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A CRITICAL ANALYSIS OF DIGITAL EXHAUSTION – WITH SPECIAL REFERENCE TO REDIGI’S CASE

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ABSTRACT

In general Copyright owner has an exclusive right on distribution of his/her work. However, doctrine of exhaustion is a limitation imposed on the right of the copyright owner, it states that once a copy has been sold to another by the owner the right to distribute that copy by the copyright owner gets exhausted and the right to resell that copy is given to the purchaser of the copy. The owner of the copyrighted work loses the control regarding the future sale and transfer of this very copy. Herein we are talking only about this very copy, therefore it is illegal to make a copy of the copy and distribute and sell such copies. It is well known that Intellectual property law is extended to digital files and technological industry with the developing society. Rapid advancements in the digital space and the technological industry have always had an impact on intellectual property legislation. In recent years, digital data has also been a factor in copyrighted works dissemination. The reason for this is simple: people obtain a variety of data every day, including music, apps, online games, and PDF files for publications like books and magazines. Few people now use CDs or DVDs to listen to their favourite music or to watch movies, TV programmes, etc. because there are already apps like YouTube, Netflix, Spotify, etc. that make these activities much simpler and more comfortable. Thus, a question herein arises that would it be reasonable to apply the same standard of exhaustion laws to digital works as to physical works? Thus, this article herein focuses on the overview of the First sale

doctrine related to copyrighted works and their reproduction in the digital sphere and finally the paper concludes with the Doctrine of exhaustion to be extended to digital files also with special reference to a U.S case study famously known as the ReDigi's case.

Keywords: Digital, Exhaustion, Copyright, File, First Sale, Intellectual Property.

INTRODUCTION

In recent years, the distribution of copyrighted works has transitioned from the delivery of tangible goods or things to the transmission of digital data or files. The information society and sharing community have centred their activities around e-books, audio files, video clips, computer programmes, and other digital items. Customers can purchase them on CDs, download temporary or permanent copies from websites or mobile apps, or watch them on demand. In each instance, they are asked to agree to extensive and complicated contract clauses that restrict their ability to transfer digital goods between devices (such as from a disc to a computer), sell, lend, or rent them, import them from another country, bring them with them, or leave them to their heirs.

Amazon, for instance, currently sells more e-books than hardcovers. Apple is now the largest music vendor in the US as CD sales are down and music downloads are rising. Boxed items are outsold by downloads in online software sales. Additionally, internet video game sales are now more comparable to offline ones.

With the transition to a digital market, rights holders now have more control over both the price and accessibility of their works as well as the applications that customers can use their purchases for. On several levels, this regulation limits the welfare of the consumer. It hinders customers from purchasing or disposing of works through secondary marketplaces, invades their privacy, reduces their prospects for innovation, and endangers market efficiency and competition by raising transaction costs and increasing the possibility of consumer lock-in.

Historically, the doctrine of exhaustion has been primarily responsible for addressing these concerns in both copyright and patent laws, which holds that when ownership of a particular embodiment of a work covered by an intellectual property right passes from the right holder to a consumer, the right holder's control over that embodiment is diminished. Though most courts and commentators have restricted copyright's exhaustion concept to a narrower norm, the first

sale doctrine - which is represented in section 109 of the US Copyright Act, which only exhausts the exclusive right to distribute copies in contrast to patent's expansive common law approach.

THE PRINCIPLE OF COPYRIGHT EXHAUSTION

The World Intellectual Property Organisation (WIPO) defines the principle of exhaustion as follows :-

“Exhaustion means the consumption of rights in intellectual property subject matter as a consequence of the legitimate transfer of the title in the tangible article that incorporates or bears the intellectual property asset in question. Exhaustion, therefore, is a natural consequence of the intangible nature of the assets covered by intellectual property, such as expressions, knowledge, reputation, quality, origin. Because of their intangible nature, they do not follow the tangible article with which they are associated.”¹

In plainer terms, the principle of exhaustion restricts the owners exclusive right to distribute their creation after the initial sale. The owner of the right cannot stop further distribution of the work after it. The overarching goal is to achieve the ideal balance between the right of owner's interests and the free flow of products.

CATEGORIES OF EXHAUSTION BASED ON TERRITORIAL EXTENT

1. National Exhaustion: It is the situation where the item's inventor loses ownership over its resale in the nation where the underlying authorised contract of sale took place. A sale in country A under a country A patent (or copyright or trademark) would weaken or exhaust the IP Owner's rights only in country A, and the IP Owner could rely on its various patents in other countries to enjoin sales, investigate damages, or possibly even require customs officials to stop encroaching imports at the border. Although IP rights are equal across the board in all countries, this requirement would still apply.

¹ WIPO Copyright Treaty, Art. 6(2) (2002), CDIP/4/4 REV./STUDY/INF/2 ORIGINAL: ENGLISH DATE: JUNE 1, 2011

2. Regional Exhaustion: It is that level of exhaustion where the original inventor loses control over the resale of the product in a certain area where the original, authorised sale took place inside that particular area. It should be noted that within the territory, rights and privileges are reduced, and the owner of IP rights can exercise all of his or her rights with regard to even that particular good outside the region. The European Community is where this mechanism's operation is most famously seen in action.
3. International Exhaustion: It is the point where the original author loses control over the location-independent resale of the particular object. This interpretation of the principle states that any sale made by or on behalf of an IP Owner somewhere revokes all of that IP Owner's rights and privileges worldwide. This principle avoids the justifiable concerns and trade barriers of a regional principle, although continually appearing to be difficult to fit with the fundamental foundations of national IP rights.

THE LAWS REGARDING THE PRINCIPLE OF EXHAUSTION OF COPYRIGHTS

The exhaustion principle was initially developed by American courts in the context of patents in 1873² then in 1908 with regard to book sales and copyrights was developed³. Although gifts as well as sales might exhaust distribution rights, courts still refer to this as the "first sale doctrine."⁴ The theory was swiftly incorporated by Congress into the U.S. Copyright Act in 1909⁵ and the same was amended from time to time to its present form⁶. Courts and laws in Europe frequently use the term "exhaustion" and implement unified standards outlined in EU

² Adams v. Burke, 84 U.S. 453, 456 (1873)

³ Bobbs-Merrill Co. v. Straus, 210 U.S. 339, 350-51 (1908)

⁴ PAUL GOLDSTEIN, GOLDSTEIN ON COPYRIGHT, 5 7.6.1 n.4 (3d ed. Supp. 2017)

⁵ Copyright Act of 1909, Pub. L. No. 60-349, 41, 35 Stat. 1075 (repealed 1976)

⁶ Copyright Act of 1976, 17 U.S.C. 5109 (2012)

Directives. An overview of the diverging cases in the new and old worlds is preceded by a succinct synopsis.

According to the U.S. Copyright Act, the owner of a copyright has the sole right to a work's reproduction, creation of derivative works based on it, distribution of copies of the work, and public display. However, "the owner of a particular copy or phonorecord... is entitled... to sell or otherwise dispose of the possession of that copy or phonorecord" within the terms of this chapter. Except for phonograms and software, the owner of a copy is also free to lend or rent out her copy. Subject to a few restrictions, the owner of a copy is generally not allowed to reproduce or modify her copy, with the exception of software copies if doing so is required "as an essential step in the utilisation of the computer programme."⁷

Parallel importation and the idea of exhaustion of rights are closely linked in India. The term "parallel importation" describes the export of legally produced and marketed commodities. Exhaustion of rights in accordance with Indian Copyright Law, to determine whether equal import is permitted, it is essential to look at whether there is a right to importation under the implications of the Act. The copyright system in India is governed by the Copyright Act, 1957. According to the Copyright Act, no person shall be granted any rights under copyright other than those expressly guaranteed by Section 16 of the Act and Section 14⁸, which provides for the rights; there is no privilege such as the right of importation.

In the case of *Penguin Books Limited v. India Book Distributors and others*⁹, the Delhi High Court held that if any person without the license from the copyright owner, imports into India or trades any literary work, the copyright over the same is infringed. Therefore, importing pirated copies is illegal unless it is done for the importer's own use.

APPLICATION OF DIGITAL EXHAUSTION

The protection of creative works is provided globally through international copyright treaties. The Agreement on Trade-Related Aspects of Intellectual Property Rights was the first-ever international treaty on intellectual property law to address the exhaustion rule for copyright and establish necessary guidelines for these proceedings' dispute resolution (hereinafter TRIPS).

⁷ Copyright Act of 1976, 17 U.S.C. 5 117(a)(1) (2012)

⁸ The Copyright Act, 1957, section 14 and 16.

⁹ Penguin Books Limited v. India Book Distributors and others, AIR 1985 Delhi 29, 26 (1984) DLT 316

Nothing in this Agreement may be utilised to address the problem of the exhaustion of intellectual property rights for the purposes of resolving disputes under this Agreement, subject to the terms of Articles 3 and 4.¹⁰ According to the TRIPS agreement, any case involving a domestic regulation is exempt from WTO law's dispute resolution procedures. The TRIPS Agreement very marginally regulates this issue and is not overly involved in the matter of exhaustion. The concept of exhaustion was still relatively new, and if it were to be regulated globally, major issues would arise should there be any gaps in international law. As a result, it presumably appeared more sensible to see how various nations approached the situation.

Positive exhaustion standards were incorporated in WIPO treaties. In accordance with Article 9 of the WIPO Copyright Treaty (WCT), "Nothing in this Treaty shall affect the freedom of Contracting Parties to determine the circumstances, if any, in 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 author's authorization"¹¹.

It is important to note the provision of the TFEU, which forbids quantitative restrictions on imports and all measures having equivalent effects, when discussing the exclusive rights of the copyright holder, particularly the distribution right, which entitles the right holder with the exclusive right of permitting the use of his works by giving licences, so that members of the public can use the copyrighted work¹². The goal of this concept was also discussed in the "Deutsche Grammophon" case, which is one of the earliest instances in Europe connected to the exhaustion rule¹³.

DIGITAL EXHAUSTION IN US LAW

The legislature made a clear effort to establish a doctrine of the digital first sale when it passed the Benefit Authors without Limiting Advancement or Net Consumer Expectations (BALANCE) Act. The proposed BALANCE Act aimed to re-establish the conventional

¹⁰ Agreement on Trade-Related Aspects of Intellectual Property (hereinafter TRIPS), art. 6 (1995).

¹¹ WIPO Copyright Treaty, art. 6(2) (2002).

¹² Treaty on the Functioning of the European Union (hereinafter TFEU), art. 34 (1957)

¹³ Deutsche Grammophon Gesellschaft mbH v Metro-SB-Großmärkte GmbH & Co. KG. (1971).

equilibrium between individual consumers and copyright owners in society. By explicitly permitting an owner of a legally acquired digital work to dispose of such work on the condition that the owner did not keep a copy, the BALANCE Act aimed to modify the first sale doctrine¹⁴. The Subcommittee on Courts, the Internet, and Intellectual Property was the only place the proposed law ever left¹⁵. With the BALANCE Act, Congress attempted but failed to adequately address the problem of applying the first sale doctrine to digital media. Congress then decided to take a "wait and see" stance.

Then, the Congress passed the Digital Millennium Copyright Act (DMCA) in 1998, with two different goals in mind. First, Congress wanted to put into effect the 1996 Copyright Treaty of the World Intellectual Property Organization (WIPO), which called for legislation to be passed outlawing the use of encryption technology. Second, in light of evolving digital technologies, Congress sought to update copyright law.

The Copyright Act governs the essential aspects of copyright law in the US. The US Copyright Act allow copyright holders the exclusive right to distribute copies of their works, similar to EU law, and also establish the "first sale doctrine" restrictions on this privilege. The owner of a specific copy or phonorecord that was lawfully prepared under this title is entitled, without the consent of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord, according to the Copyright Act.

The issue at hand in *MAI Systems Corp. v. Peak Computers Inc.*¹⁶, was whether loading computer software into temporary memory qualifies as a copy under US copyright law. The Court's answer was, "A copy is made when copyrighted computer software is loaded into the CPU's memory from a storage medium". This decision makes it clear that US law does not take a broad approach to copyright exhaustion, limiting this privilege to only physical copies of the work that is protected by copyright.

¹⁴ H.R. 1066, 108th Cong. §2(5) (2003).

¹⁵ Eric Matthew Hinkes, Access Controls in the Digital Era and the Fair Use /First Sale Doctrines, 23 SANTA CLARA COMPUTER & HIGH TECH. L.J. 685, 721 (2007).

¹⁶ *Mai Systems Corp. v. Peak Computers Inc.*, US Court of Appeal, Ninth Circuit (1993).

The issue in *Vernor v. Autodesk*¹⁷ relates to the transfer of computer programmes to the user under the shrink wrap licence and the applicability of the first sale concept. The person was a licensee, not an owner, according to the court's ruling, hence the first sale theory cannot be used. In this instance, Autodesk's distribution rights were violated.

There have been instances where the US Court made a different decision, nevertheless. One of these examples is *United States v. Wise*¹⁸, in which the US Court discovered that the distinction between the owner and a mere licensee is incredibly hazy. If the licensee has the option to keep the copy as a result of the licence, then he also gains ownership, and a sale takes place; otherwise, there isn't one.

ANALYSIS ON THE CASE OF CAPITOL RECORDS, LLC V. ReDIGI, INC.

The website ReDigi served as a digital music marketplace where users could both sell and acquire legally obtained digital music. First, a user had to download a programme called "Media Manager," which searched the user's computer for digital music that could be purchased. o Digital music from other sharing websites or CD downloads were not acceptable; only music purchased on iTunes or from another user was accepted.

Once a suitable file had been chosen by the user for sale, the application continued to run on the user's computer and any attached devices to ensure that the user did not keep a copy of the digital music file. The software asked the user to delete the digital music file if a copy was found. However, the deletion was not forced; rather, the individual chose to do so. ReDigi had a policy that if a user refused to comply with the deletion order, their account would be suspended.

The user had to submit any qualifying digital music to the website as the following step "Cloud Locker," so that the user's PC no longer contained the digital music. The digital music was again checked for eligibility during the upload process, and after that it was kept in the Cloud Locker. The users could either keep and stream the digital music for their own use or put it up

¹⁷ *Vernor v. Autodesk, Inc.*, 621 F.3d 1102 (9thCir. 2010).

¹⁸ *United States v. Wise*, 370 U.S. 405 (1962).

for sale on ReDigi's online store." "In the event that the user sold the digital music, their access to it was revoked and given to the new owner at the moment of the sale." The new owner might then sell the music, play it, or download it to a computer or other device after storing it in the Cloud Locker." Users could only purchase music using credits, which could be obtained via ReDigi or by the sale of digital music in the ReDigi marketplace. Credits were non-transferable and could only be used to buy music from ReDigi's marketplace.

On January 6, 2012, Capitol filed a copyright infringement lawsuit against ReDigi under the Copyright Act in the District Court of the Southern District of New York. Capitol sued ReDigi, asking for both temporary and permanent injunctions, but the District Court rejected Capitol's application for a preliminary injunction because it could not demonstrate that irreparable injury had occurred. The court rejected Capitol's requests for both a temporary injunction and a permanent injunction. On July 20, 2012, Capitol submitted a petition for partial summary judgement on the claims of primary and secondary infringement. On the same day, ReDigi submitted a counter-motion for summary judgement and asserted the affirmative defences of fair use and first sale.

The District Court considered three issues in relation to Capitol's motion for partial summary judgement on copyright infringement:

- (1) if Capitol had a legitimate copyright and one of Capitol's exclusive rights was violated by ReDigi's website;
- (2) whether ReDigi had a fair use or first sale defence to absolve the infringement; and
- (3) whether ReDigi was liable for both direct and secondary infringement.

According to Courts the unauthorised reproduction of digital music files over the Internet violates the copyright owner's exclusive right to reproduce. But in this case, the question was "whether the illicit transfer of a digital music file via the Internet" qualified as reproduction and distribution under the Copyright Act.

Additionally, courts held that in peer-to-peer file-sharing, it was determined that when a user downloaded a digital music file on a hard drive, the material was "reproduced" in accordance with the Copyright Act. The District Court found that "the reproduction rights are defined by the formation of a new material item and not by the creation of extra material objects." Since it

is "impossible that the same material thing" to be carried via the Internet, when a file is transferred there is a new physical object created on a different computer. The District Court finally found that the sale of digital music files on ReDigi's website infringed Capitol's exclusive distribution and reproduction rights, but it was impossible to determine from the evidence whether Capitol's display and performance rights were also breached.

The District Court then considered the fair use defence of the Capitols, the court found that all the four factors of fair use unquestionably weighed in favour of Capitol. The first factor observed that Redigi used the work for commercial purposes with gaining direct profits and moreover it did not add something new to have a transformative work. The other three factors also weighed against fair use and thus the court concluded that there was no fair use defence.

Later, the District Court considered the First sale doctrine, the court stated that the doctrine limited to assertions of distribution right and did not apply to the reproduction right. The first sale doctrine did not defend ReDigi's infringement of Capitol's distribution right because "a digital music file sold on ReDigi is not 'lawfully made,'" the District Court found, adding that "when the user used ReDigi to upload the digital music file, the lawful owner produced a new unlawful reproduction on the ReDigi server." The District Court reasoned that the first sale argument did not apply to ReDigi's infringement since its service infringed Capitol's reproduction right by making a new copy of the digital music file.

With respect to the third issue, ReDigi was found guilty by the District Court of infringing Capitol's exclusive distribution and reproduction rights directly as well as indirectly, including contributory and vicarious culpability.

Thus, the court in this ReDigi case held that the doctrine of exhaustion cannot be applied to digital files and upheld that ReDigi has infringed the right of distribution and reproduction of Capitol Records.

CONCLUSION

As practically every organisation is shifting from traditional to digital formats, it is critical to be adaptable in order to keep up with global technology advancements. As technology advances year after year, situations of digital weariness will become more and more prevalent. As discussed above, the District Court in ReDigi case limits the first sale doctrine to digital copyrighted files by its observation that any transfer of digital files over the internet requires

the creation of a new copy. The user in that case created a new illegal reproduction on the ReDigi server when they uploaded digital music to the Cloud Locker for sale or personal use. The Court further stated that owners of a copy have first sale protection, however lessees and bailees with mere possession of a copy do not receive the protection of first sale." This interpretation of the doctrine aided in the first sale doctrine's spread.

Congress and the courts will undoubtedly debate the question of the first sale doctrine's extension to digital content in the near future due to the increasing prevalence of digital content and the growth of online markets for it. The first sale defence for digital music may be further restricted by the courts in response to this call for expansion until Congress issues advice.

The District Court determined that because the transfer via the Internet inevitably resulted in the formation of a new physical object, the selling of digital music through ReDigi's website and technology violated Capitol's exclusive rights¹⁹. However in my view there is no infringement of Capitol's distribution and re- production rights by the ReDigi as it provided a service to resell the digital music when only one digital file remains after the sale, there is no duplication of the file being retained by the seller.

Thus it is required that, a more thorough approach is required to the problem of digital exhaustion. Even though the facts and circumstances are similar, case-by-case analysis might occasionally result in several conflicting outcomes. There must be a border, and this border must be governed by law. As a result, some fundamental legal provisions must be established in order to at the very least regulate some significant legal issues and to provide clarification, allowing internet users to understand their rights and what they are not allowed to do.

Moreover the doctrine of exhaustion and right to reproduction and co related when it comes to digital files. Thus, the doctrine of exhaustion can be extended to digital files only when there are fundamental legal provisions to look after the application of the doctrine.

¹⁹ Capitol Records, LLC v. ReDigi, Inc., 934 F. Supp. 2d 640, 644-645 (S.D.N.Y. March 30, 2013).