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DIGITAL EXHAUSTION

Abstract

Copyright owner has an exclusive right on distribution of his/her work. However, this right is restricted by "first sale" doctrine, which states, that after the first sale of the copyrighted work, distribution rights of the copyright owner is exhausted, and he/she cannot control future sale of the work. Talking about a physical copy of the book, no question arises regarding the application of the "first-sale" doctrine. If the author of the book, sells, gives as a gift, or in any other way transfers the property rights for the copy of the book to another person, he/she loses the control regarding the future sale and transfer of this very copy. However, we are only talking about this very copy, therefore it is illegal to make a copy of the copy and distribute and sell them. A question arises: What if the copy is not physical, but a digital copy? Can we apply the same rules, considering that a copy of physical copy can be determined easily, because of the low quality of each further made copy, while it is not the case regarding digital copies?

Intellectual property law has always been influenced by rapid developments in digital area and technological industry. In recent years, the distribution of copyrighted works concerns not only tangible, but also digital data. The reason for that is obvious: one downloads different kinds of data every day: music, apps, online games, PDF files, such as books, magazines, etc. Now only a few people use CD's or DVD's in order to listen to favorite music, or to watch films, TV shows, etc., since we already have such apps as YouTube, Netflix, Spotify, etc. which make it much easier and more comfortable. Would it be fair and appropriate to rely on the same approach with respect to digital works as related to physical works and their copies?

This article, therefore, comprises the overview of the "first sale" doctrine related to copyrighted works and their distribution and reproduction in the digital sphere, comparative analysis of different legal approaches regarding European and international legislation, and the problems and gaps existing in legislations and advantages and disadvantages of accepting the existence of digital exhaustion.

Annotasiya

Müəllif öz əsərinin yayılması üzərində müstəsna hüquqa malikdir. Lakin bu hüquq "ilkin satış" doktrinası ilə məhdudlaşdırılmışdır. Belə ki, əsərin ilk nüsxəsinin satışından sonra müəllifin həmin nüsxənin gələcəkdə yayılmasını: satışını və digər yolla özgəninkiləşdirilməsini idarə etmə hüququ itir. Əgər söhbət hər hansı kitabın fiziki nüsxəsindən gedirsə, "ilkin satış" doktrinasının tətbiqi sual doğurmur. Kitabın müəllifi həmin kitabın ilk nüsxəsini birinə bağışlayarsa, satarsa, və ya digər yolla özgəninkiləşdirərsə, o məhz bu nüsxə üzərində nəzarət hüququnu və nüsxənin gələcək satışını idarə etmək hüququnu itirir. Lakin söhbət yalnız həmin nüsxədən gedir, nüsxənin nüsxələrini çıxarıb onları yaymaq və özgəninkiləşdirmək isə qeyri-qanunidir. Lakin bu zaman sual yaranır. Bəs əgər nüsxə fiziki deyil, elektron olarsa, eyni qaydaların tətbiq olunması mümkündürmü? Əsərin fiziki nüsxəsindən çıxarılan hər növbəti nüsxədə yazıların, şəkillərin keyfiyyəti bir qədər azalır. Elektron nüsxələrə münasibətdə isə bunu anlamaq xeyli çətinləşir.

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Əqli mülkiyyət hüququ hər zaman texnologiya sahəsində baş verən müntəzəm dəyişikliklərin təsirinə məruz qalır. Son illərdə, müəlliflik hüquqlarının tükədilməsi məsələsinin yalnız daşınabilən və fiziki deyil, rəqəmsal məlumatlara da şamil olunub-olunmaması sual doğurur. Bunun səbəbi isə aydındır: hər gün müxtəlif növ məlumatlar yükləyirik: musiqi, applikasiyalar, oyunlar, kitab, jurnal və digər PDF fayllar və s. Hal-hazırda çox az insan musiqi dinləmək, filmlər və televiziya verilişləri izləmək üçün CD, DVD-lərdən istifadə edir, çünki artıq YouTube, Netflix, Spotify kimi hər şeyi asanlaşdıran applikasiyalar mövcuddur. Bəs fiziki əsərlərə və onların nüsxələrinə şamil olunan qaydalar, xüsusən də müəlliflik hüququnun tükədilməsi rəqəmsal dünyaya da şamil oluna bilərmi?

Məqalənin məqsədi "ilk satış" doktrinasının rəqəmsal dünyada hələ də müəmmada qalan keçərliliyi məsələsini Avropa və beynəlxalq qanunvericilik çərçivəsində analiz etmək, bu sahədə yaranan problemlər və qanunvericilikdəki boşluqları müəyyənləşdirmək və rəqəmsal tükədilmənin müsbət və mənfi cəhətlərini aşkar etməkdir.

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Introduction

Digital exhaustion is the exclusive right to authorize or prohibit any form of distribution to the public by sale or otherwise.[1] While continuous and progressive development in the technological area influences all areas of industry and business, the importance of the determination of rules regarding the digital (intangible) part of these areas arises. One of the most importance questions in this respect is, to what extent the protection and regulation of relationships in the digital area have to be solved the same way as in the non-digital area.

Nowadays, the transfer of the data, including copyrighted works is realized not only physically, but also via the internet. Moreover, a distribution of copyrighted works is accompanied by the exhaustion doctrine which "limits the rights-holder's exclusive right to distribute a protected work, where the distribution right is 'exhausted' following the first (authorized) sale of the work". As such, they cannot exist without each other. In that case, while

[1] Kevin Garnett, Jonathan Rayner James & Gillian Davis, Copinger and Skone James on Copyright, 392 (1999).

distribution right belongs exclusively to the copyright holder, the exhaustion rule creates a balance between the interests of the copyright holder as the creator of the particular work and public, which in the internet world is called - users. Hence, before exhaustion doctrine has been straightforwardly applied to physical works, the question arises: Does this doctrine apply to digital works, such as software, e-books?

Even though both in digital and non-digital world the works created by human are protected under and regulated by copyright law, the nature of digital works certainly differs from the physical ones, which lead to differences between the protection of the rights, enforcement of the legislation to both types of works. The issue of applicability of the "first-sale" doctrine regarding the digital copyrighted works is a complicated issue which is mostly to be analyzed on a case-by-case basis.

The works created by the author are accompanied by exclusive rights occurring from the creation of this work. Regarding to the Information Society Directive copyright holder possesses the following exclusive rights:

a) right of reproduction;
b) right of communication to the public;
c) right of distribution.

Among these rights the one which mainly falls under the scope of this paper is distribution right. The reason is, that exhaustion rights arise in order to limit the distribution rights of the copyright holder, mainly with an aim to achieve a balance of interests and prevent the dysfunction of competition rules in the copyright marketplace.

Distribution rights entitle the copyright holder to demand that any kind of distribution of his work or copy of the work is possible only after his permission, therefore licensing. This right gives the right holder a dominant control in the market regarding his work. For instance, purchasing a new copy of a copyrighted book, offering Breaking Bad on Netflix, or even giving a friend the second copy of the copyrighted work, you have obtained from the rightsholder without his permission can trigger liability if there is no permission of the right holder.[2] However, this control is not unlimited since it would prevent the development of the market and restrict standard competition rules. To what extend this particular control exists is determined by the limitations and restrictions established by the legislation and precedents.

The problem with the licenses is that they may limit the user's interaction with copyrighted work including the right to transfer since the license allows the right holder to exercise control over the content.

[2] John A. Rothchild, *The Incredible Shrinking First-Sale Rule: Are Software Resale Limits Lawful?*, 57 Rutgers Law Review (2004).

Actually, the aforementioned norms have to the serve to the protection of both interests of the copyright holders and also the interest of the public. Intellectual property rights are always considered to entitle the right holder to give the licenses and thus to decide what the "fate" of the copies of his works will be and therefore lead to the dominant position of the right holder in the market and sometimes may prevent normal competition standards. Therefore, there needs to be a balance between these two interests and for this purpose, some limitations and restrictions regarding the exclusive rights of the right holder were established. One of these limitations is exhaustion, which is also called the "first-sale" doctrine.

The principle of exhaustion means, that once the right holder has placed his/her work on the market, he has no more control on the resale of his copyrighted work, hence the right to control the distribution of the work is exhausted.[3] For instance, if an author of the book sells the copy of his work to anyone, he loses the control over the future resale, or other ways of transfer of this particular copy. The person who bought this copy, obtains the property right for this very copy, therefore he has the rights arising from property rights. Once a given product has been sold under the authorization of the IP owner, the reselling, rental, lending and other third party commercial uses of IP-protected goods in domestic and international markets is governed by the principle.[4] A proper examination shows that the main rationale for the doctrine is to balance the rights of the right holder with the need to achieve a single internal market within the Union, free from barriers.[5] In legal literature, this principle is also called "first sale doctrine", which means, that the right holder loses the control on resell, distribution of the copy of his work, once he sells it for the first time. This principle is considered as a clue to balance between interests of copyright holders, performers on the one hand, and the consumers on the other hand. Thus, the principle has to be applied properly, in order to hinder the violation of the rights of all parties subject to the license agreement. There are some criteria that should be met in order to automatically apply the exhaustion rule:

a) the right holder or another person with the authorization who can;
b) lawfully distributes, and what is more transfers the ownership over;
c) the original or the copy of the protected subject matter;

[3] Emma Gallacher, Sean Jauss, Exhaustion of copyright (2014), https://www.lexology.com/library/detail.aspx?g=29f0d605-aae8-4163-966b-3d2acb0ba3a3#:~:text=The%20principle%20of%20exhaustion%20is,owner%20or%20with%20their%20consent (last visited Nov. 27, 2020).
[4] International Exhaustion and Parallel Importation, WIPO (2015).
[5] Tritton on Intellectual Property in Europe, 639 (1996).

d) the rightful owner, which possesses the ownership of the subject matter, may resell the copy without the further consent and authorization of the author.[6]

But to what extend do these rules apply to digital works? Are these 4 criteria enough for setting exhaustion in digital sphere as well?

Digital distribution of copyrighted works causes the importance of regulating the legal acts occurring from these processes.

Digital distribution is the distribution of any digital content, including e-books, PDFs, games, software, photos and videos, etc. through download, thus digital distribution is handled through platforms that are designed to stream the digital content or allow the content to be downloaded. The feature that makes it hard to determine, is the intangibility of the copies. As it was mentioned before, the person who receives the copy of the book by the author, has the property right only on this particular copy, thus it is prohibited to make further copies and share them with others.

Certainly, tangible copies are easier to distinguish, because their quality can worsen. For instance, the second copy of the book, or image will not be as qualitative as the first one, the letters will be less and less readable by each further copy. However digital copying is a quite easy process, you can copy the text and paste it, or even write the same again, and it is hard to determine whether it is the particular copy that was transferred to the licensee, or was the copy made by the licensee himself. The facts mentioned complicate the analysis of copyright infringement and creates a disadvantageous situation for the copyright holder. Therefore, it is essential to analyze whether the digital distribution can be exhausted, therefore whether digital exhaustion is to be accepted, and if yes, to what extent it is applicable.

I. Application of digital exhaustion

International copyright treaties serve to the worldwide protection of the creative works.

The first-ever international treaty concerning Intellectual Property Law that also covered the exhaustion rule regarding copyright and established imperative rules for dispute settlement procedures in this regard, was the Agreement on Trade-Related Aspects of Intellectual Property Rights (hereinafter TRIPS). It states that "for the purposes of dispute settlement under this Agreement, subject to the provisions of Articles 3 and 4 nothing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights".[7] "In TRIPS agreement it is stated, that any dispute related to a domestic regulation shall not be the subject to a dispute settlement procedure under the WTO law. The latter does not forbid,

[6] Peter Mezei, Copyright Exhaustion: Law and Policy in the United States and the European Union, 8 (2018).

[7] Agreement on Trade-Related Aspects of Intellectual Property (hereinafter TRIPS), art. 6 (1995).

however, the initiation of legal proceedings in front of domestic courts".[8] Obviously, TRIPS Agreement is not too much involved in the matter of exhaustion and regulates this problem very slightly. The principle of exhaustion was new enough, and it would cause more problems if to regulate it internationally, since in case if there is any gap in international legislation, it will cause serious problems. Therefore, it probably seemed to be more logical to see the approach of different countries.

WIPO treaties included positive norms on exhaustion.[9] WIPO Copyright Treaty (WCT) states that "Nothing in this Treaty shall affect the freedom of Contracting Parties to determine the conditions, if any, under which the exhaustion of the right in paragraph (1) applies after the first sale or other transfer of ownership of the original or a copy of the work with the authorization of the author".[10]

When discussing the exclusive rights of the copyright holder, especially the distribution right which entitles the right holder with the exclusive right of permitting the use of his works by giving licenses, so that members of the public can use the copyrighted work, it is important to mention the provision of TFEU, which prohibits quantitative restrictions on imports and all measures having equivalent effects.[11] Also in the "Deutsche Grammophon" case, which is one of the earliest cases in Europe related to the exhaustion rule, the aim of this doctrine was considered as "promoting the internal market".[12]

A. Digital Exhaustion in EU legislation

European copyright law entitles the copyright holders with the aforementioned exclusive rights and as it was already mentioned, the exhaustion principle has been incorporated to EU legislation. More precisely, this principle is provided by Article 4 of the Information Society Directive and Article 4 of Software Directive, which set particular limitation for distribution right.

Information society directive, which is also known as EU Copyright Directive, and serves to implementation of WIPO Copyright Treaty and on the harmonisation of certain aspects of copyright and related rights in the information society.[13] The distribution right shall not be exhausted within the Community in respect of the original or copies of the work, except where the first sale or other transfer of ownership in the Community of that *object* is

[8] Peter Mezei, Digital First Sale Doctrine Ante Portas – Exhaustion in the Online Environment, 6 Journal of Intellectual Property, Information Technology and E-Commerce Law 23, 25 (2015).
[9] *Ibid.*
[10] WIPO Copyright Treaty, art. 6(2) (2002).
[11] Treaty on the Functioning of the European Union (hereinafter TFEU), art. 34 (1957).
[12] Deutsche Grammophon Gesellschaft mbH v Metro-SB-Großmärkte GmbH & Co. KG. (1971).
[13] Directive 2001/29/EC of the European Parliament and of the Council of 22 May 2001 on Harmonisation of Certain Aspects of Copyright and Related Rights in the Information Society, art. 4(2) (2001).

made by the right holder or with his consent.[14] It means that until the copyrighted work was first put to the market by the copyright holder or his consent, any action concerning the work, or its copy is *illegal*. Although the norm underlines the main features of exhaustion, it mainly aims to protect the rights of the copyright holder. However, the main question is: what exactly is meant by the word "object"? Does it also include intangible goods, or it only refers to physical copies of the work?

Furthermore, the Directive states that "copyright protection under the Directive includes the exclusive right to control the distribution of the work incorporated in a tangible article".[15] At first sight one can reckon that everything is obvious: Well, recital 28 precisely states "this directive regulates the exhaustion principle with regard to physical, thus tangible copies of the copyrighted work". But the interpretation of this rule leads to the following question: does it exclude the intangible copies? I would say, not at all. This rule does not lead to the conclusion, that there can be no exhaustion regarding the intangible copies.

Considering the aims of the principle and answering the question: what is the purpose of this "first-sale doctrine"? One can easily find the answer: exhaustion rule serves to the protection of interests, supporting fair competition rules and certainly, preventing the restrictions and abusive dominant position in the market. However, there are differences between the tangible and intangible copies of the work, which will be discussed below. While a lot of discussions were held and a lot of disputes occur concerning the question of whether the InfoSoc directive can be implemented in respect to the intangible distribution, the Court of Justice almost put an "exclamation point"- with its ruling for the case of Art & Allposters International BV v. Stichting Pictoright, holding that, the rule under 4(2) of InfoSoc Directive only applies to tangible support of the goods.[16]

When it comes to Software Directive, it is determined, that the first sale in the Community of a copy of a program by the right holder or with his consent shall exhaust the distribution right within the Community of that copy, except the right to control further rental of the program or a copy thereof.[17] The wording of this rule does not restrict the exhaustion of the distribution rights.

Therefore, Software Directive also does not provide us with precise information and therefore does not exactly regulate whether the copies can be kept only in tangible or, also intangible data carrier to fall under the scope of

[14] *Ibid*.
[15] Directive 2001/29/EC of the European Parliament and the Council on the Harmonisation of Certain Aspects of Copyright and Related Rights in the Information Society, recital 28 (2001).
[16] Judgement of the Court (Fourth Chamber) (2015), http://curia.europa.eu/juris/document/document.jsf?text=&docid=161609&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=12098699 (last visited Nov. 27, 2020).
[17] Directive 2009/24/EC of the European Parliament and of the Council of 23 April 2009 on the legal protection of computer programs, art. 4(2).

this directive and so that the exhaustion rule will apply also to the intangible copies.

Since none of the current legislation provides a precise regulation about the distribution of the intangible copies, and whether there can be any exhaustion in such cases, the issue of digital exhaustion needs to be analyzed individually based on the circumstances of each case.

B. CJEU approach to digital exhaustion

1. UsedSoft v. Oracle

According to the reasoning of the UsedSoft vs. Oracle case, the facts of which involve the distribution of software, the principle of exhaustion is regulated under Article 4(2) of Software Directive.

In this case the Court of Justice has decided "in favour" of digital exhaustion, stating that the distribution right on the software was exhausted as soon as the first copy of it is sold. The Court regulated this principle under the abovementioned legal norm: Article 4 of the Software Directive. The legal background of this case is as follows:

Oracle is a software company the main job of which is marketing the software. The clients download the software from the internet, therefore a license agreement between Oracle and its clients occur. This agreement states that after paying the fee once customers have a non-exclusive and *non-transferable* right to use the software. There is also no time limit for using this software.

UsedSoft is a company operating in the resale of the second-hand software. The important facts of this case are the following:[18]

1) The license agreement between Oracle and its clients were still in force;
2) Customers still downloaded this software from the website of Oracle, the only issue is, that the licenses are offered by UsedSoft, since they are "second-hand", which means, they are bought from customers.

The aforementioned legislative rules about exhaustion show us exactly what will happen: Once the copyright holder (in this case Oracle) sold the first copy of his copyrighted work (in this case, software) he loses the control on the future resale and transfer of this very copy. At first sight there is no problem, customers sell the very licenses that they bought from Oracle, after their first sale the rights are exhausted, there is no problem regarding selling it to UsedSoft. However, the license agreement states precisely: the right to use the software is *non-transferable.*

The answer of the CJEU in this case, to the question whether the digital exhaustion exists, or not was: Yes, it does. The court ruled, that once the software was sold to the customers for the first time, and the legal basis for this is the license agreement, that provides the customer with the use of the software for an unlimited period of time, the further control of this very copy

[18] C-128/11 UsedSoft GmbH v. Oracle International Corp., CJEU (2012).

is not controlled by the copyright owner. The rule determined in the license agreement, that the use is non-transferable, is restrictive and the right holder cannot relate to this rule and limit and restrict the future resale of the software. The court further stated, that in order to a resale (whether tangible or intangible) not to infringe, the original acquirer must make his own copy unusable at the time of its resale.[19]

The UsedSoft case showed, that digital exhaustion really exists. It made obvious the fact that EU copyright legislation is flexible enough to be able to adapt to the modern digital marketplace. The legislation related to the copyright, including the exhaustion rules is flexible enough to be applied with regard to digital distribution of the goods.

But why this decision, which is clear and precise in point of the exhaustion via the internet, it cannot be used as a precedent with respect to all digital works? The answer to this question is in the case below, where CJEU decided in a completely different manner than in the current case.

2. E-books and digital exhaustion

While talking about digital exhaustion we do not only emphasize computer programs, however there are a lot of types of digital copyrighted works. One of the most widely used of is e-books. Physical copies of the books become the subject matter of exhaustion, as soon as the first copy of the book was sold. As we see in the UsedSoft case, digital exhaustion was considered to exist, as the CJEU ruled. However, regarding the e-books, the CJEU took another position. Digital copies of e-books, the transfer via the internet of the e-books do not lead to the exhaustion. To the question "why?" the CJEU responded in the cases below:

In **VOB v Stichting** case there are some aspects that play role in the understanding of the CJEU approach to exhaustion of distribution rights in a digital world, although it does not exactly relate to this matter as the main legal framework of this case is the Rental and Lending Directive.

In this case a public library copied e-books to a server allowing users of this server to download the copies to their personal laptops, phones, etc. When the user downloads the copy, this copy is only available for him. The most essential question referred to the CJEU was if the library could lend the e-books as downloads under the aforementioned directive, or not. In this decision, the CJEU referred to the WIPO Copyright treaty. Therefore, the decision of the court was almost the same with regard to the digital exhaustion matter. The Court ruled that "intangible objects and non-fixed copies, such as digital copies, are excluded from the right of rental". [20]

Another case concerning the distribution of e-books is **Nederlands Uitgeversverbond v. Tom Kabinet,** which is considered to be an anticipated

[19] *Ibid.*

[20] C-174/15, Vereniging Openbare Bibliotheken v Stichting Leenrecht (ECJ), para. 3 (2016).

CJEU decision since the ruling of the court was a completely new approach to the problem and put the previous decisions under doubt since there was an obvious contradiction between them. The dispute was between Dutch copyright organizations: Nederlands Uitgeversverbond, Groep Algemene Uitgevers, and Tom Kabinet, a company which offered an online "reading club" which also led an online book business. NUV and GAU sued Tom Kabinet before the District Court of The Hague demanding prohibition of making available and reproducing the books, and they claimed that Tom Kabinet infringed their rights. Tom Kabinet from infringing the copyright of NUV's and GAU's affiliates by making available or reproducing e-books without any authorization. The District Court of Hague ruled, that the e-books are also "works" and therefore fall under the scope of the InfoSoc Directive. The Court also ruled that the action of Tom Kabinet does not constitute any communication to the public. The question before the CJEU was whether the actions of Tom Kabinet constitute "communication to the public" within the meaning of Article 3(1) of the InfoSoc Directive, or "distribution" under Article 4(1) of the directive.[21]

In this particular decision, CJEU referred to the "WIPO Copyright Treaty" ruling, that the CJEU held that "communication to the public" and "distribution" regarding to in Article 3(1) and Article 4(1) of the InfoSoc Directive must be interpreted under the WIPO Copyright Treaty.[22] In WIPO, exhaustion of the right of distribution only concerns tangible copies of the copyrighted works. Hence, CJEU responded that it constitutes a communication to the public, but not distribution and therefore, there cannot be any exhaustion, since distribution is not concerned. Obviously, this is one of the reasons why this ruling is so anticipated and raises so many disputes.

The reason for that was obvious: Tom Kabinet made e-books available to the public, that means everyone could see these materials, since he had a website where all the users could have access to these books. There was no restriction on how many copies can be downloaded and there was also no time limit.

Actually, there is a very narrow line between distribution and communication to the public in this case. As a matter of fact, this case could have "something to do" with distribution if Tom Kabinet bought the copy of the book from the right holder, and then purchased or transferred the rights belonging to him in respect to *this particular copy* to another person. Another reason why this ruling is so anticipated is its connection with the case mentioned above. A question arises: Why the CJEU decided differently in these 2 cases, UsedSoft and Tom Kabinet case? As a matter of fact, both of these cases are related to some digital material which is downloaded from a

[21] C-263/18, Nederlands Uitgeversverbond, Groep Algemene Uitgevers v. Tom Kabinet, CJEU (2018).
[22] *Ibid.*

website. In Tom Kabinet case, the court ruled that the directive needs to be interpreted as in WCT, and stated, that the copies must only be tangible, in order to consider exhaustion.

And then: Why in UsedSoft case, where we were also talking about downloading the software from the internet without further licensing, the court did not consider the action of UsedSoft as communication to the public? What is the difference that made the court to decide in a completely different way?

First of all, one needs to be careful while considering what exactly is exhausted. Only the right of distribution can be exhausted, therefore it relates to neither to the communication to the public nor to the right of reproduction. If from one copy, other copies are also created, it may and probably will harm the interests of the copyright holder. Even the likelihood of such harm leads to the conclusion, that such an action is not admissible. The owner to whom the copy of the copyrighted work was purchased, given, or transferred in any means by the copyright holder or with his permission, has the right of ownership only *on that very copy.* Reproduction of new copies and selling them, or even giving a gift cannot be considered legal and therefore, it does not fall under the doctrine of exhaustion.

Secondly, there is a logical reason for the approach to the copies of e-books more strictly. You can make a copy of any e-book unlimitedly and without anyone noticing that and finding out the infringement you have committed. If I make a copy of Wulf Dorn's book which is on my bookshelf and give it to my friend so that she does not pay much for buying the book (since printing is very cheap in my country) it is obvious that this copy will not have the same quality as a book, but the quality will not be that bad. However, if my friend gives that copy to another friend of hers, and she takes another copy, the quality of the second copy will be worse. Accordingly, each time the copy is copied, the quality is getting worse and worse and therefore, one can easily understand that the copy is not the first one. It is not that difficult to comprehend, however by e-books, it is almost impossible to understand, whether the particular copy is the copy obtained from the right holder, or this is a new copy that the new owner did himself.

C. US approach to digital exhaustion

In the US, the fundamental copyright law issues are regulated under the Copyright Act. As under the EU law, in the US the Copyright Acts also grant to copyright holders the exclusive right to distribute copies of their works and also determines the limitation to this right under "first sale doctrine. The Copyright Act provides that "...the owner of particular copy or phonorecord lawfully made under this title... is entitled, without the authority of the copyright owner to sell or otherwise dispose of the possession of that copy or

phonorecord".[23] This provision refers to the tangible copies of the copyrighted work.

However, in MAI Systems Corp. v. Peak Computers Inc. the question before the court was whether copying a computer software into the temporary memory is considered as a copy under US Copyright Law. And the response was, "the loading of copyrighted computer software from a storage medium into the memory of CPU causes a copy to be made.[24] This ruling makes it obvious, that US legislation does not display a flexible approach regarding copyright exhaustion, limiting this right only to physical copies of the copyrighted work.

In order to comprehend the approach to digital exhaustion under US Copyright Law, it is useful to mention some important case law involving this issue.

1. Capitol Records v. ReDigi.

ReDigi was sued by Capitol Records on the grounds that ReDigi's action infringed the copyright of Capitol Record. ReDigi is an online company which functions as a digital marketplace. The users of ReDigi have to download a "Music Manager" (which uses "a verification engine") in order to sell music. ReDigi uses some measures to ensure that each user has only one copy of the file, and that it will not be sold by another user. The seller cannot keep a copy of the file that he has already sold either. When ReDigi finds out, that there is any copy of the music in the computer, he asks them to remove it. In case of the ignorance, his account is terminated. Capitol Records sued ReDigi as they considered the action of ReDigi as an infringement. From the perspective of Capitol Records, ReDigi infringes their reproduction and distribution rights. It is unclear whether there is a prior agreement with the rightsholder as to the placing of the song on the marketplace or as to the percentage. Capitol Records considered ReDigi's business as an infringement on their reproduction and distribution rights. ReDigi argued that the scope of their business (which Capitol Records calls copying) only consists of the space shifting which does not involve anything illegal. Therefore, it has to be considered as fair use and falls under the concept of "first sale doctrine".[25] Capitol records argued that ReDigi's business involves copying and therefore, is prohibited by the Copyright Act. Actually, Copyright Act entitles a rightsholder with the right to reproduce the copyrighted work in copies or phonorecords, to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, and to publicly perform and display certain copyrighted works.[26] According to this Act, "phonorecords" are the "material objects in which sounds, other than those

[23] US Copyright Act, Section 109(a) (1976).
[24] Mai Systems Corp. v. Peak Computers Inc., US Court of Appeal, Ninth Circuit (1993).
[25] Capitol Records, LLC v. ReDigi Inc., No. 16-2321 (2d Cir. 2018).
[26] *Id.*, section 106.

accompanying a motion picture or other audiovisual work, are fixed by any method now known or later developed, and from which the sounds can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device".[27]

Moreover, the court quoted London-Sire Records, Inc. v John Doe 110, in which the court, held that downloading a digital music file to a hard disk is the reproduction of a new phonorecord.[28] Therefore, any transfer, not depending on whether one or more copies exist, will be considered as reproduction. Thus, ReDigi has infringed the copyright.

The Court ruled, that the first sale doctrine cannot apply to this case, since the doctrine applies only to a "particular" copy, which means the very copy that was received from the right holder.[29] The copy of a copy – is another reproduction, therefore is illegal and cannot be considered under the first sale doctrine. The Court stated that the action of ReDigi commits the likelihood of damage to the market. inter alia, the fact that ReDigi could potentially hurt the primary market.

Considering the facts and the judgement above, we can easily observe, that the US Court did not find the application of digital exhaustion attractive and appropriate, but vice-versa.

2. Is licensing embracing ownership in itself?

Copyright Act states, that "first sale doctrine does not apply if the possession of the copy is "by rental, lease, loan, or otherwise without acquiring ownership of it".[30]

This is a very important issue regarding to the digital exhaustion, since many copyright holders insist, that they did not sell the copies of their work, but licensed and therefore they still have an exclusive right of distribution and the first sale doctrine cannot apply in this case.

These licenses are generally called end-user licenses (EULA) and have various types:[31]

Clickthrough licenses

One becomes a party to the contract as soon as clicks on the button "I accept". We experience that every day without noticing: while visiting any website, or while downloading any content. By clicking on "I accept" we agree with the terms and conditions of the website and become a party to a clickthrough license. Another type of EULA is shrink-wrap licenses, which especially concerns the hardware. When we open the license covered by the

[27] US Copyright Act, Section 101 (1976).
[28] London-Sire Records, Inc. v. Does 1-4, Civil Action No. 04-cv-12434.
[29] Capitol Records, LLC v. ReDigi Inc., No. 16-2321 (2d Cir. 2018).
[30] *Ibid.*
[31] Niva Elkin-Koren, Governing Access to Users-generated content: the changing nature of private ordering in digital networks.

shrink wrap, usually listed on the product, we automatically become a party to this contract (license).

Certainly, the application of the first sale doctrine is under a big question, and it is a complicated issue to solve for the US Courts, therefore there are some decisions that are in contradiction with one another. One of the most valuable court rulings regarding to this matter is Vernor v. Autodesk.[32] This case concerns the applicability of the first sale-doctrine and is about the computer programs transferred to the user under the *shrink wrap license*. The Court ruled, that the person was a licensee, not an owner and therefore, the first sale doctrine cannot be applied. In this case the distribution rights of the Autodesk were infringed.

However, there are also cases where the US Court decided differently. One of these cases is United States v. Wise,[33] where the US Court found out, that there is a very thin line between the owner and just licensee. In case, if due to the license, the licensee has a right to keep the copy, then he also becomes an owner, therefore there is a sale, otherwise there is no sale. Thus, the first sale doctrine applies in the first case, but not the second one.

II. For or against?

A. Disadvantages of digital exhaustion

Not only the copyright holders, but also the courts are reluctant to accept the principle of digital exhaustion. Considering all aforementioned facts and the court rulings, there are following reasons for the so-called antipathy against digital exhaustion: First of all, there is a risk for the copyright holder's economic and moral rights. The risk concerning the economic rights is absolutely understandable, so there are no time and place limits related to the distribution of the work, since in internet everything is much easier and the control over it is complicated and sometimes even impossible.

An example of that can be copying of a book. A copy cannot be as clear and have as good quality as an original one. Each time the text is copied (copy of a book, then copy of the first copy, and it continues in such way) it degrades and the quality gets worse and worse and therefore, mostly one can easily, even without any special knowledge comprehend, whether the copy is copied from original or from another copy.

However, on the internet everything is different. One can make a copy of a file for several times, without risk of degradation, so there is nothing obvious, even if the infringement occurs. It causes difficulties for the copyright holder, and is against the exclusive rights provided for copyright holder. The purpose of copyright legislation is motivating the people to create. One cannot be

[32] Vernor v. Autodesk, Inc., 621 F.3d 1102 (9th Cir. 2010).
[33] United States v. Wise, 370 U.S. 405 (1962).

enthusiastic to create if there is always threat, that your rights will likely be violated.

Secondly, exhaustion applies in respect to the distribution right, however when creating new copies of the original one, it leads to the reproduction, since we are not talking only about the particular copy that was transferred to another party. As reproduction right can never be exhausted, this action infringes the rights of the author.

The other problem is, as mentioned above, regarding to license agreement. If we consider the digital exhaustion with regard to such license, we need to forget about the basic legal principles. Licenses do not make one an owner of the copy, however, just gives a right to use it. One does not become the proprietor or owner just by obtaining a license. Therefore, he cannot purchase, or transfer by any means the copy he has received, and we cannot speak about digital exhaustion.

Furthermore, from the copyright holder's perspective, a reward for his work becomes more, when exhaustion does not apply. He will get remuneration every time he gives a license for the copy, therefore copyright holder does not support this doctrine much. However, when the general exhaustion rule applies in respect with the physical copies, they only get remuneration once for a copy.

B. Advantages of digital exhaustion

New technological period possesses an undeniable influence on copyright law. Before, authors distributed their works only physically, for instance gave, the copy of their books to someone by hand, or sent by post. As a result, one received a tangible copy of the book.

The court's perspective, that "not every copy is a copy" is not satisfactory, since it restricts the customers' rights, prevents the application of fair competition standards, which is against to the principles of TFEU. The only reason for such a restriction is the intangibility of these copies. Not accepting the first sale doctrine with regard to intangible copies, it can be said that legal systems are not able to demonstrate flexibility and adapt to the new technology. Therefore, it will however not result in the fact, that the need for exhaustion just disappears, only because the technology has developed, and also digital copies of the works exist. It cannot be considered as a fair reason to restrict the customers' rights on the copyrighted work, as we should not forget the purposes of the exhaustion doctrine, and the consequences, in case if there was no such a principle. Exhaustion rule exists, to prevent the imbalance between the interests, and to support the competition rules, that play an important role in the functioning and development of the market.

One of the most important advantages of digital exhaustion, and certainly the exhaustion in general is, encourages the secondary market. Reluctance of

acceptance of digital exhaustion will lead to decrease in this field. However, primary and secondary market has a strong connection between each-other.

Additionally, in the secondary market the prices are usually lower. It is absolutely logical, since "second-hand" products are always cheaper than the new ones. It is beneficial mostly for the customers, however, since the lower the costs are, the more attractive is the product considered, the more of it is sold and therefore, the work of the author is in circulation. His work is getting known and reaches more public. It can be said that it is also beneficial from the copyright holder's point of view.

Nevertheless, a digital secondary market can increase innovation.[34] It creates something new, for instance, new services, new goods, that can be very innovative and useful for the public, and also for the development of business. Such a restriction towards intangible copies and therefore, digital exhaustion does nothing but demotivates such a development.

Although at first sight, it can be thought that acceptance of digital exhaustion supports the secondary market and therefore the licensee (the one who receives the digital copy), while non-acceptance of this principle serves to interests of the right holder. However, to look more deeply, secondary market, even if it cannot exist with the primary market, also contributes to the primary market.

In this instance, the UsedSoft case has a great value and importance since the court has ruled in a very flexible and tolerant way. The court showed that the exhaustion principle has great importance to apply that not only to the tangible copies but also to distribution via the internet. However, in most of the rulings afterwards, the court decided in a completely different way, showing antipathy towards exhaustion in respect with intangible copies of works.

Considering all information above, it can be said, that such a reluctance and antipathy toward this matter hinders the development of the secondary market, as well as contradicts the principle of exhaustion and its fundamental goals to create a balance between interests. The aim of balancing is that none of the interests prevails, and none of them is underestimated, but if digital exhaustion is not accepted, we cannot provide such a fair balance.

Conclusion

As almost every business is shifting from traditional to digital format, it is important to be flexible in order to adapt to technological changes in the world. The cases related to digital exhaustion will be even more and more, since technology develops year by year.

We cannot underestimate the role of copyright exhaustion in the digital marketplace. As we observed, this uncertainty caused several problems, since

[34] Aaron Perzanowski, Jason Schultz, *Digital Exhaustion*, 58 UCLA L. Rev. 889, 891-897 (2010).

the members of the digital marketplace cannot reckon, whether their business is considered legal, or not. While UsedSoft case displays tolerance towards the first-sale doctrine in the digital area, the faith of Tom Cabinet turned out to end as a sad story.

Considering all the aforementioned, it becomes obvious, that the copyright owner will get remuneration, both if the transfer of the copy is physical, or via the internet. However, the problem here occurs especially regarding other members of the digital marketplace, users and their rights. Since customer's rights and public interest generally is very important as well as balance in the market and providing fair competition and preventing the abusive dominant position in the market. However, when it comes to the digital world, the users', this balance is somehow underestimated. It can be said that such problems arise since the development of technology and its transmission to the copyright sphere is quite new, however, it will continue in a few years probably, intangible copies will be more actual than the physical ones.

Therefore, there needs to be a more detailed approach to the issue of digital exhaustion. Analyzing case-by-case can sometimes cause much uncertainty, since some of the decisions contradict each other, although the facts and circumstances are similar. There needs to be some border, and this border has to be regulated by law, accordingly some fundamental legal provisions have to be established in order to at least regulate some important legal matters, and to have some clarification, so that users on the internet also know, what rights they have and what they may not do.

Even lawyers are confused when it comes to the exhaustion in the digital world, related to intangible copies, and even national courts of Member States find it too complicated to solve this issue. Therefore, there needs to be fair and balancing fundamentals, in order to simplify this situation and avoid confusion.