No. 09-35969

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

TIMOTHY S. VERNOR,

Plaintiff-Appellee,

v.

AUTODESK, INC.,

Defendant-Appellant.

Appeal from the United States District Court
for the Western District of Washington

PETITION FOR REHEARING EN BANC

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RULE 35(b)(1) STATEMENT

Appellee Timothy S. Vernor seeks en banc reconsideration of the panel's decision in this case because it conflicts with decisions of the Supreme Court, *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339 (1908), and this Court, *In re DAK Indus.*, 66 F.3d 1091 (9th Cir. 1995); *United States v. Wise*, 550 F.2d 1180 (9th Cir. 1977), and "consideration by the full court is therefore necessary to secure and maintain uniformity of the court's decisions." Fed. R. App. P. 35(b)(1)(A). In addition, the decision involves "questions of exceptional importance," Fed. R. App. P. 35(b)(1)(B), because it conflicts with decisions of the Second and Federal Circuits, *Krause v. Titleserv, Inc.*, 402 F.3d 119 (2d Cir. 2005); *DSC Commc'ns Corp. v. Pulse Commc'ns, Inc.*, 170 F.3d 1354 (Fed. Cir. 1999), and because, by redefining the nature of ownership of software and other copyrighted works, the decision will adversely affect nearly every consumer who is subject to its authority.

INTRODUCTION AND BACKGROUND

More than a century ago, the Supreme Court in *Bobbs-Merrill Co. v. Straus* rejected a book publisher's attempt to impose restrictions on resale with a limited "license." 210 U.S. at 341, 350. Congress later codified this fundamental limit on the scope of the copyright monopoly, known as the "first-sale doctrine," by providing that the "owner of a particular copy" of a copyrighted work is entitled to resell that copy "without the authority of the copyright owner." 17 U.S.C. § 109. In this case, the district court held that § 109 allowed Vernor to resell on eBay authentic copies of Autodesk's AutoCAD software that he bought second-hand at garage and office sales. The panel, however, reversed, holding that the first-sale doctrine is inapplicable to copies of Autodesk software—and that resale of those copies therefore constitutes copyright infringement—because the software is accompanied by a "license agreement" that purports to prohibit resale.

The panel's opinion adopts an artificial distinction between "licenses" and "sales" that flatly conflicts with decisions of the Second and Federal Circuits and misconstrues the plain language of the Copyright Act, creating divergent and incompatible standards of ownership in an area of law where national uniformity is of paramount importance. *See Krause*, 402 F.3d 119; *DSC Commc'ns*, 170 F.3d 1354. Moreover, the panel's test for determining whether a transaction is a sale relies entirely on the copyright owner's characterization of the transaction and formalistic reservation of rights, while ignoring the economic realities of the exchange—an approach that conflicts with decisions of the Supreme Court, this Court, and the Second Circuit. *See Bobbs-Merrill*, 210 U.S. 339; *Krause*, 402 F.3d 119; *DAK Indus.*, 66 F.3d 1091; *Wise*, 550 F.2d 1180.

The panel's decision also involves an issue of exceptional importance because it is the first by any court to hold that a consumer is not the owner of an ordinary package of commercial software that is distributed with a "license agreement." By holding that a relatively typical software license is sufficient to withhold ownership, the decision effectively abolishes the first-sale doctrine for the software industry and has the immediate effect of depriving almost all consumers of ownership of their software. The panel's test also provides a cost-free formula for the book, music, movie, and other copyright industries to follow software's example, thus rendering *Bobbs-Merrill* a dead letter.

Although the panel recognized these policy concerns, it did not reach them because it considered itself bound by a line of authority originating from a one-sentence footnote in *MAI Systems Corp. v. Peak Computer, Inc.*, an early software copyright decision later overruled by statute. 991 F.2d 511, 518 n.5 (9th Cir. 1993). This Court in a later case recognized the extensive criticism *MAI* has engendered and the Federal Circuit's express rejection of its holding, but declined to revisit the decision because the case could be decided on other grounds. *Wall Data, Inc. v. Los Angeles County Sheriff's Dept.*, 447 F.3d 769, 785 n.9 (9th Cir. 2006). Here, the panel held that *MAI* squarely controlled the result, and there is no reason for this Court to defer reconsideration.

ARGUMENT

I. The Panel's Distinction Between "Licenses" and "Sales" Conflicts With Decisions of the Second and Federal Circuits and Is Based on a Fundamental Misunderstanding of Copyright Law.

The panel's central holding in this case is that the first-sale doctrine as codified in § 109 does not apply when "a software user is a licensee rather than an owner of a copy" of software. Op. 13879. The panel's holding arises from a false distinction between "licenses" and "sales"—a misunderstanding of copyright law that directly conflicts with the plain language of the Copyright Act and decisions of the Second and Federal Circuits.

Although many courts "have failed to grasp this utterly fundamental point," there is nothing incompatible between a "license" and a "sale." John A. Rothchild, *The Incredible Shrinking First Sale Rule*, 57 Rutgers L. Rev. 1, 4 (2004). To "license" a copyrighted work under the Copyright Act is to grant a portion or all of the copyright owner's exclusive rights, such as the right to make copies of a work, to distribute it, or to perform it publicly. 17 U.S.C. § 101 ("transfer of copyright ownership"). Section 109, however, does not limit the availability of the first-sale doctrine to the owner of a *license* in a copyrighted work, but to the "owner of a *particular copy*" of that work. As opposed to a copyright, which is an incorporeal concept, a "copy" is a "*material object* … in which a work is fixed." *Id.* § 101 (emphasis added). Physical goods, in contrast to copyright rights, are not distributed by "license." Rather, the Copyright Act anticipates that copyright owners will distribute particular copies of their works in the ways that physical goods are typically distributed—"by sale or other transfer of ownership, or by rental, lease, or lending." *Id.* § 106.

Here, Autodesk's licensing notice stated that it granted a "nonexclusive … license" in the "products *contained in the media*," not the physical media itself. 2-ER-170 (emphasis added). That Autodesk granted a license in its software, however, says nothing about whether it transferred the "material objects" that constitute the "particular copies" at issue. *See* 17 U.S.C. § 202 ("Ownership of a copyright … is distinct from ownership of any material object in which the work is embodied."). Indeed, as the district court recognized below, transfer of a copyrighted work commonly involves *both* the sale of a particular copy and a license to make certain uses of the copyrighted work. 1-ER-10; *see* Rothchild, 57 Rutgers L. Rev. at 28-29, 34-35.

The artificial distinction between "licenses" and "sales" on which the panel relied originated with this Court's decision in *MAI*, 991 F.2d at 518 n.5. There, this Court concluded that a computer maintenance company committed copyright infringement because its use of a computer during maintenance caused a temporary copy of software to be automatically loaded into the computer's memory. *Id.* at 517-19. *MAI* addressed the software-ownership issue in a one-sentence footnote, without analysis or citation to authority, stating that, "[s]ince MAI licensed its software, [its] customers do not qualify as 'owners' of the software." *Id.* at 518 n.5. Congress later overruled the result in *MAI* by statute, specifically citing the decision as the basis for creating a right for computer technicians to copy software into memory. H.R. Rep. No. 105-551 pt. 1, at 27 (1998). Because Congress did not specifically overrule *MAI*'s footnote on ownership, however, the panel regarded it as binding authority. Op. 13879.

The *MAI* footnote has been widely criticized for failing to make the critical distinction between ownership of a copyright and ownership of a copy. *See, e.g.*, Melville B. Nimmer & David Nimmer, 2 *Nimmer on Copyright* § 8.08(B)(1)(c) (2006) (describing the footnote's logic as "inadequate"). For this reason, the Federal Circuit in *DSC Communications* expressly declined to "adopt the Ninth Circuit's characterization [in the *MAI* footnote] of all licensees as non-owners," holding that "[p]lainly, a party who purchases copies of software from the copyright owner can hold a license under a copyright while still being an owner of a copy of the copyrighted software for purposes of section 117." 170 F.3d at 1360. The Second Circuit also rejected the premise of *MAI*'s footnote in *Krause*, 402 F.3d 119. Like Autodesk, the copyright owner in *Krause* argued that the alleged infringer "never owned the program copies … but rather possessed the copies as a licensee." *Id.* at 122. The court rejected that argument, noting that it "confuses ownership of a copyright with ownership of a copy of the copyrighted material." *Id.* at 124.

This Court in *Wall Data* recognized the split in authority and the criticism the *MAI* footnote has received, but avoided revisiting the decision by resolving the case on another ground. 447 F.3d at 785 n.9. Here, however, the panel considered itself bound by *MAI*'s footnote and applied it in deciding the case. Op. 13876. This time, the Court should not decline to revisit *MAI*'s misapplication of copyright law.

II. The Panel's Reliance on Formalistic Licensing Language Instead of Economic Realities to Determine the Nature of a Transaction Conflicts With Decisions of the Supreme Court, this Court, and the Second Circuit.

The panel created a unique three-part test that, as a matter of federal copyright law, gives copyright owners a purely formalistic and cost-free way to bypass the first-sale doctrine and longstanding common-law restrictions on restraints of trade. To accomplish that result, a copyright owner needs to include a licensing notice with copies of its work that "(1) specifies that the user is granted a license; (2) significantly restricts the user's ability to transfer the software; and (3) imposes notable use restrictions." Op. 13879. No matter how much a particular transaction otherwise resembles a sale, a notice that satisfies these criteria ensures that a putative purchaser "is a licensee rather than an owner" and is thus not entitled to the benefits of the Copyright Act's first-sale right. The three prongs of the panel's test conflict with decisions of the Supreme Court, this Court, and the Second Circuit.

A. Whether the Copyright Owner Specifies that It Is Granting a "License"

1. The panel's reliance on formalistic claims of "licensing" to determine ownership is flatly inconsistent with *Bobbs-Merrill*. The publisher in *Bobbs-Merrill* purported to grant a "license" that limited subsequent distribution ("No dealer is *licensed* to sell it at a less price, and a sale at a less price will be treated as an infringement of the copyright."), just as Autodesk purported to grant a limited license here ("Autodesk … grants you a nonexclusive, nontransferable *license* to use the enclosed program … ."). 210 U.S. at 341 (emphasis added); 2-ER-170 (emphasis added). The Supreme Court refused to give effect to the purported license, concluding that a copyright owner cannot, with a printed notice, "qualify the title of a future purchaser." 210 U.S. at 351. Under the panel's decision here, however, the publisher in *Bobbs-Merrill*—by following the roadmap in the panel's opinion—could today draft a licensing notice that accomplishes the result the Supreme Court prohibited a century ago.

The panel distinguished *Bobbs-Merrill* on two grounds. First, it stated that, because the case was "[d]ecided in 1908, *Bobbs-Merrill* did not and could not address the question of whether the right to use software is distinct from the ownership of copies of software." Op. 13884. But the Copyright Act does not distinguish books and software in this way. On the contrary, it provides that a "copy" includes fixation of a work not only by printing on paper, but "by any method now known or later developed," and regardless of whether the purchaser can read the copyrighted material "directly or with the aid of a machine or device" such as a computer. 17 U.S.C. § 101. Moreover, Congress has already spoken directly to the first-sale doctrine's applicability to software in § 109 by providing that software cannot be *rented*, but has not imposed any similar limitation on whether software can be sold or given away. *Id.* § 109(b).

Second, the panel relied on the Supreme Court's statement in *Bobbs-Merrill* that the case involved "no claim … of contract limitation, nor license agreement controlling the subsequent sales of the book." 210 U.S. at 350. The panel apparently read the lack of a license *agreement* to mean that there was no *license*. But there is no question that the publisher in *Bobbs-Merrill* was attempting to use a license to impose a restriction on resale. *Id.* at 341 ("No dealer is licensed to sell it at a less price … ."). When *Bobbs-Merrill* said there was "no contract or license agreement," it meant only that there was no relevant *agreement*—i.e., there was "no privity of contract" between the copyright owner and the alleged infringer. *Id.* at 350; *see Quality King Distribs. v. L'anza Rsch. Int'l*, 523 U.S. 135, 143 & n.10 (1998) (noting that the quoted language "emphasiz[es] the critical distinction between statutory rights and contract rights"). That is precisely the situation in this case—as in *Bobbs-Merrill*, Vernor was a third party who did not agree to the copyright owner's license agreement and thus could not be bound by the license terms as a matter of contract law.

2. The panel's reliance on the copyright owner's characterization of a transaction also contradicts this Court's own precedent. In *DAK Industries*, this Court held that the "economic realities" of an exchange, rather than the label attached by the copyright owner, determine the nature of a software transfer. 66 F.3d at 1095 & n.2. Holding that Microsoft's characterization of the transaction as a "license" and payments as "royalties" did "not control [the] analysis," the Court concluded that the transaction was "best characterized as a sale." *Id.*

The panel here distinguished *DAK* on the ground that it was a bankruptcy case, but gave no reason why ownership of copyrighted works under federal law should differ depending on whether a case involves bankruptcy. Op. 13884-85. The panel's distinction creates a split in circuit authority between bankruptcy and other cases and would lead to strange results—the "owner" of software, for example, could be forced to sell the software in bankruptcy, even though, under copyright law, the software is "licensed" and resale would constitute copyright infringement. The Bankruptcy Act avoids such problems by requiring courts to apply "applicable nonbankruptcy law" with respect to intellectual property. 11 U.S.C. § 365(n).

In any event, this Court has also held in a non-bankruptcy setting that the character of a transaction, rather than the label attached to it, determines copyright ownership. In *Wise*, the Court determined whether particular agreements constituted sales based not on whether they "expressly reserve[d] title," but on the "general tenor" of the transactions. 550 F.2d at 1191. The district court correctly concluded that *Wise* irreconcilably conflicts with the *MAI* line of authority on which the panel relied. 1-ER-21. In this Court, "the appropriate mechanism for resolving an irreconcilable conflict is an *en banc* decision." *Atonio v. Wards Cove Packing Co.*, 810 F.2d 1477 (9th Cir. 1987) (en banc).

3. The panel's approach conflicts with the Second Circuit's decision in *Krause*, which, like *DAK* and *Wise*, held that Congress did not intend owners' rights under the Copyright Act to hinge on a "narrow, formalistic definition of ownership dependent on title." 402 F.3d at 123. In stark contrast to *Krause*, the panel here relied heavily on Autodesk's formal reservation of title and gave no weight to the factor (equally applicable here) that *Krause* held to be determinative of a sale—the copyright owner's permanent relinquishment of possession of the copies at issue in exchange for a one-time payment. *Id.* at 124-25.

The panel distinguished *Krause* on the ground that "the parties [there] did not have a written license agreement, the defendant-employer had paid the plaintiff-employee significant consideration to develop the programs for its sole benefit, and the plaintiff had agreed to allow the defendant to use the programs 'forever,' regardless of whether the parties' relationship terminated." Op. 13883. Of those facts, the first and third also exist in this case—the "parties did not have a written license agreement" because Vernor never agreed to Autodesk's terms, and Autodesk relinquished possession of the copies permanently (i.e., "forever.") The remaining factor—the payment of "significant consideration" to develop software for the defendant's "sole benefit"—might be relevant to the question of who owns the *copyright* in software, but it sets far too high of a bar for ownership of particular copies. Nobody would suggest that ownership of a book depends on whether there was payment of "significant consideration" or whether the book was written for one's "sole benefit."

B. Whether the Copyright Owner Significantly Restricts the User's Ability to Transfer the Software

The second question under the panel's three-part test is whether the copyright owner "significantly restricts the user's ability to transfer the software." This element of the test is entirely circular—under the panel's analysis, a licensing notice that allowed resale would indicate that the recipient is an owner who is entitled to resell the work, while a notice that purported to prohibit resale would indicate that the recipient is a licensee for whom resale would be prohibited. Such reasoning is irreconcilable both with *Bobbs-Merrill* and § 109's guarantee that particular copies of copyrighted works may be resold "*without the authority of the* *copyright owner*." 17 U.S.C. § 109 (emphasis added). Indeed, it was in the course of rejecting this precise argument that the Supreme Court in *Bobbs-Merrill* recognized the existence of the first-sale doctrine, concluding that Congress did not intend the Copyrigtht Act to "create the right to impose, by notice … a limitation at which the book shall be sold at retail by future purchasers." 210 U.S. at 350.

C. Whether the Copyright Owner Imposes Notable Use Restrictions

The final prong of the panel's test asks whether the copyright owner imposed "notable use restrictions." Under the panel's test, such restrictions need not be enforceable or reflect the actual relationship between the parties. As long as they are included in the fine-print of the licensing notice, they are relevant to the question of ownership.

This portion of the panel's test conflicts with this Court's decisions holding that contractual restrictions on use do not demonstrate a lack of ownership. In *Wise*, this Court concluded that certain "licenses" were actually sales in cases involving carefully controlled distributions of films to networks and celebrities. 550 F.2d 1180. For example, the Court concluded that a studio's transfer of a copy of the film *Camelot* to actress Vanessa Redgrave was a "sale with restrictions on use," focusing on the fact that Redgrave (like Vernor) retained permanent possession of the copyrighted work in exchange for a one-time fee. *Id.* at 1192. The *Camelot* license was far more restrictive than the license here—where the

Camelot license restricted use to Redgrave's home, Autodesk's license allows use anywhere in the Western Hemisphere; and where the *Camelot* license restricted any use that was not personal or non-commercial, Autodesk's license purports to restrict reverse engineering and removal of proprietary notices.[1]

To be clear, Vernor does not dispute that Autodesk can impose restrictions on those who purchase its software by *contract* and can enforce those terms against the original purchaser. Indeed, Autodesk pursued the original purchaser in this case (Cardwell/Thomas & Associates) and obtained a consent judgment. Op. 13868 n.2. But the panel's holding would give Autodesk *additional* causes of action against every person who, like Vernor, subsequently possessed and transferred a copy during that copy's lifetime. *Bobbs-Merrill* rejected this approach based on the common-law's traditional hostility to contractual restrictions that "run with" personal property to bind future possessors. *See* Molly Shaffer Van Houweling, *The New Servitudes*, 96 Geo. L.J. 885, 910-14 (2008). By concluding that the imposition of such restrictions has the effect of destroying ownership, which in turn renders the restrictions enforceable, the panel turned *Bobbs-Merrill* on its head. Indeed, the panel's test would have the perverse effect of *encouraging*

[1] *See also United States v. Atherton*, 561 F.2d 747, 750-51 (9th Cir. 1977) (even a "sale to a purchaser with restrictions that are subsequently breached constitutes a first sale"); Restatement (First) of Prop. §10 cmt. c (1936) ("The owner may part with many of the rights … that constitute complete property and his relation to the thing is still termed ownership both in this Restatement and as a matter of popular usage.").

copyright owners who wish to circumvent the first-sale doctrine to include use restrictions in their licenses.

III. This Case Involves a Question of Exceptional Importance Because the Panel's Rule Undermines Consumers' Personal Property Rights and Destroys the Balance Created by the First-Sale Doctrine.

The first-sale doctrine is one of the key components of the balance of interests under the Copyright Act, reconciling copyright's interest in encouraging creative works with the countervailing individual interests in property ownership and societal interests in free alienability. *See Bobbs-Merrill*, 210 U.S. at 349-51. The doctrine reflects "the traditional bargain between the rights of copyright owners" and "ensures that the copyright monopoly does not intrude on the personal property rights of the individual owner" by providing that owners of particular copies of a copyrighted work have the same right to sell, give away, or destroy those copies as they traditionally have with other personal property. *Brilliance Audio, Inc. v. Haights Cross Commc'ns, Inc.*, 474 F.3d 365, 373-74 (6th Cir. 2007); *see Sebastian Int'l v. Consumer Contacts*, 847 F.2d 1093, 1096 (3d Cir. 1988) ("The first sale rule is statutory, but finds its origins in the common law aversion to limiting the alienation of personal property.").

By giving copyright owners the authority to control disposition of their works by "license" after releasing them into the stream of commerce, the panel's decision cuts deeply into traditional rights of ownership and converts a wide range of otherwise innocent activities into copyright infringement. The panel's holding means that individual consumers will face the risk of copyright liability every time they distribute a work by selling it, donating it to a library, or loaning it to a friend. In the case of software, consumers would be liable for copyright infringement simply by *using* the software, because the panel held that a non-owner's act of loading software into a computer's memory is copyright infringement. Op. 13880-81 n.13. Even worse, copyright liability could attach not only to obviously copyrighted works like books and software, but to any product that is sold with labels, logos, packaging, or instruction manuals in which the copyright owner claims a copyright interest.[2]

To avoid the risk of liability under the panel's holding, consumers would be forced to trace the chain of title of copyrighted works to ensure that ownership has been properly transferred and that no licensing terms have been imposed in the copy's history. A consumer purchasing a package of new software from a computer store, for example, would face copyright liability for installing and running the software if either the store or its suppliers breached any licensing terms

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[2] *See, e.g., Quality King*, 523 U.S. at 138 (copyrighted shampoo label); *Omega, S.A. v. Costco Wholesale Corp.*, 541 F.3d 982 (9th Cir. 2010), *cert. granted*, 130 S. Ct. 2089 (copyrighted watch logo); *Denbicare U.S.A. Inc. v. Toys R Us, Inc.*, 84 F.3d 1143 (9th Cir. 1996) (copyrighted diaper packaging); *Parfums Givenchy v. Drug Emporium*, 38 F.3d 477 (9th Cir. 1994) (copyrighted perfume boxes); 2-ER-171 (Autodesk license claiming copyright in software documentation).

contained in their distribution agreements. But unlike real property, for which transfer of titles are recorded, there is no practical way for a purchaser of consumer goods to obtain such information. Moreover, a mistake in determining a product's ancestry could subject the purchaser to severe liability, including up to $150,000 in statutory damages per infringing work, attorneys' fees, and, if the infringement is willful, even criminal penalties. *See* 17 U.S.C. §§ 504, 506(a)(1); 2-ER-171 (Autodesk license agreement warning of civil and criminal penalties). Such costly burdens on the stream of commerce are the basis for the common law's hostility to restrictions on alienation. *See* Thomas F. Merrill & Henry E. Smith, *Optimal Standardization in the Law of Property, the Numerous Clauses Principle*, 110 Yale L.J. 1, 26-34 (2000).

Allowing copyright owners to restrict downstream distribution by license also harms consumers by giving copyright owners an easy way to prohibit all resale and rental. The availability of second-hand stores, rentals, and libraries promote the distribution of copyrighted works and exert a downward pressure on prices by requiring copyright owners to compete with used copies of their own works. Rothchild, 57 Rutgers L. Rev. at 79-80. Under the panel's decision, textbook publishers, for example, could prohibit resale by used book stores and online sites like eBay, thereby requiring every student to buy a new copy at a higher price. The inevitable outcome of the panel's rule, if adopted by this Court, would be to undercut copyright's purpose of encouraging distribution of creative works by lessening the availability of those works and increasing their price. *See id.* at 15; R. Anthony Reese, *The First Sale Doctrine in the Era of Digital Networks*, 44 B.C. L. Rev. 577, 627 (2003).

CONCLUSION

The Court should grant rehearing en banc.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that on October 1, 2010, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system.

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/s/Gregory A. Beck
Gregory A. Beck