



**BEFORE THE UNITED STATES COPYRIGHT OFFICE**

**COMMENTS OF THE OWNERS' RIGHTS INITIATIVE ON THE ROLE OF  
COPYRIGHT LAW WITH RESPECT TO SOFTWARE-ENABLED CONSUMER  
PRODUCTS**

The Owners' Rights Initiative (ORI) is an organization of over 20 companies and trade associations that have joined together to protect ownership rights in the United States.<sup>1</sup> We believe in the fundamental premise that **if you bought it, you own it**, and should have the right to sell, lend, or give away your personal property. ORI formed when the *Kirtsaeng v. Wiley* case was pending before the Supreme Court. We now are dedicated to preserving that holding, and making sure that it is not undermined in Congress, the executive branch, or in the courts. We also work to protect the principles of the first sale doctrine as technology continues to evolve, such as when software is incorporated into other products. Additionally, we try to prevent the misuse of IP law as a trade barrier that obstructs legitimate competition in other countries.

We appreciate this timely study on the impact of copyright law on software-enabled consumer products. At the outset, we note that we do not believe the inquiry should be limited to “consumer products” or “everyday products.” These distinctions have little meaning in a world where individuals run businesses out of their homes on

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<sup>1</sup> A list of ORI members can be found at <http://ownersrightsinitiative.org/about/>.

their laptop computers, where over 200 million Americans own smart phones that can operate millions of apps, and where an Internet of things is emerging in which a wide range of products have network connectivity that allow them to collect and exchange data. Accordingly, in these comments we will not distinguish between business products and consumer products, nor between general-purpose computers and products with more limited functionality. The impact of copyright and contract law on all these products is the same.

These comments will focus on the importance of preserving the principles that underlie the first sale doctrine—of ensuring an owner’s right to transfer the products that he has purchased. ORI is also concerned about the adverse impact of copyright and contract law on the right to repair and customize software-enabled products, but in this opening round we largely are leaving these topics to other commenters.

## **I. The Importance of the First Sale Doctrine**

Justice Breyer, writing for the U.S. Supreme Court in *Kirtsaeng v. John Wiley & Sons, Inc.*, 133 S. Ct. 1351, 1363 (2013), stated that the first sale doctrine “is a common-law doctrine with an impeccable historic pedigree.” He quoted a 17<sup>th</sup> century articulation of “the common law’s refusal to permit restraints on the alienation of chattels,” *id.*, and observed that “a law that permits a copyright holder to control the resale or other disposition of a chattel once sold is similarly ‘against Trade and Traffi[c], and bargaining and contracting.’” *Id.* Justice Breyer underscored “the importance of leaving buyers of goods free to compete with each other when reselling or otherwise disposing of these goods.” *Id.* Competition, “including the freedom to resell, can work to the advantage of the consumer.” *Id.*

The first sale doctrine operates at every level of our economy. It allows wholesalers to sell products covered by copyright, including products distributed in copyrighted packaging, to retailers without first securing distribution licenses from the manufacturers. The first sale doctrine likewise permits retailers to sell products to consumers without obtaining distribution licenses. Finally, the first sale doctrine permits consumers to rent or lend the products to other consumers, or to sell or give the products away when they no longer need them. The first sale doctrine reduces transaction costs and enables competition between sellers of new products as well as between new and used products. In *Kirtsaeng*, the Court recognized the importance of the first sale doctrine to libraries, used-book sellers, car dealers, technology companies, retailers, and consumers. The limitation on the distribution right provided by the first sale doctrine is critical to the functioning of our economy because the distribution right applies not only to products whose primary value is their protected expression, such as books, films, and sound recordings, but also to the protected expression in the packaging of products and the software essential to the operation of products. The application of the first sale doctrine to software-enabled products is of particular concern to our members.

## **II. The First Sale Doctrine and Software-Enabled Products**

Many products, ranging from high-end servers to toasters, rely on software for their operation. Even though the consumers buy the physical products, some manufacturers claim that they are just licensing the software essential to the products' operation.<sup>2</sup> These licenses could contain a variety of restrictive terms that limit ownership

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<sup>2</sup> The software often is pre-installed into the product by the manufacturer or the vendor. However, sometime the user must install the software provided by the manufacturers via the Internet or storage media such as DVDs.

rights by interfering with resale of the products, thereby harming the consumers that want to sell equipment they no longer want and the secondary market consumers that want to buy that equipment.<sup>3</sup> Often, these secondary market consumers are federal, state, and local government entities. ORI believes that manufacturers should not be permitted to use software licenses to interfere with the resale of products.

Manufacturers currently employ software licenses to place the following impediments on the alienability of physical products:

- **Prohibition on transfer.** Some license agreements provide that the software license is non-transferable. For example, the license for the software that comes installed on a NetApp disk storage device is not transferable. As a practical matter, NetApp gets paid twice for the right to use the same software: once by the original purchaser of the product, and a second time by the purchaser of the used product. Purchasers of Cisco equipment often find that it is cheaper to buy new equipment than pay the excessively high price for a license for the software essential to the operation of the used equipment.
- **Refusal to provide updates.** Some license agreements specify that routine updates such as security-patches will be provided only to the original licensee. For example, Oracle refuses to supply routine updates to the purchasers of used hardware products containing essential Oracle software, unless they make an additional payment.

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<sup>3</sup> These licenses also interfere with the sale of unused products by resellers. Further, the licenses often require that product repairs be performed by authorized maintenance centers, thereby restricting the freedom of product owners to repair the products themselves or to use independent repair facilities.

- **Bundling of maintenance contracts.** Some manufacturers will use control over the essential software as a means of forcing purchasers of used equipment to buy additional services from them. IBM, for example, will charge purchasers of used equipment a fee for software updates, but will provide the updates for free to purchasers that enter into maintenance agreements.<sup>4</sup>

The legal fiction on which these restrictive practices is based is that the essential software is licensed, not sold, to the purchaser of the hardware in which the software is installed. The manufacturers argue that because the purchaser is merely a licensee of the copy of the software, it does not have rights that normally accrue to the owner of a copy, such as the first sale doctrine or the right to make temporary internal copies necessary for the operation of a computer. *See* 17 U.S.C. §§ 109(a) and 117(a).

Cisco's own Frequently Asked Questions (FAQs), updated on May 4, 2015, make this argument in response to a question by a customer who had been approached by a third party hardware reseller who is not a Cisco-authorized channel partner. Cisco defended the lawfulness of its licensing policy as follows:

The United States Court of Appeals for the 9th Circuit recently upheld the right of intellectual property owners such as Cisco to place reasonable restrictions on the licensing (and transferability) of their software, even where embedded in hardware, in the landmark case of Autodesk v. Vernor. In Vernor, the Court ruled that when a company sells its software with a license agreement (as Autodesk did - and as Cisco does), then the original user of the software is a licensee and not an owner. This means that the original user cannot transfer/sell the software without the permission of the owner of the intellectual property being licensed (i.e., AutoDesk or Cisco). In sum, the entity that is trying to sell you the hardware does not own the software on the product - and therefore has no

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<sup>4</sup> Here are links to examples of these restrictive licenses: Palo Alto Networks (<https://www.paloaltonetworks.com/support/support-policies/secondary-market-policy.html>); and EMC (<http://www.emc.com/collateral/software/warranty-maintenance/h2483-sw-use-rights.pdf>).

rights to sell it to you. This means that if you purchased the product from that seller, your company would not have a license to use the software and would be in violation of Cisco's intellectual property rights. Cisco's licensing policy is in 100% alignment with this legal precedent.<sup>5</sup>

Cisco's FAQ neglects to mention that the U.S. circuit courts are split on the validity of this argument. While the Ninth Circuit has accepted it in *Vernor v. Autodesk*, 621 F.3d 1102 (9<sup>th</sup> Cir. 2010), the Second Circuit has rejected it in *Krause v. Titleserv*, 402 F.3d 119 (2d Cir. 2005). Underlying this split concerning whether a person who acquires a copy of a computer program is an owner or a licensee of the copy is an even more profound split concerning preemption of contract terms inconsistent with the Copyright Act. Compare *Bowers v. Baystate Techs., Inc.*, 320 F.3d 1317 (Fed. Cir.), *cert. denied*, 539 U.S. 928 (2003) (holding that the Copyright Act does not preempt contractual terms prohibiting actions permitted under fair use), with *Vault Corp. v. Quaid Software Ltd.*, 847 F.2d 255 (5th Cir. 1988) (holding that under the Supremacy Clause of the U.S. Constitution, contract terms prohibiting copyright exceptions are unenforceable).<sup>6</sup>

Congress previously dealt with a similar issue in the context of software rental. In 1990, when Congress was considering amending the Copyright Act to prohibit the rental of software because it facilitated infringement by consumers, companies that rented cars and other equipment that contained software expressed concern that the amendment could prevent these rentals. Accordingly, Congress added an exception to the software rental prohibition that applies to "a computer program which is embodied in a machine or

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<sup>5</sup> [http://www.cisco.com/web/about/doing\\_business/legal/service\\_descriptions/docs/Third\\_Party\\_Maintenance\\_Services\\_FAQ.pdf](http://www.cisco.com/web/about/doing_business/legal/service_descriptions/docs/Third_Party_Maintenance_Services_FAQ.pdf). Cisco further suggests these resellers "may sell equipment that purports to be "Cisco Product" but is in fact non-genuine or counterfeit."

<sup>6</sup> This issue is discussed in great detail in Section IV.

product and which cannot be copied during the ordinary operation or use of the machine or product.” 17 U.S.C. § 109(b)(1)(B)(i).

Preserving the resale rights of consumers of physical products that contain software is important for reasons that go beyond the protecting the economic interests of these consumers and the secondary market consumers who would purchase these products. If the manufacturer refuses to provide to the secondary market consumer the security patches it provides to the original consumer, the security of the secondary consumer’s computer system could be compromised.<sup>7</sup> Such security patches typically are provided to the original consumer free of charge. In essence, the original purchase price entitles the consumer to receive security patches and other patches that fix bugs in the program.

Preserving a secondary market in these physical products is also important for the environment. If older products can be refurbished and resold, those products stay out of landfills. Moreover, the recycling of the older products reduces the need to mine raw materials and produce new components.

We recognize that the problem of restrictions placed on software essential to the operation of hardware implicates complex issues of legal theory at the intersection of Constitutional preemption, the Copyright Act, antitrust law, and contract law.<sup>8</sup> Nonetheless, this is a very concrete practical problem of manufacturers attempting to leverage the copyright in a component into perpetual control over a much larger device. At present, primarily manufacturers of computer and telecommunications equipment

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<sup>7</sup> Cisco’s FAQ makes clear that a reseller “is not authorized to provide you with Cisco bug fixes, patches, and updates.”

<sup>8</sup> These are discussed in Section IV below.

misuse software license agreements to interfere with resale. Yet as more products are distributed with pre-installed software, such as cars and consumer appliances, this problem will become more widespread.

### **III. The Solution: YODA**

We believe that this problem can be addressed by a relatively simple amendment to the Copyright Act, such as the You Own Devices Act (YODA), H.R. 862. YODA, introduced by Congressmen Blake Farenthold (R-TX) and Jared Polis (D-CO), solves this problem by adding a new subsection to section 109 of the Copyright Act, which contains the first sale doctrine. New subsection (f)(1) would provide that if a computer program enables any part of a machine or other product to operate, the owner of the machine is entitled to transfer the computer program when he sells or otherwise transfers the machine. This right to transfer the program cannot be waived by license or other agreement.

New subsection (f)(2) would provide that the purchaser of the machine is entitled to receive any bug patches or security fixes that the person who sold him the machine was entitled to receive from the manufacturer.

New subsection (f)(3) would make clear that nothing in this subsection allows the seller of the machine to retain an unauthorized copy of the computer program after he transfers the machine to the purchaser.

YODA is not retroactive; it would apply only to transfers of software that occur after its enactment. YODA thus appropriately balances the interests of the original equipment manufacturer, the reseller, and the consumer.

#### **IV. The Enforceability of Contractual Restrictions on Copyright Exceptions**

The alternative to YODA is to allow the courts to sort out the complex and unresolved issue of the enforceability of contractual terms limiting copyright exceptions. There is little doubt that a restriction contained in a negotiated agreement between parties of equal bargaining strength would be enforceable. But what about a non-negotiated agreement between parties of unequal bargaining position?

##### **A. Enforceability under state contract law.**

Some courts have viewed this issue as a matter of state contract law: has the licensee truly manifested assent to the agreement? Because a user cannot use a program without “agreeing” to these license terms either by opening the package or clicking the “I agree” icon, significant questions arise whether the user has in fact manifested assent to the license’s terms. Courts around the country have considered the enforceability of shrink-wrap and click-on licenses for two decades, but a consensus has not yet emerged.<sup>9</sup> Moreover, numerous commentators have questioned the enforceability of such

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<sup>9</sup> Compare *Novell, Inc. v. Network Trade Ctr., Inc.*, 25 F. Supp. 2d 1218, 1230 (D. Utah 1997); *Morgan Labs., Inc. v. Micro Data Base Sys., Inc.* 41 U.S.P.Q.2d 1850 (N.D. Cal. 1997); *Arizona Retail Sys., Inc. v. The Software Link, Inc.*, 831 F. Supp. 759, 764-66 (D. Ariz. 1993); *Step-Saver Data Sys. v. Wyse Tech.*, 939 F.2d 91, 98-100 (3d Cir. 1991); *Foresight Resources Corp. v. Pfortmiller*, 719 F. Supp. 1006, 1010 (D. Kan. 1989); *Ticketmaster Corp. v. Tickets.com, Inc.*, 2000 U.S. Dist. LEXIS 12987 (C.D. Cal. August 10, 2000), *aff’d*, 248 F. 3d 1173 (9th Cir. 2001); *Specht v. Netscape Communications Corp.*, 306 F.3d 17 (2d Cir. 2002); *Softman Prods. Co. v. Adobe Systems, Inc.*, 171 F. Supp. 2d 1075 (C.D. Cal. 2001); and *Klocek v. Gateway, Inc.*, 104 F. Supp. 2d 1332, 1338-39 (D. Kan. 2000); with *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447, 1449 (7th Cir. 1996), *Register.com, Inc., v. Verio, Inc.*, 356 F.3d 393 (2d Cir. 2004); *cf. Hill v. Gateway 2000, Inc.*, 105 F.3d 1147, 1150 (7th Cir. 1997), *cert. denied*, 522 U.S. 808 (1997).

contracts.<sup>10</sup> If the contracts are not enforceable, then obviously their terms prohibiting fair use and other user rights have no effect.

To the extent any pattern can be discerned in these cases, courts seem more willing to enforce click-on licenses than browse-wrap or shrink-wrap licenses, largely because it is difficult for a licensee to argue that he did not manifest assent when he clicked on an “I agree” icon. Additionally, courts seem more willing to enforce these licenses against corporate licensees than against consumers, presumably because they feel that corporate licensees are better able to protect their interests.

## **B. Preemption**

Other courts have examined this question from the perspective of preemption – either preemption under Section 301(a) of the Copyright Act or the U.S. Constitution. With both theories, courts are split on whether contractual restrictions on copyright exceptions are preempted.

### **1. Section 301(a) Preemption**

Courts have interpreted Section 301(a) as not preempting a state cause of action that requires proof of “extra elements” not present in a copyright claim. The Seventh Circuit in *ProCD, Inc. v. Zeidenberg*<sup>11</sup> ruled that Section 301(a) did not preempt enforcement of a contract prohibiting the copying of telephone listings because the

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<sup>10</sup> E.g., Michael J. Madison, “Legal Ware”: *Contract and Copyright in the Digital Age*, 67 *FORDHAM L. REV.* 1025 (Dec. 1998); Robert J. Morrill, Comment, *Contract Formation and the Shrink Wrap License: A Case Comment on ProCD, Inc. v. Zeidenberg*, 32 *NEW ENG. L. REV.* 513, 537-50 (1998); Apik Minassian, *The Death of Copyright: Enforceability of Shrinkwrap Licensing Agreements*, 45 *UCLA L. REV.* 569 (1997); Christopher L. Pitet, Comment, *The Problem With “Money Now, Terms Later”: ProCD, Inc. v. Zeidenberg and the Enforceability of “Shrinkwrap” Software Licenses*, 31 *LOY. L.A. L. REV.* 325 (1997); L. Ray Patterson & Stanley W. Lindberg, *The Nature of Copyright: A Law of Users’ Rights*, 220 (1991).

<sup>11</sup> 86 F.3d 1447 (7th Cir. 1996).

contract claim required proof of an extra element -- the existence of an enforceable contract.

However, in *Data General Corp. v. Grumman Systems Support Corp.*,<sup>12</sup> the First Circuit noted that not every extra element will establish a qualitative variance between rights under copyright and those protected by state law. Thus, if the extra elements are “illusory ... mere labels attached to the same odious business conduct,” then preemption will occur. Likewise, some scholars have rejected the *ProCD* analysis:

[A]t times a breach of contract cause of action can serve as a subterfuge to control nothing other than the reproduction, adaptation, public distribution, etc. of works within the subject matter of copyright. That situation typically unfolds when the “contract” at issue consists of a “shrinkwrap license” to which the copyright owner demands adhesion as a condition to licensing its materials. To the extent that such a contract is determined to be binding under state law, then that law may be attempting to vindicate rights indistinguishable from those accorded by the Copyright Act. Under that scenario, the subject contract cause of action should be deemed pre-empted .... Although the vast majority of contract claims will presumably survive scrutiny ... nonetheless pre-emption should strike down claims that, although denominated “contract,” nonetheless complain directly about the reproduction of expressive materials.<sup>13</sup>

Relying on this passage, the court in *Selby v. New Line Cinema*<sup>14</sup> declined to enforce an implied-in-fact contract prohibiting the use of an idea without attribution. Similarly, the court in *Symantec Corp. v. McAfee Associates*<sup>15</sup> declined to enforce a contractual restriction on reverse engineering. The court found that the mere existence of the agreement was insufficient to transform “what essentially is a copyright infringement

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<sup>12</sup> 36 F.3d 1147 (1st Cir. 1994).

<sup>13</sup> 1 Melville B. Nimmer & David Nimmer, *NIMMER ON COPYRIGHT*, § 1.01[B][1][a] at 1-19 and 1-22 (2001) (citations omitted).

<sup>14</sup> 96 F. Supp. 2d 1053 (C.D. Cal. 2000).

<sup>15</sup> 1998 WL 740798 (N.D. Cal. June 9, 1998).

claim” into “something more.”<sup>16</sup> See also *Ass’n for Info. Media and Equip. v. Regents of the Univ. of California*, No. 2:10-CV-09378-CBM, 2012 WL 7683452 (C.D. Cal. Nov. 20, 2012).

## 2. Constitutional Preemption

Courts have also preempted contractual terms on Constitutional grounds. In 1988, the U.S. Court of Appeals for the Fifth Circuit set aside a contractual restriction on reverse engineering in *Vault Corp. v. Quaid Software Ltd.*<sup>17</sup> The *Vault* court cited *Sears, Roebuck & Co. v. Stiffel Co.*,<sup>18</sup> where the Supreme Court relied on the U.S. Constitution’s Supremacy Clause to conclude that “[w]hen state law touches upon an area of [the copyright statutes], it is ‘familiar’ doctrine’ that the federal policy ‘may not be set at naught, or its benefits denied’ by state law.”<sup>19</sup> The *Vault* court held that a reverse engineering prohibition in a shrinkwrap license “conflicts with the rights of computer

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<sup>16</sup> *Id.* at \*5. See also *Kabehie et al., v. Zoland, et al.*, 125 Cal. Rptr. 721 (Cal.App.2nd Dist. 2002):

The cases that have decided the issue of federal copyright preemption of state breach of contract causes of action can be roughly divided into two groups: (1) a minority of the cases hold state breach of contract causes of action are never preempted by federal copyright law; and (2) a majority of the cases hold state breach of contract actions are not preempted by federal copyright law when they seek to enforce rights that are qualitatively different from the exclusive rights of copyright. .... We adopt the majority view.... The promise alleged to have been breached in a breach of contract action does not always make the contract action qualitatively different from a copyright infringement action. If the promise was simply to refrain from copying the material or infringing the rights protected by copyright, then the promisor has promised nothing more than that which was already required under federal copyright law. The promise not to infringe adds nothing to a breach of contract action for copyright infringement. A breach of contract action based on this type of promise must be preempted in order to prevent parties from circumventing federal copyright law and nullifying the preemption provided for in section 301.

<sup>17</sup> 847 F.2d 255 (5th Cir. 1988).

<sup>18</sup> 376 U.S. 225 (1964).

<sup>19</sup> *Sears*, 376 U.S. at 229 (citations omitted).

program owners under Section 117 and clearly ‘touches upon an area’ of federal copyright law.’<sup>20</sup> Likewise, the Supreme Court relied on the Supremacy Clause to preempt a Florida plug mold statute it found inconsistent with the federal intellectual property system.<sup>21</sup>

On the other hand, the courts in *Bowers v. Baystate Techs., Inc.*<sup>22</sup> and *Davidson & Assoc. v. Jung*<sup>23</sup> rejected constitutional preemption arguments with respect to contractual restrictions on copyright exceptions. Judge Dyk, however, wrote a powerful dissent in *Bowers*, stating that a software firm could not eliminate a user’s privileges under the Copyright Act simply “by printing a few words on the outside of its product....”<sup>24</sup> Such an approach “permits state law to eviscerate an important federal copyright policy reflected in the fair use defense....”<sup>25</sup>

### **C. Copyright Misuse**

The courts could also employ the copyright misuse doctrine to address manufacturers’ attempts to use their copyright in the software embedded in products to prevent resale of those products. The misuse doctrine prohibits the enforcement of a copyright for the purpose of preventing legitimate competition—here, by resellers of legitimate products.

The Fourth Circuit in *Lasercomb America v. Reynolds*, 911 F.2d 970, 977 (4<sup>th</sup> Cir. 1990), found that the copyright misuse doctrine is premised on the principle that public

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<sup>20</sup> *Vault*, 847 F.2d at 270.

<sup>21</sup> *Bonito Boats Inc., v. Thunder Craft Boats Inc.*, 489 U.S. 141 (1989).

<sup>22</sup> *Bowers v. Baystate Techs., Inc.*, 320 F.3d 1317 (Fed. Cir.), *cert. denied*, 539 U.S. 928 (2003).

<sup>23</sup> 422 F.3d 630 (8th Cir. 2005).

<sup>24</sup> 320 F.3d at 1337 (Dyk, J., dissenting).

<sup>25</sup> *Id.* at 1335.

policy “forbids the use of the [copyright] limited monopoly to secure an exclusive right or limited monopoly not granted by the [Copyright] Office and which is contrary to the public policy to grant.” In *Lasercomb*, the plaintiff’s standard software license prohibited the licensee from developing competing software for 99 years. This prohibition went beyond any reasonable need to protect Lasercomb’s own software, and was directed at limiting competition from independently developed, non-infringing software. Lasercomb, by the terms of its copyright license agreement, was attempting to monopolize something which clearly was not part of the bundle of rights granted by copyright: the right to develop competing software utilizing the same ideas. Because Lasercomb used its copyright to force Reynolds to agree to these anticompetitive license terms, the court excused Reynold’s copying of the Lasercomb’s software.

Similarly, in *DSC Communications Corp. v. DGI Technologies, Inc.*, 81 F.3d 597, 601 (5th Cir. 1996), the Fifth Circuit found copyright misuse when DSC used its copyright to gain control over a competitor’s use of its microprocessor cards. DGI developed microprocessor cards that could be used on DSC’s phone switches. To ensure that the cards were compatible with the DSC’s phone switch operating system, DGI had to test its card on a DSC phone switch. Such a test necessarily made a copy of DSC’s operating system in the memory of DGI card when the card was “booted up.” DSC sued DGI for infringing the copyright in its operating system. The Fifth Circuit found that “if DSC is allowed to prevent such copying, then it can prevent anyone from developing a competing microprocessor card, even though it has not patented the card.” *Id.* at 601. The court observed that “DSC seems to be attempting to use its copyright to obtain a patent-like monopoly over unpatented microprocessor cards.” *Id.* Quoting *Lasercomb*, the Fifth

Circuit held that copyright misuse doctrine “forbids the use of a copyright to secure an exclusive right or limited monopoly not granted by the Copyright Office.” *Id.*

Likewise, the Ninth Circuit in *Practice Management Information Corporation v. American Medical Association*, 121 F.3d 516 (9<sup>th</sup> Cir. 1997), found that the AMA misused its copyright when it negotiated a contract with the Health Care Financing Administration under which AMA licensed its coding system to HCFA in exchange for HCFA agreeing not to use any other coding system. When publisher PMI could not reach an agreement with AMA to republish the coding system, PMI filed a declaratory judgment action, seeking a declaration that AMA’s copyright was invalid because AMA had misused it. The Ninth Circuit agreed with PMI:

What offends the copyright misuse doctrine is not HCFA's decision to use the AMA's coding system exclusively, but the limitation imposed by the AMA licensing agreement on HCFA's rights to decide whether or not to use other forms as well. Conditioning the license on HCFA's promise not to use competitors' products constituted a misuse of the copyright by the AMA.

*Id.* at 519.

The district court in the complex litigation between Omega and Costco likewise found that Omega misused its copyright. Costco, the discount retailer, sold luxury Omega watches without the authorization of the Swiss watchmaker. In an effort to prevent Costco from importing and selling its watches, Omega began engraving an “Omega Globe” logo on the back of its watches. When Costco started importing and selling the watches bearing the logo, Omega sued Costco for infringing the importation right under the Copyright Act. Costco responded that the importation right was a subset of the distribution right, and that the first sale doctrine provided it with an exception to the distribution right. The first sale doctrine provides that the distribution right with respect

to any particular copy of a work extinguishes with the first authorized sale of that copy. 17 U.S.C. § 109(a). The district court granted summary judgment in favor of Costco on the basis of the first sale doctrine. The Ninth Circuit reversed, finding that the first sale doctrine did not apply to copies manufactured outside of the United States. Costco appealed to the Supreme Court. With Justice Kagan recusing herself, the Supreme Court in 2010 reached a 4-4 tie.

On remand, the district court once again granted summary judgment to Costco, this time on a copyright misuse theory. *Omega S.A. v. Costco Wholesale Corp.*, 2011 WL 8492716 (C.D. Cal. 2011). It noted that the Ninth Circuit held that “the misuse defense prevents copyright holders from leveraging their limited monopoly to allow them to control areas outside of their monopoly.” *A&M Records, Inc. v. Napster, Inc.*, 239 F.3d 1004, 1026 (9<sup>th</sup> Cir. 2001). The district court found that Omega misused its copyright in the logo “by leveraging its limited monopoly in being able to control the importation of that design to control the importation” of its watches. The district court also awarded Costco \$396,000 in attorneys’ fees.

Omega appealed the misuse finding and the fee award to the Ninth Circuit. While the case was pending before the Ninth Circuit, the Supreme Court handed down its decision in *Kirtsaeng v. John A. Wiley & Sons*. In that 2013 decision, the Supreme Court held that the first sale doctrine applied to noninfringing copies, regardless of where they were manufactured. In other words, the Supreme Court in *Kirtseang* agreed with the district court’s original decision in favor of Costco.

In January 2015, the Ninth Circuit finally ruled on Omega’s appeal of the district court’s 2011 decision. *Omega S.A. v. Costco Wholesale Corp.*, 776 F.3d 692(9<sup>th</sup> Cir.

2015). Because the Supreme Court's *Kirtsaeng* holding provided Costco a complete defense to the Omega's infringement claim, the Ninth Circuit did not reach the district court's misuse holding. It did, however, affirm the award of attorneys' fees to Costco. The Ninth Circuit noted that the district court had observed that Omega had not sought to provide creative works to the general public. Rather, Omega sought to exert control over the distribution of its watches. The Ninth Circuit held that the district court had not erred when it concluded that "it should have been clear to Omega that copyright law neither condoned nor protected its actions, and the imposition of fees would thus further the purpose of the Copyright Act."

Of particular relevance here is Judge Wardlaw's concurring opinion, where she argued that the panel should have affirmed the district court's copyright misuse finding rather than decide the case on the basis of *Kirtsaeng*. Judge Wardlaw agreed with the district court that "Omega impermissibly used the defensive shield of copyright as an offensive sword."

In the closing paragraph of her concurrence, Judge Wardlaw stated that Omega's attempt to expand the scope of its statutory monopoly by misusing its copyright in its logo would upset the balance the copyright law establishes between rewarding creative work and promoting the broad public availability of literature, music, and the other arts. Omega's "anticompetitive acts promoted neither the broad public availability of the arts nor the public welfare." Rather, they were designed to eliminate price competition in the retail market for Omega watches and deprive consumers of the opportunity to purchase discounted gray market Omega watches from Costco.

The elimination of price competition from the sale of used products is exactly what manufacturers are attempting to do through their restrictions on the resale of the software embedded in their products. Courts may well conclude that such practices constitute misuse.

## **V. Conclusion**

Rather than force resellers and consumers to spend decades in the courts resolving these thorny issues of preemption and misuse, Congress should adopt targeted legislation such as YODA. It bears emphasis that permitting the transfer of software-enabled products would not lead to the unauthorized copying of the software. The product already contains the software, there typically are technological protections that inhibit the copying of the software,<sup>26</sup> and the software usually has no independent economic value. Accordingly, resale of software-enabled products does not facilitate software “piracy.”

We look forward to working with the Copyright Office as this inquiry proceeds.

February 16, 2016

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<sup>26</sup> Legal prohibitions on the circumvention of these technological protections are the subject of a separate notice of inquiry issued by the Copyright Office.