

Reseller Beware: Digital Media Files and the First Sale Doctrine

by Steve Kramarsky

New technologies, and the business models that accompany them, often create challenges for existing law, and nowhere is that friction more evident than where digital content bumps into the federal copyright law intended to regulate it. Much of current U.S. copyright law was drafted decades ago—before digital content creation and distribution tools were widely available to the public. Even the Digital Millennium Copyright Act (the DMCA), designed specifically to “update” U.S. copyright law for the Internet age, is now 20 years old. So it isn’t surprising that the underlying “exclusive rights” protected by the copyright law—some of which have not changed much in over two centuries—are not always a good fit for content paradigms. For over 200 years, the Copyright Act has granted authors and owners the exclusive right to control reproduction of their works. But the scope of that right has shifted as the statute has been revised and the case law around it has developed. As the concept of “reproduction” changes, the law sometimes struggles to keep up.

For example, the relevant statutes concerning reproduction of copyrighted materials were drafted, and the body of case law developed, with a tangible medium of expression in mind—a book, a record, a compact disc or some other object. Historically, the question of whether and when a “reproduction” occurred was generally clear, because a physical object was created that either was or was not a copy of the protected work. But the introduction of digital media introduced new challenges: At what point, exactly, is a digital file “reproduced” and how can copyright holders tell? The DMCA provides the legal context for some digital media use cases, but it is fairly specific in the new rights it creates, and it cannot begin to cover every new innovation. Courts must address those as they arise. A recent case decided by the Second Circuit, *Capitol Records v. ReDigi*, 910 F.3d 649 (2d Cir. 2018), provides useful insight into how courts approach these issues.

ReDigi

ReDigi is an “online marketplace for digital used music” and other used digital content. Beginning in October 2011, ReDigi allowed its users to “sell their legally acquired digital music files, and buy used digital music from others at a fraction of the price” that a user would pay for a “new” music file (for example, from iTunes). ReDigi advertises itself as the only marketplace where users can legally purchase used digital music, and as such it took pains to ensure that all transactions through its service are consistent with the copyright laws to the best of its ability. To that end, ReDigi requires its users to use “Media Manager” software to confirm that they have acquired their music files legally from iTunes or another ReDigi user.

Upon verification that a file is eligible, the user can upload the music they wish to sell to ReDigi's "Cloud Locker" where it remains accessible to the seller until sold to another ReDigi user.

Once a digital music file is transferred to ReDigi's "Cloud Locker," it is no longer operable on the seller's computer. ReDigi's "Media Manager" aims to ensure that the seller does not retain any copies of the file or redownload it by continually running "on the user's computer and attached devices to ensure the user has not retained music that has been sold or uploaded for sale." If the "Media Manager" detects that the seller has additional copies, it prompts the user to delete those additional copies (but does not automatically delete them). The seller retains the ability to access any music on the "Cloud Locker" until it is purchased through ReDigi, at which point the seller can no longer access the file.

ReDigi's software thus seeks to ensure that only legally purchased files are sold through the platform and that the user is only able to sell one copy of any digital files they sell and loses the ability to use any sold files. In short, ReDigi attempts to accomplish through software what already happens in the physical world: If a person sells her CD collection at a yard sale (which is perfectly legal), she no longer has that music. ReDigi attempts to accomplish the same thing for a music collection acquired through legal purchases from digital sources such as iTunes.

The First Sale Doctrine

Section 106 of the Copyright Act grants copyright owners certain "exclusive rights," "including 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." *Capitol Records v. ReDigi*, 934 F. Supp. 2d 640, 648 (S.D.N.Y. March 30, 2013). Based on this language, ReDigi's sale of copyrighted material would appear to infringe the copyright holder's exclusive rights to control the sale and resale of its material—but so would the CD collection yard sale. In reality, these rights are not absolute; they are subject to exceptions.

Sale" exception, set out in §109 of the Copyright Act, which provides that "the owner of a 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." *Id.* at 648. This is the exception that permits the yard sale, the sale of books at used book stores, and a host of other familiar examples of the sale of second-hand media. The question for the court in *ReDigi* was whether that same exception (or any other statutory exception, such as fair use) could apply to the resale of an entirely digital media product.

Capitol Records v. ReDigi

On Jan. 6, 2012, just months after ReDigi began offering its users the ability to sell "used" digital music

files, Capitol Records brought an action against it asserting violations of the Copyright Act. Capitol Records sought injunctive relief as well as damages on the basis that ReDigi's services deprived it of its exclusive right to control the reproduction and distribution of its works. ReDigi argued that its services were protected by the fair use and the first sale doctrines. In particular, ReDigi argued that because it merely enabled its users to resell copyrighted materials that they lawfully owned, the first sale doctrine applied.

On March 30, 2013, U.S. District Judge Richard Sullivan of the Southern District of New York granted Capitol Records's motion for summary judgment. In that opinion, he found that ReDigi infringed on both Capitol Records's exclusive right of reproduction and distribution and that ReDigi's affirmative defenses of fair use and first sale were legally inapplicable. The crux of the holding was that ReDigi, in transferring the digital files between the seller's computer and its "Cloud Locker," was inevitably copying the materials from one "material object" (their computer hard drive) to another (the cloud server in Arizona where ReDigi stored its data). The court found that "reproduction" to be in violation of §106. *Capitol Records v. ReDigi*, 934 F. Supp. 2d 640, 651 (S.D.N.Y. March 30, 2013). In cursory fashion, the court also determined that, by allowing users to sell digital files through its platform, ReDigi violated Capitol Records's exclusive distribution rights. The court further held that ReDigi was not engaged in a fair use because it sold for profit exact copies of Capitol Records's materials and the first sale doctrine was inapplicable because that exception only applies to sales of "lawfully made" copies and ReDigi was allowing its users to sell unlawfully reproduced digital files.

ReDigi appealed to the Second Circuit, but the Second Circuit upheld the District Court's ruling, holding that ReDigi's use was infringing because it involved an unlawful reproduction of copyrighted materials. *Capitol Records v. ReDigi*, 910 F.3d 649 (2d Cir. 2018). Clarifying the District Court's decision on the first sale doctrine, the Second Circuit noted that the first sale exception only applies to distribution, *not* to reproduction. In other words, under the first sale doctrine, a person who legally obtains a copy of a protected work is permitted to sell *that copy*, but not to make additional copies. Because the court found that ReDigi's use infringed upon Capitol Records's exclusive reproduction rights by making additional copies in the cloud, the first sale doctrine was not applicable.

ReDigi argued that "its system effectuates transfer of the *particular* digital file that the user lawfully purchased" and once that file was sold through the platform, the seller no longer had access to the digital file. In essence, ReDigi argued that selling through its platform, whereby the digital file was transmitted piece by piece, never fully existing simultaneously on both the seller's hard drive and in the Cloud Locker, is no different from selling a used record and shipping it the buyer on a train. Because the process is designed to ensure that only one copy of the precise digital file transferred is in existence at any given time, ReDigi argued that it had not *reproduced* anything.

The Second Circuit disagreed. Relying on precedent set forth in *Cartoon Network LP v. CSC Holdings*, 536 F.3d 121, 127 (2d Cir. 2008), it held that "in the course of transferring a digital music file from an original purchaser's computer ... to a new purchaser, the digital file is first received and stored on ReDigi's server, and then, at the new purchaser's option, may also be subsequently received and sorted on the

new purchaser's device. At each of these steps, the digital files is fixed in a new material object 'for a period of more than transitory duration'" rendering the transferred file an unlawful reproduction. By transferring the materials to a new storage medium, the Second Circuit held, ReDigi created a reproduction. ReDigi asserted policy arguments, noting that the holding would place substantial burdens on reselling digital media in any modern digital marketplace. While the Second Circuit acknowledged the potential burden, it noted that there were potential alternatives, and, in any event, it was not authorized to modify the scope of the Copyright Act, even if good cause to do so were present.

The court granted Warby Parker's motion to dismiss on the misappropriation of trade secrets claim under federal law. A necessary element of such a claim is that the defendant use improper means to acquire the trade secret or know that the trade secret has been acquired by improper means. Opternative alleged that Warby Parker's "assurances" that it was not developing a competing system when in fact it was doing so were false and misleading. However, Judge Keenan, parsing the language of the statement by Warby Parker that it was "excited to move forward" and "sens[ed]" that Opternative's concerns were "misplaced," did not explicitly address the question of whether Warby Parker was developing a competing eye exam technology and thus whether those statements were "deceptive" for purposes of federal trade secrets law. The court also dismissed the remaining state law and quasi-contract claims (unjust enrichment, state trade secrets, and unfair competition) as duplicative of the contract claim.

Singular Reproduction

Both the Second Circuit and the District Court were unconvinced by arguments (offered by ReDigi and various amici) that selling a digital file through ReDigi was no different from selling a used book. These courts were not swayed, in part because ReDigi's software could not guarantee that the seller was forever unable to access the work they had sold, but also as a result of a strict, and technical, interpretation of "reproduction" under the Copyright Act. Under the law as currently drafted, any digital transfer of a file across a network—particularly if it includes more than transient storage, such as in a cloud-based model—presents significant legal challenges. As a result, ReDigi filed for bankruptcy shortly after the District Court's opinion. The Second Circuit's opinion, however, recognizes that this state of affairs is not optimal, and the Circuit explicitly did not rule on the issue of whether the first sale doctrine might be applicable to some other technology that "may exist or be developed that could lawfully effectuate a digital first sale." Until that technology appears, or Congress clarifies the law, we are apparently stuck with our most regrettable digital purchases.

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