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# Legally Speaking

## A Copyright Challenge to Resales of Digital Music

*A currently pending case will have significant implications for secondary markets in digital goods.*

**H**AVE YOU EVER purchased music from iTunes? If you no longer listen to certain songs or no longer like the band, you might want to resell those tunes. But is it lawful to do so? Capitol Records says no in a lawsuit it brought against ReDigi, Inc., whose platform enables resales of digital music to take place. To technologists, iTunes music might seem like an environmentally friendly substitute for CDs, but the law may see things differently.

Both Capitol and ReDigi filed motions for summary judgment in July 2012 to resolve their dispute. (A judge can grant summary judgment when there are no facts in dispute requiring a trial to determine who is right and when the only issue is how the law should apply to the undisputed facts.) The presiding judge heard oral argument on these motions in October 2012 and is likely to rule on them soon.

Because the case presents some novel legal issues, it is difficult to predict the outcome. Whatever the trial judge rules, though, this case will un-

doubtedly go to the Second Circuit Court of Appeals, and maybe even to the U.S. Supreme Court.

The stakes could hardly be higher for all of us who have purchased digital copies of copyrighted works. If Capitol wins, secondary markets for digital goods will be illegal. And resales of digital music or e-books, even among friends, would be as illegal as peer-to-peer file sharing of copyrighted content (unless that content is covered by a Creative Commons license).

### ReDigi's Service

ReDigi provides a platform through which owners of digital music purchased from iTunes can resell that music to other music lovers. To initiate this process, prospective resellers must download ReDigi software and designate files they want to resell. ReDigi's software checks to make sure the files are eligible for transfer (by verifying the files were purchased from iTunes) and then migrates the data files for that music from the reseller's computer to cloud storage. ReDigi's client-side software deletes the data from the resell-

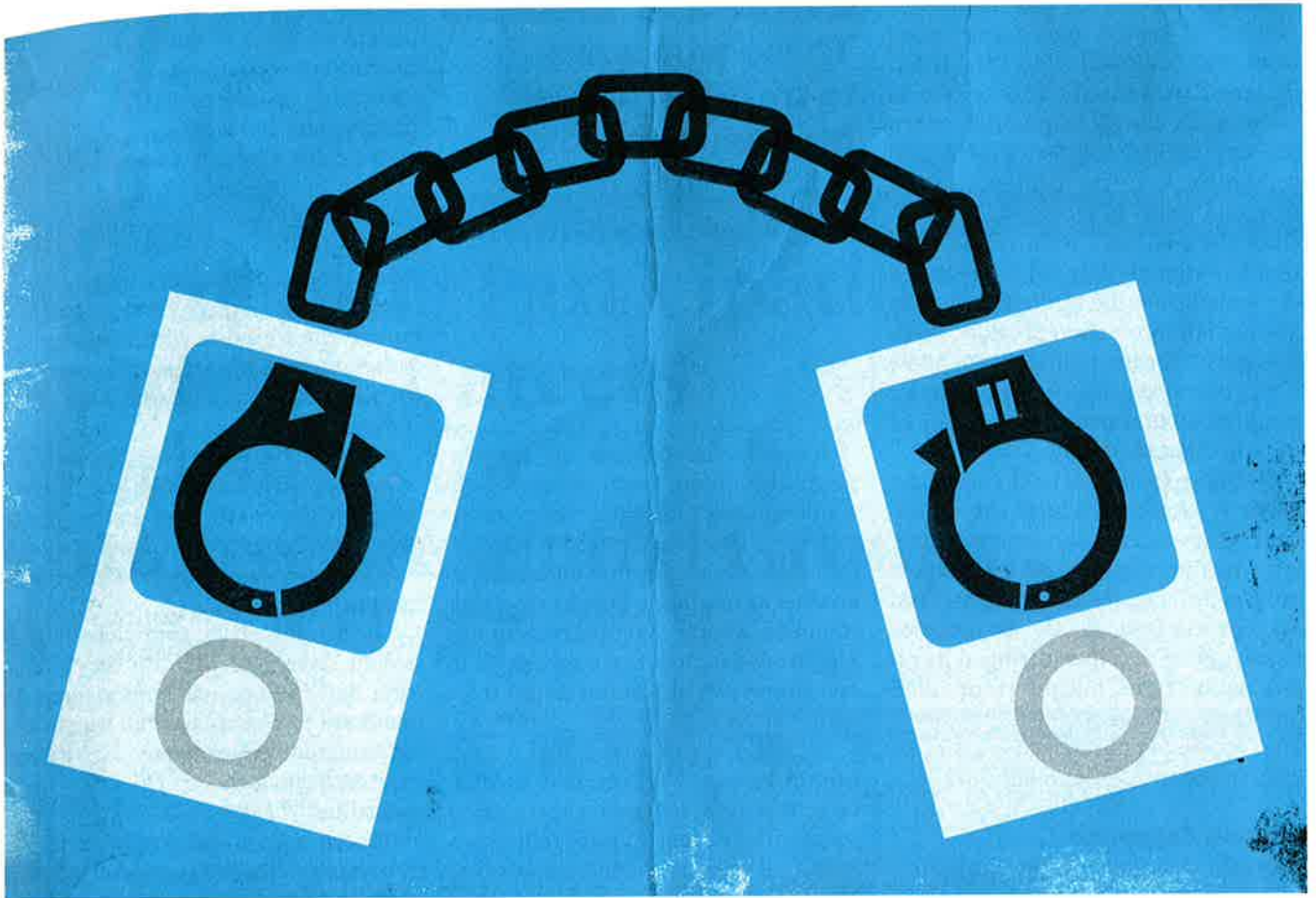
er's hard drive as the data is migrated to cloud storage.

Once in the cloud, that music is available for purchase by other ReDigi users. Those who purchase the music can maintain it in personal lockers in the cloud and access it there through streaming. ReDigi makes no new copy of the resold music; it simply updates its database about who owns that music. Alternatively, a purchaser can download resold music to his or her computer. Downloading music purchased through ReDigi migrates the digital file from cloud storage to the purchaser's hard drive.

ReDigi keeps a share of the resale price and provides credits to resellers so they can purchase more music from other resellers on the ReDigi platform. ReDigi also encourages its users to make more music available through the service by offering discounts on future purchases or prizes to those who use the service to buy music.

### Capitol's Complaint

Capitol's main claim is that ReDigi makes infringing copies of sound re-



cordings in which Capitol owns copyrights: One copy is made in transmitting the music to the cloud, another when storing the music in the cloud, and a third when purchasers download the resold music.

A second claim is that ReDigi infringes Capitol's exclusive right to distribute copies to the public. Capitol argues that this occurs when ReDigi software transmits music files from the reseller's computer to the cloud and then when the ReDigi software transmits those files to purchasers.

In addition, Capitol asserts that ReDigi is indirectly liable for infringements committed by its customers who resell and purchase music through ReDigi's services. The uploaders are said to be unlawfully distributing the music, while those who download or access music in the cloud are alleged to be making unlawful copies of the music. ReDigi induces these user infringements, knowingly contributes to them, and financially benefits from infringements it could have prevented. Capitol charges that "ReDigi is [ ] a clearinghouse for infringement and [has] a

business model built on widespread, unauthorized copying of sound recordings" owned by Capitol and others.

Capitol alleged infringement of copyrights it owns in music found on ReDigi's site. Tracks by Coldplay, Katy Perry, Lady Antebellum, Lily Allen, KT Tunstall, and Norah Jones were, for instance, found there.

#### **ReDigi's First Sale Defense**

It is common knowledge that when we buy a CD of recorded music, a book, or a DVD movie, we are free to resell that copy to anyone we choose for whatever

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price we are able to get. We can also lend out the copy, give it as a gift, or throw it away if we get tired of it. That is because our personal property rights in the artifact we purchased override the copyright owner's rights to control further distribution of that artifact.

A more legalistic way to make this point is to say that copyright law grants owners the right to control distribution of copies to the public, but that right extends only to the first sale of that copy to the public. After that first sale, the copyright owner's right to control distribution of copies is said to be "exhausted." (Internationally, this principle is known as "exhaustion of rights" because any transfer of title to a copy of a copyrighted work—whether by sale, gift, or bequest—exhausts the copyright owner's distribution right.)

The exhaustion rule enables bookstores, libraries, video rental stores, and used CD stores to operate free from copyright owner control. Flea markets and Salvation Army stores also benefit from the exhaustion rule when they resell books, CDs, and DVDs.

ReDigi believes the exhaustion rule applies to digital music purchased from iTunes as well as to CDs. It has designed its software and service to conform as closely as possible, given the unique characteristics of digital technologies, to the contours of the first sale rule. "Congress has not excluded digital files from resale," ReDigi has argued. "Capitol has received the benefit that the limited monopoly of copyright protection provides when it was paid for the first sale." To allow it to control resales of digital music would be an unwarranted extension of the copyright monopoly.

ReDigi relies on a 1973 case, *C.M. Paula v. Logan*, in which the defendant, after purchasing copies of Paula's greeting cards, used a technical process to transfer the designs onto ceramic tiles for resale as artwork. Paula argued that this infringed its reproduction right, but the court ruled that no duplication had taken place. The copy Logan purchased was simply transferred to another medium.

### Capitol's Responses

Capitol's rebuttals to ReDigi's first sale defense mainly focus on technicalities of U.S. copyright law. As statutorily codified, the exhaustion of rights rule limits the distribution right, not the reproduction right. Insofar as ReDigi makes or encourages the making of unauthorized copies of digital music, Capitol asserts the exhaustion rule is inapplicable.

Capitol also claims that ReDigi is ineligible for an exhaustion defense because ReDigi does not own the music being resold. Even if the purchaser of music from iTunes owns that music, he or she is not reselling to ReDigi but rather to other ReDigi customers. ReDigi thus cannot rely on the exhaustion defense.

Although ReDigi claims to resell "used" music, Capitol says there is "no such thing as a 'used' digital file, akin to a dog-eared book or scratched CD because digital works can only be uploaded and transmitted in new copies...embodied on different disks or servers. Those copies are, in Capitol's view, infringing because purchasers "get pristine copies of song files for less than they would pay through legitimate channels."

## Those who want to traffic in pirated files will not find a haven on ReDigi's platform.

Capitol characterizes as "semantic machinations" and "technological smokescreens" ReDigi's characterization of its process of transferring digital music files from one computer to another as migrating data by moving it in blocks to other computer memory. Migrating data involves copying, plain and simple, which Capitol claims to be entitled to control.

Finally, Capitol asserts that ReDigi cannot be sure that resellers of digital music have not saved the tunes on some other device. Capitol relies on a 2001 U.S. Copyright Office report that concluded that the exhaustion principle should not apply to transmission of digital copies because it poses an unreasonable risk of copying that would harm the market for copyrighted works.

### So Who Is Right?

There is merit in ReDigi's argument that it has gone "to great lengths to build a system that was compliant with copyright law in every respect." Having determined that existing technologies were not suitable for such compliance, it developed technologies capable of operating within the constraints of the law. Its system does not allow duplication of copies, nor of dissemination of multiple copies, which ReDigi agrees would infringe copyright. ReDigi only facilitates the migration of data files from the reseller's computer to the purchaser's computer, which is consistent with the spirit, if not the strict contours, of copyright law.

Also meritorious is ReDigi's claim that its "entire business model is to provide incentives for legally purchasing music." It has built in numerous

checks on abuse of the system. Its terms of service forbid users from infringing copyrights; its software checks to ensure files designated for resale were lawfully acquired; it provides tools through which users can get rid of files they downloaded illegally; and it gives consumers the opportunity to acquire music lawfully. Moreover, ReDigi's customers cannot cash out of the system; they must spend their credits within ReDigi on other music. Those who want to traffic in pirated files will not find a haven on ReDigi's platform.

Whether Capitol or ReDigi wins on summary judgment will likely turn on whether the courts take a strict statutory approach to the exhaustion rule or construe the rule in light of its historical purposes.

Under the strict approach, ReDigi would seem ineligible for an exhaustion defense because copies made to facilitate resales do not fall within the current statutory language and ReDigi itself does not own copies whose resale it enables.

Under a purposeful approach, ReDigi has a far better chance of success because it has designed its system so there is "virtually no chance" that infringement would occur through use of its system "in anything more than isolated instances." Moreover, the principle that one can resell property one has purchased runs deep in American law.

Capitol also does not seem to comprehend how computers work. Digital music residing on a hard drive is copied innumerable times as it is used, and it is often shifted around from one part of memory to another as the computer carries out different operations. This kind of copying is not what copyright law worries about.

ReDigi is surely right that this case will set a precedent that will have profound implications for the continued existence of secondary markets in digital goods and for the lawfulness of any resale or lending of copyrighted works in digital form. Stay tuned. This case really matters. ■

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