U.S.C. § 101 ("To 'perform' a work means to recite, render, play, dance, or act it, either directly or by means of any device or process . . . .").

[247] *See, e.g.*, 17 U.S.C. § 114(d)(3) ("[A]n interactive service may not publicly perform a sound recording unless a license has been granted for the public performance of any copyrighted musical work contained in the sound recording . . . .").

[248] *Id.*

[249] SOUNDEXCHANGE, SOUNDEXCHANGE DRAFT ANNUAL REPORT FOR 2012 PROVIDED PURSUANT TO 37 C.F.R. § 370.5(C) 1 (2012) (on file with author) ("During 2012, SoundExchange was the sole entity designated by the Copyright Royalty Board to collect royalties paid by services operating under the statutory licenses set forth in Sections 112 and 114 of the Copyright Act and the implementing regulations established thereunder."); *see also* 17 U.S.C. §§ 112(e)(2), 114(e)(1) (providing for the designation of a common agent to collect, manage, and in limited cases set royalties, bypassing the antitrust laws); U.S. COPYRIGHT OFFICE, *supra* note 231, app. E at 8.

[250] SOUNDEXCHANGE, *supra* note 249, at 1 ("Services paying royalties to SoundExchange are generally doing so under rates and terms established by the Copyright Royalty Board . . . .").

Office, indicating that it intends to rely on the license.[251] It then periodically submits to SoundExchange a Statement of Account based on the number of instances it performs each digital recording, along with its payment at the established royalty rates.[252] SoundExchange then uses that information to distribute the royalties to copyright holders on a pro rata basis.[253] SoundExchange matches the submitted recordings data with the appropriate copyright holder to ensure that payment reaches the proper party.[254] In cases where copyright ownership of a specific work is shared, SoundExchange splits the royalties owed for use of the recording equally.[255] Copyright holders must register with SoundExchange before they begin receiving royalty payments.[256] When a copyright holder cannot be found, SoundExchange retains the royalties, undistributed, for a period of at least three years; if it still cannot locate the holder during that period, then it may share them with the other copyright holders.[257]

SoundExchange has successfully administered the statutory license associated with the digital performance right, collecting and distributing approximately five hundred million dollars in royalties in 2012 alone.[258] Since it entered the market in 2003, it has distributed over one billion dollars in royalties, at a remarkably low administrative cost, most of which is covered by income from interest and an administrative assessment applied to royalties prior to distribution.[259] SoundExchange demonstrates that management of a royalty in the digital era can be efficient and successful. It therefore provides a

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[251] *Id.* ("In order for a service to avail itself of the statutory license, it must first file a Notice of Use of Sound Recordings . . . with the U.S. Copyright Office.").

[252] *Id.* at 3.

[253] SoundExchange provides the following illustrative example:

> [I]f the net royalties (after deducting costs) paid by Service *A* total $100 for period *X* and Service *A* reported 10,000 discrete sound recordings during that period with identical usage reported for each track, then each distinct sound recording would be valued at one cent . . . ($100 ÷ 10,000).

*Id.* at 4.

[254] *See General Questions*, SOUNDEXCHANGE, http://www.soundexchange.com/generalfaq (last visited Aug. 21, 2013) ("[SoundExchange's] Data Management team focuses entirely on ensuring that the millions of lines of data received from service providers is clean and matched correctly in our expansive database. Our Claims Department is solely dedicated to ensuring that repertoire is properly claimed by artists and labels.").

[255] SOUNDEXCHANGE, *supra* note 249, at 4-5.

[256] *Id.* at 5.

[257] *Id.* at 6.

[258] *Id.* at 7.

[259] Press Release, SoundExchange, SoundExchange Ends Record-Setting Year with $462 Million in Total Distributions (Jan. 16, 2013), http://www.soundexchange.com/pr/soundexchange-ends-record-setting-year-with-462-million-in-total-distributions; *see also* SOUNDEXCHANGE, *supra* note 249, at 1, 8 (reporting that SoundExchange's administrative rate in 2011 equaled five percent).

model by which a digital resale royalty can be effectuated. Like Internet or satellite radio services, a digital reseller like ReDigi can periodically provide an accounting of the works it resells to a nonprofit entity like SoundExchange. That organization would compile a registry of copyright holders, match them with titles resold, and remit the resale royalty payment to the relevant copyright holders. Unlike peer organizations ASCAP and BMI, the entity would not run afoul of antitrust laws if it operated upon express statutory authorization and pursuant to rates set by the Copyright Royalty Board. SoundExchange's success at implementing the digital performance right proves that a digital resale royalty, enacted to preserve the delicate balance between copyright holders and consumers, is a realistic possibility, and one that could generate significant revenues for copyright holders.

5. A Pragmatic Approach to Digital First Sale

By serving both the interests of consumers and copyright holders, a digital resale royalty would achieve the optimal "copyright balancing act." It rebalances and reconciles the right of consumers to resell their unwanted digital property with the unique risks copyright holders face vis-à-vis resale over the Internet. Naturally, copyright holders are alarmed by any large-scale enterprise selling their works online, fearful such efforts could lead to a new Napster and eviscerate recent inroads they have made in vending digital works.[260] As a policy solution, a digital resale royalty navigates between two first sale extremes staked out by scholars. On the one hand lies the notion that the first sale exception is wholly applicable to the digital context, that "'a guaranteed one-time compensation per copy is deemed by the copyright law to provide sufficient incentive to spur creation.'"[261] These scholars believe that the digital format alters nothing about the respective rights of copyright holders and consumers and therefore leaves the copyright balance unaffected. Drawing from the common law principle of exhaustion, they urge courts to recognize processes necessary for digital resale, such as intermediate copying, as permissible.[262] An exhaustion-based analysis would essentially recognize an unfettered digital resale right, similar to the legislation introduced in 2003.[263]

[260] *See generally* Jennifer Norman, Note, *Can the Recording Industry Survive Peer-to-Peer?*, 26 COLUM J.L. & ARTS 371 (2003) (chronicling how, in the aftermath of Napster, different file-sharing technologies emerged, once again enabling widespread and unauthorized distribution of copyrighted materials between users).

[261] Davis, *supra* note 20, at 366 (quoting Cary T. Platkin, Comment, *In Search of a Compromise to the Music Industry's Used CD Dilemma*, 29 U.S.F. L. REV. 509, 515 (1995)).

[262] Perzanowski & Schultz, *supra* note 34, at 892 (recommending that courts, relying on the exhaustion principle at common law, recognize and endorse the rule that owners of digital works may permissibly reproduce or create derivative ones when necessary for use, preservation, or alienation).

[263] *See* discussion *supra* Part II.C.

Others, alternatively, believe that first sale is by definition confined to the physical world and thus cannot be extended to digital works by judicial fiat or by Congress itself. They fear that digital first sale will lead consumers to dramatically increase reliance on the exception, far beyond levels envisioned by the Supreme Court in *Bobbs-Merrill* or by Congress in drafting § 109.[264] These scholars argue that since digital works do not degrade but rather maintain their quality indefinitely, the lawful resale of digital works in secondary markets would unduly threaten a copyright holder's primary sale market.[265] From this perspective, technology tilts the balance between the interests of the copyright holder and the copy owner toward the latter, and a digital resale royalty would only further that imbalance. Notwithstanding the statutory language, the first sale exception must therefore remain confined to the physical world, even if its applicability fades as consumers rapidly shift to digital works.[266]

Between these two extremes lies a resale royalty. A resale royalty scheme recognizes the unique risks that nondegrading digital formats, connected to a vast and limitless distribution system, pose for copyright owners. At the same time, it stays true to the axiom that a consumer has the right to alienate his personal property, though it be digital. To the extent that the first sale exception has historically sought to balance these interests,[267] a balance which reflects the broader copyright balancing act, a digital resale royalty would be a successful avenue to meeting the needs of each side. Such a compromise would be far more legislatively feasible than the blunt and unbalanced proposal contemplated by Congress in 2003.[268] Copyright holders such as record labels and publishers, along with their respective lobbying groups, would find the stream of income offered by a resale royalty preferable to a judicially recognized digital first sale exception or even legislation similar to that proposed in 2003. Consumer advocates would see a digital resale royalty as recognition that consumers are free to sell their digital property with only minimal interference or added financial burden. Both sides would benefit.

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[264] Kupferschmid, *supra* note 26, at 853 ("[I]f the first-sale exception is applied to Internet transmissions, the lack of practical delivery barriers associated with such systems will unduly increase usage of the exception, thereby adversely impacting the rights of copyright owners."); *see also* discussion *supra* Part II.C.

[265] Kupferschmid, *supra* note 26, at 852 ("Application of the first-sale exception to Internet and other network transmissions would be incompatible with the purpose of the first-sale exception. The purpose of the first-sale exception is to promote alienation and trade in copyrighted works. This purpose is balanced against the copyright owner's commercial exploitation interest. Where the first-sale exception adversely impacts the copyright owner's legitimate commercial interests it has been limited by statutory provisions in the Copyright Act.").

[266] *Id.* at 838.

[267] *See* Perzanowski, *supra* note 33 (characterizing the first sale exception as mediating the conflict between the property interests of copyright holders and copy owners).

[268] *See supra* Part IV.A.

Perhaps the strongest endorsement of a digital resale royalty comes indirectly from ReDigi itself. In a 2011 interview with the *New York Times*, ReDigi CEO John Ossenmacher indicated that the company had voluntarily offered to pay artists and record labels a "gratuity" despite the fact that the first sale exception, in ReDigi's view, rendered such profit sharing unwarranted.[269] That offer later morphed into ReDigi's Artist Syndication Program, a profit-sharing scheme wherein artists register with ReDigi for a percentage of the resales of their work.[270] Unfortunately, it is unclear how many artists have availed themselves of the program or how much money ReDigi has thus far disbursed. Nevertheless, the existence of the program provides a clue that even ReDigi has recognized a need to rebalance the interests of parties vis-à-vis a digital secondary market. At the very least, it constitutes a recognition of economic and political realities. If the program was conceived of as a way to placate copyright holders, in light of Capitol Records' suit, that attempt appears to have failed.

## CONCLUSION

Just two years ago, ReDigi leapt into the digital secondary market, in the process putting forth remarkable efforts to clear the relevant licensing, technological, and legal hurdles. Its efforts point to a growing awareness that the increasing prominence of digital works will leave consumers with massive digital libraries that they are prohibited from reselling, gifting, transferring, and even inheriting. Major competitors in the primary market for digital works, such as Amazon and Apple, have taken notice and are themselves laying groundwork to enter the digital secondary market, necessarily driven by the first sale exception. But as Professor James Grimmelmann has wryly observed, "if there's a party at digital first sale's house, federal judge Richard Sullivan just called the cops."[271]

Judge Sullivan's rejection of ReDigi's business model underscores the need for Congress to step in and revisit the first sale exception and the secondary markets it enables.[272] In fact, even Judge Sullivan observed that ReDigi set

[269] Sisario, *supra* note 14.

[270] *Artists Get Paid for Secondary Sales with the ReDigi Syndication Program,* REDIGI, https://www.redigi.com/syndication (last visited June 23, 2013); *see also* Rosen, *supra* note 2.

[271] Grimmelmann, *supra* note 92.

[272] ReDigi now differentiates between its original system (the one at issue in the *ReDigi* litigation) and "ReDigi 2.0," which supposedly avoids the issue that Judge Sullivan found the most problematic – the copying that occurs when transferring digital works. *See* Ben Sisario, *A Setback for Resellers of Digital Products*, N.Y. TIMES, Apr. 2, 2013, at B3, *available at* http://www.nytimes.com/2013/04/02/business/media/redigi-loses-suit-over-reselling-of-digital-music.html. Though details are scarce, ReDigi 2.0 apparently invites users initially to send their purchases of digital works, not to their personal computers, but directly to ReDigi's cloud. Matt Peckham, *ReDigi CEO Says the Court Just Snatched away Your*

forth some "attractive policy arguments."[273] To be sure, the first sale exception, as the key to lawful secondary markets, promotes innovation, preserves privacy, safeguards consumer welfare, and promotes the accessibility of works to a wide swath of consumers by enhancing affordability and availability. At the same time, Judge Sullivan rightly recognized that digital works present unique risks to copyright holders. To avoid opening up Pandora's Box or unwittingly christening a new Napster, Congress must take stock of the way consumers and copyright holders use and interact with digital works and rebalance their interests through legislation. It can accomplish this goal by designing a digital resale royalty scheme to remit a portion of the proceeds from any digital resale to copyright holders and expressly permitting intermediary copying necessary to effectuate resales. Such a system can mirror the current royalty collection regime pertaining to the digital performance right for sound recordings. Only when Congress undertakes to weigh the interests of copyright holders against those of consumers will the first sale exception, and the secondary markets it drives, enter the twenty-first century.

*Right to Resell What You Legally Own*, TIME (Apr. 25, 2013), http://techland.time.com/2013/04/25/redigi-ceo-says-the-court-just-snatched-away-your-right-to-resell-what-you-legally-own. Then, if and when a user later decides to resell, the file remains in ReDigi's cloud and does not need to be copied to the buyer, who is simply given access to it. *Id.* The *ReDigi* court did not take any position on whether such a process would be lawful under the Copyright Act. Capitol Records, LLC v. ReDigi, Inc., No. 12-95, 2013 WL 1286134, at *14 (S.D.N.Y. Mar. 30, 2013) ("[T]o comply with the law, either the law or ReDigi must change. While ReDigi 2.0, 3.0, or 4.0 may ultimately be deemed to comply with copyright law – a finding the Court need not and does not now make – it is clear that ReDigi 1.0 does not.").

[273] *ReDigi*, 2013 WL 1286134, at *11; *see also id.* at *10 ("[A]mendment of the Copyright Act in line with ReDigi's proposal is a legislative prerogative that courts are unauthorized and ill suited to attempt.").