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ARTICLE

Imperishable Intellectual Creations: The Limits of the First Sale Doctrine

I. Neel Chatterjee*

INTRODUCTION

Although the application of intellectual property laws has adjusted over time to respond to changing commercial practices and evolving technologies,¹ the continuing stream of new scientific advances mandates a rethinking of the very concepts on which those laws are based. Copyright protection strikes a balance between the public interest in access to intellectual creations and the private incentive to obtain financial rewards for such creations.² One of the methods of compensating creators is by granting an exclusive right of distribution to all copyright owners.³ The exclusive

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1. NATIONAL COMM'N ON NEW TECHNOLOGICAL USES OF COPYRIGHTED WORKS (CONTU), FINAL REPORT 9-12 (1979) [hereinafter CONTU FINAL REPORT].

2. U.S. CONST. art. I, § 8, cl. 8; *Mazer v. Stein*, 347 U.S. 201, 219, *reh'g denied*, 347 U.S. 949 (1954) ("The economic philosophy behind the clause empowering Congress to grant patents and copyright is the conviction that encouragement of individual effort by personal gain is the best way to advance public welfare through the talents of authors and inventors in 'Science and the useful Arts.'"); *Sebastian Int'l, Inc. v. Consumer Contacts (PTY) Ltd.*, 847 F.2d 1093, 1095 (3d Cir. 1988); *Sony Corp. of Am. v. Universal City Studios, Inc.* 464 U.S. 417, 429 (1984); *Twentieth Century Music Corp. v. Aiken*, 422 U.S. 151, 156 (1975); 1 MELVILLE B. NIMMER & DAVID NIMMER, *NIMMER ON COPYRIGHT* § 1.03[A] (1994) [hereinafter NIMMER]; 1 PAUL GOLDSTEIN, *COPYRIGHT: PRINCIPLES, LAW & PRACTICE* § 1.1 (1989); Jessica D. Litman, *Copyright, Compromise, and Legislative History*, 72 CORNELL L. REV. 857 (1987).

3. 17 U.S.C. § 106(3) (1988 & Supp. V 1993).

right of distribution grants a copyright holder the right to benefit financially from the first sale of copies of literary or artistic works that are embodied in tangible mediums of expression (referred to as the "first sale doctrine").⁴

Recently, an author's distribution right has faced a new challenge due to the increased durability of mediums of expression. The precarious balance between the public interest in access to intellectual creations and the author's market interest is destabilized by this increased durability. Durability extends the life and the quality of a publicly distributed intellectual good and in turn allows for widespread access to individual copies (e.g., through resale and rentals), thus reducing the need for consumers to purchase new copies.⁵ Congress has acted in an *ad hoc* fashion at times to protect the author's market interest when the distribution right has been threatened by durability and widespread access. The changes and adjustments enacted by Congress, however, do not fully address the underlying problems causing tension in the distribution right. As a result, entirely different rights are emerging for the creators of different forms of copyrightable creations depending on the nature of the market for each type of artistic creation. Adjustments to lending and rental rights reflect uncertainty about the continuing viability of the first sale doctrine for many types of expression. Public lending rights and resale royalty laws—enacted as *droit de suite* rights in other countries—also demonstrate a concern for the preservation of authors' market interests but have not yet received the same support in the United States.⁶

One of the most current examples of instability in the copyright paradigm is the effect that compact discs ("CDs") have on the durability and access to the market for musical works.⁷ Congress has acted to limit rentals of CDs and phonorecords, but has yet to address the controversial issue of CD resales. Additionally, electronic distribution channels, such as the Internet, pose an imminent

4. See *infra* notes 19-26 and accompanying text.

5. See *infra* notes 38-44 and accompanying text.

6. See *infra* notes 45-60 (public lending) and 154-195 (*droit de suite*) and accompanying text.

7. See *infra* notes 196-208 and accompanying text.

threat to the distribution right as well as other exclusive rights. Electronic distribution channels provide simultaneous, unlimited access to multiple users from a single tangible copy. Since the current copyright regime only requires compensation for the reproduction of a tangible copy, durability of an electronically-distributed product increases the amount of public access to a single good without providing extra financial rewards to the creator.

Thus, the market rewards for the intellectual creation is not reflective of actual consumer access and use. In the past, Congress has made piecemeal alterations to copyright law to compensate for this problem, but it now needs to evaluate the viability of the first sale doctrine in the context of increasingly durable secondary markets. A potential solution to this problem would be to enact a uniform system of compulsory commercial blanket licensing to protect an author's economic interest in creating a work.⁸ To ensure proper compensation, Congress must enact laws to expand the scope of the exclusive rights to compensate the author based on the nature and extent of the use, rather than the current framework which is based on tangible property interests. Such a proposed system creates rights which adequately protect a creator's market interests and maintain the highest possible economic efficiencies for consumers of goods as well as the distributors of such goods.

I. THE DISTRIBUTION RIGHT UNDER COPYRIGHT LAW

By granting a limited monopoly over an intellectual creation, copyright law balances an author's interest in remuneration with the public's interest in access to the author's works.⁹ This monopoly, in the form of a copyright, allows a creator to reap the economic benefits of his labor by selling the creation in the marketplace—thereby controlling the scope of its use.¹⁰ The market interest for creators is preserved through the exclusive nature of intellectual property rights.¹¹ Under this scheme, the authors have the

8. See *infra* notes 226-251 and accompanying text.

9. 1 GOLDSTEIN, *supra* note 2, § 1.2.

10. *Id.*

11. The privileges granted under copyright law give the copyright owner the exclu-

sole right to profit from the initial sale of their copyrighted works as well as to retain various commercially valuable rights for a limited period of time.¹²

On the other hand, since the public desires access to these works, a strong incentive exists to avoid granting overly broad protection which would limit the ability of others to develop future works based on the creation,¹³ or to use the goods for education, news, or commentary.¹⁴ To satisfy this public interest, the monopoly conveyed in the manner of expression is limited by sections 106A to 120 of the Copyright Act.¹⁵

Exclusive rights provide the basic scheme for the exploitation of a copyrighted work.¹⁶ For musical works, the public performance right and the distribution right are particularly important.¹⁷

sive right to authorize: the reproduction of the copyrighted work in copies and phonorecords; the adaptation of the copyright in the form of a derivative work; the distribution of the copies or phonorecords to the public; the public performance of the work; and the public display of the work. 17 U.S.C. § 106 (1988 & Supp. V 1993).

12. 17 U.S.C. §§ 302-305 (1988 & Supp. V 1993). Some have characterized the time limits as "lead" time to exploit the creation before others. See, e.g., Michael Lehmann, *Property and Intellectual Property—Property Rights as Restrictions on Competition in Furtherance of Competition*, 20 INT'L REV. INDUS. PROP. & COPYRIGHT 1, 14-15 (1989) (characterizing the exclusive rights for a limited duration as artificial lead time in intellectual property systems); J.H. Reichman, *Intellectual Property in International Trade: Opportunities and Risks of a GATT Connection*, 22 VAND. J. OF TRANSNAT'L L. 747, 803 (1989) (characterizing the exclusive right to reproduce as a statutory period of artificial lead time). See generally ROBERT P. BENKO, *PROTECTING INTELLECTUAL PROPERTY RIGHTS: ISSUES AND CONTROVERSIES* 21-24 (1987) (discussing the benefits that copyright law confers upon the general public).

13. 1 GOLDSTEIN, *supra* note 2, § 1.2; 1 NIMMER, *supra* note 2, § 1.03[A]; Kenneth R. Corsello, Note, *The Computer Software Rental Amendments Act of 1990: Another Bend in the First Sale Doctrine*, 41 CATH. U. L. REV. 177, 183 (1991).

14. See 17 U.S.C. § 107 (1988 & Supp. V 1993) (fair use exceptions).

15. 17 U.S.C. §§ 106A-120 (1988 & Supp. V 1993).

16. Shira Perlmutter, *Resale Royalties for Artists: An Analysis of the Register of Copyrights' Report*, 40 J. COPYRIGHT SOC'Y 284, 293 (1992) ("Copyright's methodology is to compensate authors not when their works are created, but when they are exploited by others"). See also *supra* note 3.

17. STANLEY ROTHENBERG, *COPYRIGHT AND PUBLIC PERFORMANCE OF MUSIC* 26-27 (1987). The public performance right extends only to the underlying written composition and not to the sound recording. See SIDNEY SHEMEL & M. WILLIAM KRASILOVSKY, *THIS BUSINESS OF MUSIC* 39-43 (1990). For sound recordings embodied in phonorecords, these exclusive rights are particularly important because sound recordings of musical works are

These rights provide the means by which a writer collects royalties and is rewarded for public performances and sales of copies of the work.¹⁸ Thus, preservation of these rights is pivotal to authors and creators of musical works under the current copyright paradigm.

Section 109 of the Copyright Act subjects an author's distribution right to the first sale doctrine.¹⁹ The doctrine entitles a purchaser of a copy of a copyrighted work to use or dispose of that copy freely without paying a royalty to the copyright holder.²⁰ Although the purchaser may freely dispose of the copy, he is still bound by the other exclusive rights granted to the author under copyright law.²¹ By limiting a copyright owner's control over the future disposition of copies that have entered the stream of commerce, the first sale doctrine supports the policy of freedom of alienation.²² The freedom of alienation policy allows the owner of property to sell, rent, or dispose of property free of any encumbrances.²³ The policy was intended to promote economic efficiencies and allow for simple, efficient transfer of goods.²⁴ U.S. law

only entitled to the rights of reproduction and distribution. *Id.* See also Judy A. Kim, Note, *The Performers' Plight in Sound Recordings—Unique to the U.S.: A Comparative Study of the Development of Performers' Rights in the United States, England and France*, 10 COLUM.-VLA J.L. & ARTS 453 (1986) (discussing performers' rights and neighboring rights in various countries).

18. See generally SHEMEL & KRASILOVSKY, *supra* note 17, at 39-43, 176-90 (discussing the mechanics of compensating authors and publishers in the music business).

19. "Notwithstanding the provisions of § 106(3), the owner of a particular copy or phonorecord lawfully made under this title or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord." 17 U.S.C. § 109(a) (1988).

20. 2 NIMMER, *supra* note 2, §§ 8.12[A], [B][2]; 1 GOLDSTEIN, *supra* note 2, § 5.6.1.

21. For example, the purchaser may not publicly perform or display the purchased copy without the copyright owner's consent. 17 U.S.C. § 106 (1988 & Supp. V 1993).

22. The first sale doctrine was originally conceived under European patent law and was eventually adopted into copyright under English common law which disapproved of restraints on alienation of owned property. David H. Horowitz, *The Record Rental Amendment of 1984: A Case Study in the Effort to Adapt Copyright Law to New Technology*, 12 COLUM.-VLA J.L. & ARTS 31, 34-38 (1987); John M. Kernochan, *The Distribution Right in the United States of America: Review and Reflections*, 42 VAND. L. REV. 1407, 1412-14 (1989).

23. RESTATEMENT (SECOND) OF PROPERTY §§ 4.1-4.3 (1988).

24. *Id.*; see generally Michael D. Kirby, *Restraints on Alienation: Placing A 13th Century Doctrine in a 21st Century Perspective*, 40 BAYLOR L. REV. 413 (1988) (discussing current restraints on alienation).

effectively allows a purchaser to obtain a copy with the absolute minimum of limitations necessary to protect the market interests of the author.²⁵ In this manner, the purchaser obtains the distribution right with respect to that particular copy under the first sale doctrine.²⁶

II. ECONOMIC TENSIONS WITH THE DISTRIBUTION RIGHT

The money obtained by a copyright holder through the distribution right is a function of the volume of sales times the royalty paid per unit.²⁷ The copyright holder expects to obtain a royalty each time a copy of the creation is purchased. Since the copyright holder initially controls the entire inventory of her work, she is free to exploit the limited monopoly power as she sees fit.²⁸ This limited monopoly allows the copyright holder to limit the supply of the work and to attain quasi-monopolistic prices by such restraints.²⁹ In a primary market with no possibility of secondary markets, the

25. 1 NIMMER, *supra* note 2, § 1.03[A]; 1 GOLDSTEIN, *supra* note 2, § 5.6.1.

26. *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339, 350-51 (1908) (stating that a copyright owner extinguished sale rights upon initial vending and owner could not compel retailers to sell at a certain price); *United States v. Drebin*, 557 F.2d 1316 (9th Cir. 1977), *cert. denied*, 436 U.S. 904 (1978); *United States v. Wise*, 550 F.2d 1180, 1187 (9th Cir.), *cert. denied*, 434 U.S. 929 (1977). See also Richard Colby, *The First Sale Doctrine—The Defense that Never Was?*, 32 J. COPYRIGHT SOC'Y 77 (1985) (discussing the history and application of the first sale doctrine); Julie S. Congdon, Case Note, *The First Sale Doctrine of Copyright Law Closes Another Avenue of Redress*, 34 VILL. L. REV. 597 (1989) (evaluating the first sale doctrine and importation right).

27. See SHEMEL & KRASILOVSKY, *supra* note 17, at 3-6 (discussing various royalty arrangements and rates).

28. S.J. Liebowitz, *Some Puzzling Behavior by Owners of Intellectual Products: An Analysis*, 5 CONTEMP. POL'Y ISSUES 44, 46 (1987). The term "limited monopoly" is used in this context because of the fair use and other exceptions to the exclusive rights. Because the rights are exclusive, but not absolute, the monopoly conferred on a copyright owner is limited.

29. Potential substitutes limit the monopoly power granted by copyright. *Id.* Some consumers, however, will choose to either purchase a given work or not buy one at all. As such, some intermediate price between marginal price and marginal revenue exists where the copyright holder sells at a monopolistic-type price. *Id.* But see *Report of the Register of Copyrights on the General Revision of the U.S. Copyright Law Before the House Comm. on the Judiciary*, 87th Cong., 1st Sess. 3-6 (Comm. Print 1961), reprinted in 3 GEORGE S. GROSSMAN, OMNIBUS COPYRIGHT REVISION LEGISLATIVE HISTORY 3-6 (1976).

copyright holder, as a quasi-monopolist, can distribute the good at any supply level.³⁰ By determining supply, the copyright holder can extract a monopoly price for the work—thereby effectively charging any price for the work.³¹ Only those consumers who value the product and who are willing to accept the seller's price can obtain the good. By adjusting the supply against demand, the copyright holder can maximize profit levels.³²

As a good becomes partially durable, secondary markets develop. Once the price in secondary markets exceeds the value the initial purchaser retains in the good, the purchaser may choose to sell the good in secondary markets.³³ The possibility of secondary markets, in turn, expands the number of resellers demanding the initial seller's product.³⁴ In the primary market, the purchasers attach value to certain qualities, such as: (1) being the first owner; (2) obtaining a high quality good; (3) retaining the ability to sell in secondary markets; and (4) merely possessing the good for a period of time.³⁵ As a good becomes more durable, secondary markets gain in importance and become a viable alternative to primary markets. Secondary market consumers often do not place a premium on being the first purchaser of a good, and they place a lower value on obtaining a high quality good.³⁶ Rather, these secondary market consumers are satisfied with mere possession and use and will ordinarily pay a lower price than they would in the initial market.³⁷

30. See WILLIAM J. BAUMOL & ALAN S. BLINDER, *ECONOMICS: PRINCIPLES & POLICY* 224-27 (1986) (discussing supply decisions of monopolists).

31. This value will normally be higher than the competitive price. *Id.* at 224-28.

32. *Id.* at 224-27; see KARL E. CASE & RAY C. FAIR, *PRINCIPLES OF ECONOMICS* 303-23, 334-44 (1989).

33. See generally R.H. Coase, *Durability and Monopoly*, 15 *J.L. & ECON.* 143 (1972) (discussing instability in monopolistic markets caused by durability); John Conlisk et al., *Cyclic Pricing By A Durable Goods Monopolist*, 99 *Q.J. ECON.* 489 (1984) (discussing supply and pricing decisions of monopolist to ensure maximum profits).

34. See generally Coase, *supra* note 33, at 143-49 (discussing the economic underpinnings of a highly durable secondary market).

35. See Daniel K. Benjamin & Roger C. Kormendi, *The Interrelationship Between Markets for New and Used Durable Goods*, 17 *J.L. & ECON.* 381, 397 (1974), for a thorough economic analysis of these principles.

36. Coase, *supra* note 33, at 144; Benjamin & Kormendi, *supra* note 35, at 382-88.

37. Coase, *supra* note 33, at 147-48.

As goods become extremely durable, the secondary market and the initial market begin to coalesce.³⁸ When a good is very durable, it will not deteriorate over time, thus facilitating repeated access by a number of users.³⁹ Therefore, with a highly durable good, the quality of the product in initial and secondary markets will not differ significantly. The initial sales market, therefore, will no longer necessarily include the discriminating consumer, since the increased durability allows him to purchase in a subsequent market at a discounted rate without loss of quality.⁴⁰ The remaining customers in the initial sales market will accordingly be the vendors in the subsequent markets for the product. These customers will also be those purchasers who value being the first owner of the good.⁴¹ Thus, with increased secondary market durability, the quantity demanded and the price charged for initial sales will likely decrease.⁴² In the current copyright paradigm, the net effect is thus a loss in profits and royalties to the copyright owner because of loss of sales in the initial markets.

Finally, when a good becomes imperishable and provides unlimited concurrent access to all consumers at near perfect quality, the correlation between price, possession, and quantity is virtually destroyed.⁴³ The supplier need only place one product into the market, and all those who want access can have it. Supply, then, becomes independent of possession or access, and the supplier loses the ability to control the price of the work. Consequently, the durable goods monopolist faces tremendous instability to his monopoly when a good becomes imperishable without proper safeguards.⁴⁴

38. *Id.* at 143.

39. *Id.* at 144.

40. *Id.*

41. Benjamin & Kormendi, *supra* note 35, at 382-88.

42. Coase, *supra* note 33, at 144.

43. *Id.* Although Coase did not specifically identify this as a result, the independence of price and quantity when unlimited access is available is a logical conclusion of his theory.

44. Under the current copyright scheme, the primary remuneration rights of distribution and reproduction are severely undermined. See INFORMATION INFRASTRUCTURE TASK FORCE, INTELLECTUAL PROPERTY AND THE NATIONAL INFORMATION INFRASTRUC-

III. EARLY CHALLENGES TO THE DISTRIBUTION RIGHT: PUBLIC LENDING AND RENTAL

A. *The Public Lending Right*

Perhaps the most controversial challenge to the first sale doctrine is the public lending right. As enacted in foreign countries, public lending rights compensate authors for a library's interference with the distribution right.⁴⁵ Public libraries purchase only a few copies of a book and disseminate them to a large number of people who might otherwise buy the book. To counteract the detrimental effect that such lending has on an author's income, the public lending right compensates authors for the lost sale of copies.⁴⁶

Directly opposed to the public lending right is the first sale doctrine, which allows a purchaser to obtain a particular copy without any such restraints.⁴⁷ Under the first sale doctrine, libraries have no duty to compensate authors for the lending of any work.⁴⁸ By enacting a public lending right, however, a state recognizes the need to balance the first sale doctrine against the market interference caused by the impact of lost sales of such works. In such cases, the rights granted under copyright law are expanded to cover future uses of a copyrighted work by libraries, and the libraries must pay a fee for such use.

TURE: A PRELIMINARY DRAFT OF THE REPORT OF THE WORKING GROUP ON INTELLECTUAL PROPERTY RIGHTS, July 1994, 34-42 [hereinafter NII REPORT]. Additionally, such access can fundamentally undermine the other exclusive rights, such as the derivative and public performance rights. *Id.* at 42-44.

45. Daniel Y. Mayer, Note, *Literary Copyright and Public Lending Right*, 18 CASE W. RES. J. INT'L L. 483 (1986) (discussing international application of public lending rights). See also BRIGID BROPHY, A GUIDE TO PUBLIC LENDING RIGHT 2 (1983) (outlining the mechanics of public lending right systems); LEON E. SELTZER, EXEMPTIONS AND FAIR USE IN COPYRIGHT: THE EXCLUSIVE RIGHTS TENSIONS IN THE 1976 COPYRIGHT ACT 110 (1978) (discussing the tension in the public lending right under the current copyright system).

46. ROBERT A. GORMAN & JANE C. GINSBURG, COPYRIGHT FOR THE NINETIES 493 (1993). See STEPHEN M. STEWART, INTERNATIONAL COPYRIGHT AND NEIGHBORING RIGHTS 71-73 (1989) (explaining the policy underlying the public lending right).

47. 1 GOLDSTEIN, *supra* note 2, § 5.6.1.1(c); NEIL BOORSTYN, COPYRIGHT LAW §§ 4:4, 5:18 (1981 & Supp. 1992).

48. 17 U.S.C. § 108 (1988).

The public lending right has not been adopted by the United States but is part of the law in at least thirteen other countries.⁴⁹ Germany has one of the most advanced public lending right systems, protecting all copyrighted materials owned by a library.⁵⁰ Its public lending right provides an author with compensation from libraries via a general contract with collecting societies which are grouped by forms of expression (e.g., pictures, movies, music, or literature).⁵¹ The collecting societies receive a percentage of a lump sum public lending right payment authorized by the German government based on their share of total lending.⁵² The collecting society then distributes the income it receives based upon internal administrative procedures.⁵³

Each country which has adopted a public lending right, with the exception of Germany, enacted it independently of copyright law.⁵⁴ The public lending right is often not incorporated into existing copyright systems in order to avoid extending the rights to non-nationals as would be required under existing international copyright agreements.⁵⁵ The extension of such rights to non-nationals

49. Countries having a public lending right include Germany, Sweden, Great Britain, Denmark, Iceland, Canada, Australia, New Zealand, France, Belgium, Norway, The Netherlands, and Finland. Different countries have different means of compensation for authors. In some countries, the royalty is correlated to the number of times a book is loaned to a consumer. In others, the royalty is calculated based on the holdings of the library, regardless of the frequency of loans of the copy. Finally, some countries provide for a one-time payment to the author at the time of purchase of a copy. STEWART, *supra* note 46, at 418-20; Jennifer M. Schneck, Note, *Closing the Book on the Public Lending Right*, 63 N.Y.U. L. REV. 878, 891-97 (1988). Unlike the United States, many countries have expanded rights for authors and creators. The widespread acceptance of public lending rights in other countries—as well as the continuing debate about such a right in the United States—demonstrates an widespread concern for the market interference to an author's distribution right under international as well as U.S. copyright law.

50. STEWART, *supra* note 46, at 418-20.

51. *Id.*

52. *Id.*

53. Mayer, *supra* note 45, at 495-96.

54. Schneck, *supra* note 49, at 897.

55. *Id.* at 898-99. Under the Berne Convention and the Universal Copyright Convention, copyright protection extended to nationals of a country must also be extended to authors from all other convention countries. Berne Convention for the Protection of Literary and Artistic Works, Sept. 9, 1886, *as last revised*, Paris, July 24, 1971, 828 U.N.T.S. 221 [hereinafter Berne Convention]; Gerald Dworkin, *Public Lending*

would diminish economic resources without directly benefiting the public of any given nation.⁵⁶ Enacting a public lending right for non-nationals also would not enhance the access already enjoyed by the general public.⁵⁷

The United States has considered the public lending right and on occasion has examined its effect on authors.⁵⁸ In fact, Congress specifically enacted the first sale doctrine so as to allow library lending without infringing an author's copyright.⁵⁹ The Record of the House states:

[t]he outright sale of an authorized copy of a book frees it from any copyright control over its resale price or other conditions of its future disposition. A library that has acquired ownership of a copy is entitled to lend it under any conditions it chooses to impose.⁶⁰

B. Rentals

Closely related to the public lending right is the rental of various forms of copyrighted subject matter. Rentals are similar to public lending in that numerous members of the public are provided with access to a single copy of a work. Rentals are different,

Right—The UK Experience, 13 COLUM.-VLA J.L. & ARTS 49, 58 (1988). The German system limits the lending right to non-nationals whose countries afford German nationals a public lending right. Schneck, *supra* note 49, at 898.

56. Schneck, *supra* note 49, at 899.

57. *Id.* at 905-06. This policy, however, is arguably inconsistent with the Berne Convention's national treatment clause. See Berne Convention, *supra* note 55, art. 14^{ter} (requiring that each signatory country provide as full copyright protection to citizens of other signatory nations as they give to their own citizens).

58. *Copyright Law Revision Hearings on S. 597 Before the Subcomm. on Patents, Trademarks, & Copyrights of the Sen. Comm. on the Judiciary*, 90th Cong., 1st Sess. 591 (1967) (statement of Dr. Charles F. Gosnell, Chairman, Comm. on Copyright Issues, Am. Library Ass'n) (commenting on the effects of a public lending right).

59. H.R. 553, 94th Cong., 2d Sess. § 5693 (1976). For further examples, see *infra* notes 61-89 and accompanying text concerning record rentals and notes 108-114 concerning software rentals. In both situations, Congress has specifically carved out the public lending right for non commercial institutions.

60. H.R. 553, 94th Cong., 2d Sess. § 5693 (1976).

however, because users are charged for the access and because the renter's motive is profit-based. The renter extracts his profits without any duty to compensate the creator of the work. Congress has dealt with rentals on a case-by-case basis and has developed differing policies depending on the medium of expression and the use of the goods.

1. Record Rentals

The rental of sound recordings displaces sales and diminishes the revenue pool available to the author.⁶¹ Record rentals interfere with the sales market because people who would otherwise purchase a record will rent instead. Accordingly, the market pool of purchasers decreases because of the extra access provided by rentals. Specifically, rentals may directly and substantially interfere with an author's exclusive rights of reproduction and distribution, since a person renting a tape or compact disc may copy the work and never purchase a legitimate copy.⁶² Administrative costs of monitoring such infringement are prohibitively high, thereby making an author's rights virtually unenforceable.⁶³ A private user, then, can reproduce the work without any liability, thus diminishing the author's primary market. As a result, the record rental market

61. H.R. 1029, 98th Cong., 2d Sess. (1983), reprinted in *Audio and Video First Sale Doctrine: Hearings on H.R. 1027, H.R. 1029 and S. 32 Before the Subcomm. on Courts, Civil Liberties and the Administration of Justice of the House Comm. on the Judiciary*, 98th Cong., 1st Sess. 729 (1983) (statement of Stanley Gortikov, Pres. of Recording Industry Ass'n of America) [hereinafter *House Hearings*]; S. 33, 98th Cong., 1st Sess. (1983), reprinted in *Audio and Video Rental: Hearings on S. 32 and S. 33 Before the Subcomm. on Patents, Copyrights and Trademarks of the Senate Comm. on the Judiciary*, 98th Cong., 1st Sess. 5 (1983) (Senate Hearings) [hereinafter *Senate Hearings*].

62. Some have commented, however, that the first sale doctrine explicitly permitted a dealer to lawfully engage in the commercial rental of records, even when the express purpose and effect of the rentals was "to enable the consumer to make a copy of the record on a home audio cassette recorder." Horowitz, *supra* note 22, at 31.

63. H.R. Rep. No. 735, 101st Cong., 2d Sess. 7 (1990), reprinted in 1990 U.S.C.A.N. 6935, 6938 (stating that "technology has been both a boon and a bane to authors: a boon because it has fostered new methods of creation and distribution; a bane because it has also resulted in inexpensive, easy and quick ways to reproduce copyrighted works, in many cases in private or semi-private environments that render detection all but impossible").

creates a substantial interference with the compensation scheme under copyright law because it impedes the author from fully exploiting his distribution and reproduction rights.

Japan's experience with record rentals highlights the effects of record rentals on the dilution of an author's rights. The early 1980s were marked by a proliferation of record rental stores in Japan.⁶⁴ Nearly 20% of all retail record outlets were rental stores.⁶⁵ More than 97% of all rental customers stated that they made home recordings of rented records.⁶⁶ Further, 61% percent of the customers loaned or gave reproductions to their friends.⁶⁷ This development had a devastating effect on the Japanese record industry, and Congress feared that a similar development in the United States could severely undermine the rights of American authors.⁶⁸

Further complicating this concern was the advent of CDs in the 1980s. CDs not only provide extremely high quality sound, but they are also highly durable. CDs are not subject to the wear and tear of tapes and records because the disc is played by laser scanning (which does not cause deterioration) rather than by direct physical interaction of a metal stylus or tape heads. A CD can be rented hundreds of times without any reduction in sound quality or need for repurchase.⁶⁹ As a result, any renter can copy the sound recording at near perfect quality and at much less than the authorized purchase price.⁷⁰

In response to the technological advances in sound recordings, Japan developed a licensing system for the rental of phonorecords.⁷¹ Under this system, rental stores could continue to rent sound recordings in return for a royalty on each phonorecord

64. Horowitz, *supra* note 13, at 31-32.

65. *Id.* at 32.

66. *Senate Hearings, supra* note 61, at 248-49.

67. *Id.*

68. *Id.*

69. Horowitz, *supra* note 22, at 33.

70. See 135 Cong. Rec. S568 (daily ed. Jan. 25, 1989) (statement of Sen. Hatch); H.R. Rep. No. 987, 98th Cong., 2d Sess. 7 n.6 (1984), *reprinted in* 1984 U.S.C.C.A.N. 2899.

71. Horowitz, *supra* note 22, at 33; Robert Adachi & Michael Fedrick, *A Comparison of Responses to the Record Rental Industry Under Japanese and U.S. Copyright Law*, 9 PAC. BASIN L. J. 210, 212 (1991).

rented.⁷² This system ensured a continuous stream of royalties as partial compensation for the potential loss of sales income that the author experienced.⁷³

In the United States, bills were introduced by Senator Charles Mathias, Jr. and Representative Don Edwards to reconcile the first sale doctrine with the unique compensatory problems raised by rentals.⁷⁴ These bills prohibited the owner of a particular phonorecord or videotape from renting, leasing, or lending the phonorecord or videotape for purposes of direct or indirect commercial advantage unless authorized by the copyright owner.⁷⁵ Although the bills received widespread support from the recording industry and the Register of Copyrights,⁷⁶ the proposal was abandoned due to the decision in the *Betamax*⁷⁷ case, which held that home videotaping of copyrighted materials for time-shifting purposes was a fair use.

Although the decision in *Betamax* weakened the debate surrounding videotape rentals, the recording industry continued to pursue legislation banning the rental of phonorecords.⁷⁸ Record rental was still in its infancy in the United States, and the recording industry sought to limit expansion of the record rental industry before it experienced the same degree of growth as in Japan.⁷⁹ The recording industry was concerned that once a full-fledged rental industry was established, the rental industry would have sufficient political power to fight any legislation against record rental.⁸⁰

In 1984, Congress enacted the Record Rental Amendment Act which banned the unlicensed rental of records.⁸¹ The Amendment

72. Adachi & Fedrick, *supra* note 71, at 215.

73. *Id.*

74. *See supra* note 61.

75. *Senate Hearings, supra* note 61, at 127; *House Hearings, supra* note 61, at 128.

76. *Senate Hearings, supra* note 61, at 31-33, 356-421; *House Hearings, supra* note 61, at 548.

77. *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417 (1984).

78. Adachi & Fedrick, *supra* note 71, at 216-18.

79. *Id.* at 218.

80. *Id.*

81. Record Rental Amendment of 1984, Pub. L. No. 98-450, 98 Stat. 1727 (1984) [hereinafter the Amendment] (codified as amended at 17 U.S.C. §§ 109(b)(1)(A) &

expanded the distribution right of an author by exempting phonorecords from some of the first sale doctrine limitations of section 109(a).⁸² The Amendment forbade the use of phonorecords for direct or indirect commercial advantage by rental, lease, or lending without the consent of the copyright owner.⁸³ The Amendment was passed, according to a Senate report, because

[t]he Committee has no doubt that the purpose and result of record rentals is to enable and encourage customers to tape their rented albums at home Thus, a record rental and a blank tape purchase is now an alternative way of obtaining a record without having to buy one. The rental is a direct displacement of a sale.⁸⁴

The report continued on to say that

[c]ommercial record rentals in the United States hurt copyright owners when record rentals displace record sales. This is because record rentals are almost invariably followed by unauthorized home taping, thereby resulting in even fewer record sales. Yet copyright owners are not compensated either for the rental itself or for the unauthorized home recording.⁸⁵

Congress was careful, however, to carve the public lending right out of the act.⁸⁶ Section 109(b)(1)(A) specifically states that “[n]othing in the preceding sentence shall apply to the rental, lease, or lending of a phonorecord for nonprofit purposes by a nonprofit library or nonprofit library or nonprofit educational institution.”⁸⁷

The Amendment was one of the first situations where copyright law was specifically amended to address the threat of particular

115(c)(3) (1988 & Supp. V 1993)).

82. Kernochan, *supra* note 22, at 1418.

83. 17 U.S.C. § 109(b)(1) (1988 & Supp. V 1993).

84. S. REP. NO. 98-162, 98th Cong., 1st Sess. 2 (1983).

85. *Id.* at 3. Such statements recognize the interference with both the distribution and reproduction rights.

86. See 135 Cong. Rec. S568 (daily ed. Jan. 25, 1989) (statement of Sen. Hatch); H.R. Rep. No. 987, 98th Cong., 2d Sess. 7 n.6 (1984), reprinted in 1984 U.S.C.A.N. 2899.

87. 17 U.S.C. § 109(b)(1)(A) (1988 & Supp. V 1993).

technological advances to distribution and reproduction rights (i.e. increased access to phonorecords via rentals and unauthorized home copying of phonorecords). It presented the first instance where the first sale doctrine was modified to ensure an author's economic interests in the face of widespread public access. The Amendment acknowledged the threat to the exclusive rights caused by rentals and acted to protect the limited monopoly granted under existing copyright law. The Amendment, however, only limited the lending of a phonorecord by commercial entities.⁸⁸ It did not prohibit future sales of the initial copy of the phonorecord by noncommercial actors.⁸⁹

2. Video Rentals

The technological advent of the home video cassette recorder also posed new challenges to the first sale doctrine. Video rentals were a concern because the movie industry feared that such rentals would replace box office sales.⁹⁰ Since a single tape could be viewed by a large number of people over a long period of time, movie producers and the Register of Copyrights advocated a change in the first sale doctrine for videocassettes.⁹¹ Movie producers argued that the first sale doctrine precluded them from participating in rental profits and possibly interfered with their ability

88. *Id.*

89. *Id.*

90. See *Senate Hearings*, *supra* note 61, at 313-14 (testimony of David Lange, Professor of Law, Duke University).

91. The Register of Copyrights reported:

[T]he first sale doctrine had existed since the beginning of printing . . . and had never been perceived as a threat to the sale of new copies of the work. The major reason for this seems to be that the public prefers to purchase unused books: the second hand copy generally is not competitive with an unused book. In the case of videocassette rentals, the same product is being rented as is sold. The competition is direct.

Senate Hearings, *supra* note 61, at 248-50 (1983). See also Joseph J. Beard, *The Sale, Rental, and Reproduction of Motion Picture Videocassettes: Piracy or Privilege?*, 15 N. ENG. L. REV. 435 (1980) (discussing potential interferences with the first sale doctrine caused by the emerging market for videocassettes); Debra A. Opri, Note, *Video Rentals and the First Sale Doctrine: The Deficiency of Proposed Legislation*, 8 WHITTIER L. REV. 331, 338 (1986) (criticizing act which would limit video cassette rentals).

to make money through the box office.⁹² Although the movie industry acted to expand the sales market for tapes, the market demand for rentals eclipsed that of sales—effectively eliminating sales as a viable method for recovering lost profits.⁹³

Video rentals were originally included in the Amendment, but were removed because of the then-pending *Betamax* case.⁹⁴ The *Betamax* case held that the use of a videocassette recorder to record a broadcast show simply assisted in “shifting” the timing of a particular show rather than contributing to any copyright infringement or pecuniary loss to a creator.⁹⁵ Rather than opening the door for unauthorized and wholesale copying, the *Betamax* decision has not unduly burdened the movie and television industry for two reasons. First, the quality of a rental videotape is superior to a home copy, and the cost to rent a videotape is similar to the cost of a blank tape.⁹⁶ Consumers therefore would rather pay the cost of renting a videotape, because in this manner they can obtain a higher quality tape for about the same price as an unlawful copy.⁹⁷ Second, people generally listen to repeat performances of a musical work, but consumers are less likely to watch the same movie repeatedly.⁹⁸ Thus, they would be more willing to rent a videocassette than to purchase a blank tape or a copy of a videocassette.⁹⁹

The advent of videocassette rentals did not precipitate any amendment to the first sale doctrine despite the attempts to do so. In fact, studios are free to sell their cassettes to both private and

92. *Senate Hearings*, *supra* note 61, at 313-14; *see generally* Opri, *supra* note 91 (providing a brief history surrounding the proposed video rental legislation).

93. Opri, *supra* note 91, at 338-39; ROBERT SIMON, *THE MOVIE INDUSTRY: THE BIG PICTURE* 628 (1984).

94. *See supra* notes 74-78 and accompanying text.

95. *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417, 443 (1984).

96. *House Hearings*, *supra* note 61, at 238 (statement of economist Nina W. Cornell).

97. *Id.*

98. *Id.* This fact is also demonstrative of the differing nature of the movie and music markets. Movies have numerous mediums which fulfill differing consumer needs (i.e. big screens, television, cable). Music, on the other hand, is produced in limited mediums of expression which all serve the same functional purpose. Because of the nature of the movie industry, the market interference for any given medium is not as severe.

99. Corsello, *supra* note 13, at 192-93; *Senate Hearings*, *supra* note 61, at 238.

commercial actors, and the purchasers may resell or rent the tapes without restriction.¹⁰⁰ The relative strength and growth of the video rental industry has precluded any legislative action similar to the Amendment.¹⁰¹

The future of videocassette rentals in an increasingly global trade regime is less certain, however. Recently, the United States implicitly has acknowledged that commercial rental of cinematographic works and software is a potential problem.¹⁰² Article 11 of the General Agreement on Trade and Tariffs ("GATT"), Agreement on Copyright and Related Rights states:

In respect of at least computer programs and cinematographic works, a party shall provide authors and successors in title the right to authorize or prohibit the commercial rental to the public of originals or copies of their copyrighted works. A member shall be excepted from this obligation in respect of cinematographic works *unless such rental has led to widespread copying of such works which is materially impairing the exclusive right of reproduction conferred in that party on authors and their successors in title.*¹⁰³

This provision illustrates a concern for the market interest of authors and creators of certain kinds of works when another person obtains a pecuniary benefit in the work, or when there is an interference with the exclusive rights of reproduction and distribution. U.S. support of the intellectual property component of GATT demonstrates a concern for videocassette "piracy" and the potential interference with an author's rights caused by video rentals. The federal government, however, has yet to take any remedial action.

Video rentals interfere with the market interest of producers of

100. See 17 U.S.C. § 109(a) (1988 & Supp. V 1993). Although rental of software and music is prohibited under § 109(b), the same prohibitions do not apply to videocassettes.

101. Kernochan, *supra* note 22, at 1421.

102. Draft Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, GATT Doc. MTN. TNC/W/FA, Dec. 20, 1991, Agreement on Trade Related Aspects of Intellectual Property Rights, Including Trade in Counterfeit Goods [hereinafter GATT].

103. *Id.* art. 11 (emphasis added).

video products as there is no collection of royalties based upon rental volume.¹⁰⁴ The money a creator of a work receives bears little relationship to the number of consumers that view the product.¹⁰⁵ Unlike record rentals, videocassette rentals do not interfere with reproduction because of the lack of durability inherent in videocassettes and the nature of the market. This lack of durability requires video stores to purchase replacement copies after heavy use.¹⁰⁶ Congress has not yet acted to balance the public interest of access of video rentals with the private interest of the creator, but the recent GATT treaty indicates that a change in policy may occur in the near future. Currently, however, section 109(a) of the Copyright Act governs, and the first sale doctrine allows purchasers to rent the videotapes totally unencumbered.¹⁰⁷

3. Software Rentals

The advent of software rentals offers the most recent example of tension within the first sale doctrine where Congress has acted. Software programs are often extremely expensive to develop.¹⁰⁸ The copying of software, however, provides an inexpensive alternative to purchasing.¹⁰⁹ Software rentals benefit all parties except the creator of the work. When software is rented, individuals can borrow the software and copy it at a fraction of the actual cost.¹¹⁰ The

104. The first sale doctrine extends only to new copies of works but not private rentals of existing copies. 17 U.S.C. § 109(a) (1988 & Supp. V 1993).

105. Rather, the royalty accrues based on the purchases made by the intermediate distributors/renters of the videotapes as a function of sales. See *Senate Hearings, supra* note 61, at 238; Opri, *supra* note 91, at 331; Beard, *supra* note 91, at 436.

106. To the extent that the copies are not perfectly durable, the videocassettes are reflective of some market demand. However, the ability to rent repeatedly still drives the overall demand toward competitive equilibrium pricing.

107. 17 U.S.C. § 109(a) (1988 & Supp. V 1993).

108. Pamela Samuelson et al., *A Manifesto Concerning the Legal Protection of Computer Programs*, in *Symposium, Toward a Third Intellectual Property Paradigm*, 94 COLUM. L. REV. 2310, 2371-78 (1994).

109. *Id.* at 2332-65. See also Dennis S. Karjala, *Misappropriation as a Third Intellectual Property Paradigm*, 94 COLUM. L. REV. 2594, 2598-99 (1994).

110. Vance Franklin Brown, Comment, *The Incompatibility of Copyright and Computer Software: An Economic Evaluation and a Proposal for a Marketplace Solution*, 66 N.C. L. REV. 977, 980 (1988); Judith Klerman Smith, Comment, *The Computer Software*

“pirate” obtains a copy of the work without any degradation in quality.¹¹¹ The commercial renter makes significant profits by renting the software repeatedly without significant degradation in quality and by suffering no extra financial liability beyond the initial purchase. The creator of the work loses all distribution rights at the time of the first sale and is not compensated for the rentals, despite the interference with his reproduction and distribution rights.

Protection of software is problematic because of the nature of its use.¹¹² When an individual pirates software, she has the ability to use the pirated work *ad infinitum*.¹¹³ Computer discs, like CDs, do not deteriorate quickly because they are scanned by a laser rather than by direct physical interaction. Also, in the event the disc wears down, the user can simply copy the program on to a new disc. Thus, the owners and manufacturers of that software may lose a sale each time software is rented and copied instead of purchased.¹¹⁴

Rental Act: Amending the “First Sale Doctrine” to Protect Computer Software Copyright, 20 *LOY. L.A. L. REV.* 1613, 1615 (1987).

111. Karjala, *supra* note 109, at 2594. See generally Wendy Gordon, *Assertive Modesty: An Economics of Intangibles*, 94 *COLUM. L. REV.* 2579 (1994) (discussing the economics and risks of intellectual property rights).

112. Some commentators have argued that the nature of the use and the structure of the software is incompatible with copyright. Randall Davis, *The Nature of Software and Its Consequences for Establishing and Evaluating Similarity*, 5 *SOFTWARE L.J.* 299 (1992); Peter S. Menell, *An Analysis of the Scope of Copyright Protection for Application Programs*, 41 *STAN. L. REV.* 1045 (1989); Pamela Samuelson, *CONTU Revisited: The Case Against Copyright Protection for Computer Programs in Machine Readable Form*, 1984 *DUKE L.J.* 663.

113. *Computer Software Rental Amendments Act of 1988: Hearings on S. 2727 Before the Subcomm. on Patents, Copyrights and Trademarks of the Senate Comm. on the Judiciary*, 100th Cong., 2d Sess. 15 (1988) [hereinafter *Computer Software Rental Hearings I*]; *Computer Software Rental Amendments Act of 1989: Hearings on S. 198 Before the Subcomm. on Patents, Copyrights and Trademarks of the Senate Comm. on the Judiciary*, 101st Cong., 1st Sess. 39 (1989) [hereinafter *Computer Software Rental Hearings II*] (statement of Heidi Roizen, President, Software Publishers Association); Corsello, *supra* note 13, at 201.

114. Some opponents of the expansion of a software creator’s distribution rights argue that the rentals allow for “try before you buy.” They argue that because so many programs are very complicated, rental allows consumers to test the product. Rather than reducing the software sales market, such a scheme allows for an expansion in that market. Smith, *supra* note 110, at 1624.

Initially, private efforts to limit the rental or unauthorized reproduction of software were unsuccessful.¹¹⁵ The two most commonly employed methods were embedded code protection and shrink wrap licensing agreements.¹¹⁶ Embedded codes were programs embedded in the software to prevent the unauthorized copying of the product.¹¹⁷ Efforts to maintain a viable code which precluded copying ultimately proved futile.¹¹⁸ Many software rental businesses sold code breaking software to facilitate the copying of software, thereby encouraging piracy.¹¹⁹ These embedded codes inevitably failed, and the software was left unprotected.¹²⁰

Another technique used by the computer industry was to license the software to consumers at large through "shrink wrap" licensing agreements.¹²¹ The software was wrapped in shrink wrap and, by tearing open the package, the purchaser would theoretically consent to the terms of the licensing agreement. One of the terms of the agreement typically prohibited resale or rental.¹²² Such efforts at licensing have been extremely controversial, and some courts have explicitly struck them down.¹²³ Some states, however, have passed

115. *Id.* at 1630-36.

116. *Id.* at 1630.

117. One type of code protection scheme embeds a date on the software. The software is then programmed to no longer function after that date. Other embedded code protection systems encode software instructions to specifically preclude copying.

118. Smith, *supra* note 110, at 1626.

119. *Id.*

120. *Id.* at 1634-36.

121. For articles addressing issues involving shrink wrap licenses, see Gary W. Hamilton & Jeffrey C. Hood, *The Shrink-Wrap License—Is It Really Necessary?*, 10 *COMPUTER L.* 16 (1993); Karen Puhala, Note, *The Protection of Computer Software Through Shrink-Wrap License Agreements*, 42 *WASH. & LEE L. REV.* 1347 (1985); David A. Rice, *Public Goods, Private Contract and Public Policy: Federal Preemption of Software License Prohibitions Against Reverse Engineering*, 53 *U. PITT. L. REV.* 543 (1992); David A. Rice, *Licensing the Use of Computer Program Copies and the Copyright Act First Sale Doctrine*, 30 *JURIMETRICS J.* 157 (1990); Michael Schwarz, Note, *Tear-Me-Open License Agreements: A Uniform Commercial Code Perspective on an Innovative Contract of Adhesion*, 7 *COMPUTER L.J.* 261 (1986).

122. Smith, *supra* note 110, at 1630-31.

123. Shrink-wrap licenses have generally been unenforceable under traditional contract law as courts view them as a unilateral attempt to add conditions to the purchase of a good without any additional consideration. See *Vault Corp. v. Quaid Software Ltd.*, 655 F. Supp. 750 (E.D. La. 1987); *S.O.S. v. Payday, Inc.*, 886 F.2d 1081 (9th Cir. 1989);

statutes expressly validating such "shrink wrap" agreements.¹²⁴ Aside from the state legislative validation of the shrink wrap licenses, the enforceability of these clauses is unclear at best.¹²⁵ Thus, such private contractual remedies have been only marginally successful and does not assure creators of adequate protection of their market interest.

In an effort to limit the rental and unauthorized reproduction of computer software, Representative Patricia Schroeder of Colorado introduced the Software Rental Act in Congress in the late 1980s.¹²⁶ In introducing the bill, Representative Schroeder analogized software rental to record rental, maintaining that copying from diskette to diskette was even faster and more efficient than copying from record or compact disc to tape.¹²⁷ By curbing the duplication of licensed software and thereby increasing sales, the Software Rental Act strove to increase incentives to create new software.¹²⁸ Congress believed that allowing software rental did not serve the public interest.¹²⁹ Although no immediate action was taken, Representative Schroeder's concerns later provided the foundation of the Computer Software Rental Amendments Act of 1990 ("Software Rental Act") which gave authors of software the right to authorize or prohibit the rental of software copies.¹³⁰

Congress created a number of exceptions to the general prohibi-

Allen v. Kaiser Aluminum & Chemical Corp., 583 F. Supp. 154 (E.D. Mo. 1984); A & M Produce Co. v. FMC Corp., 135 Cal. App.3d 473, 489 (Cal. App. 1982); Accusystems, Inc. v. Honeywell Info. Sys., 580 F. Supp. 474 (S.D.N.Y. 1984).

124. See, e.g., Illinois Software License Enforcement Act, ILL. REV. STAT. ch. 29, paras. 801-808 (1986), *repealed by* 1987 Ill. Laws 85-254 § 1, 85-264 § 1; LA. REV. STAT. ANN. § 51:1963 (West 1987).

125. In fact, one court has held that such state legislation is preempted by federal law. Vault Corp. v. Quaid Software Ltd., 655 F. Supp. 750, 762 (E.D. La. 1987).

126. H.R. 4949, 99th Cong. 2d Sess., 132 CONG. REC. H3437 (daily ed. June 5, 1986).

127. 132 CONG. REC. 12,294-95 (1986).

128. 136 CONG. REC. S16,310-11 (daily ed. Oct. 19, 1990) (statement of Sen. Hatch).

129. *Computer Software Rental Hearings I*, *supra* note 113, at 15; *Computer Software Rental Hearings II*, *supra* note 113, at 16.

130. Computer Software Rental Amendments Act of 1990, Pub. L. No. 101-650, 104 Stat. 5089 (codified at 17 U.S.C. § 109(b) (Supp. V 1993)) [hereinafter Software Rental Act]. The Software Rental Act is consistent with article 11 of the GATT Treaty.

tion against software rentals. Nonprofit libraries and educational institutions could loan software to individuals.¹³¹ These institutions were specifically excepted because Congress believed that they served a "valuable public purpose"¹³² and did not want to undermine their objectives.¹³³

The Software Rental Act also exempted hardware rentals which contained video game software and software which could not be copied in the normal use of the machine.¹³⁴ This exemption was created in order to facilitate and allow for hardware rentals.¹³⁵ Since many cars, microwaves, and other modern-day amenities have software embedded in the product, Congress believed that a limitation on the rentals of these products would be unduly prohibitive and would not serve the purposes of copyright law.¹³⁶ Thus, Congress permitted rentals of these types of equipment under the Software Rental Act.¹³⁷

The Software Rental Act also changed the exclusive rights granted to the software creator.¹³⁸ It permitted copying or adaptation of software if: (1) it was an essential step in the use of the program in conjunction with a machine; or (2) the copy or adaptation was used for archival purposes only.¹³⁹ It allowed for backup copies of software to be made and permitted repeated operation of the software.¹⁴⁰ Finally, it allowed a user to repair a program if the user finds bugs in the system or to adapt a program to meet the

131. 17 U.S.C. § 109(b)(2)(A) (Supp. V 1993).

132. H.R. REP. NO. 735, 101st Cong., 2d Sess. 8 (1990).

133. *Id.*

134. 17 U.S.C. § 109(b)(1)(B)(i)-(ii) (Supp. V 1993).

135. Most computer hardware, particularly video games, have software programs embodied within them.

136. *Computer Software Rental Hearings II*, *supra* note 113, at 15-16 (statement of Rep. Kastenmeier).

137. 17 U.S.C. § 109(b)(1)(B)(i)-(ii) (1988).

138. *See generally* Robert A. Kreiss, *Section 117 of the Copyright Act*, 1991 B.Y.U. L. REV. 1497 (1991) (outlining the changes in rights of software producers under § 117 of the Copyright Act).

139. 17 U.S.C. § 117 (1988); Kreiss, *supra* note 138, at 1498.

140. Each time the program is used, a copy of the program is made inside the software. Section 117 allows the hardware to make such a copy without infringing on the copyright of the software creator. *See* Kreiss, *supra* note 138, at 1507.

requirements of a particular computer.¹⁴¹

By enacting the Software Rental Act, Congress preserved the reproduction and distribution rights of software creators. In prohibiting software rentals in many situations, the Software Rental Act modified the first sale doctrine by expanding it to reach the unauthorized rental and copying of computer software.¹⁴²

C. *Summary of Rentals and Public Lending*

Congress has drafted exceptions to the first sale doctrine without fully appreciating the underlying problem causing the tensions within the doctrine—specifically, the increased durability of new mediums of expression coupled with increased low-cost access.¹⁴³ Durability precludes degradation in quality and facilitates continued rental.¹⁴⁴ Durable goods which are continually rented do not require extensive repurchase.¹⁴⁵ Thus, numerous people have access to a particular rented work, and the author never receives a royalty payment for such use. In these situations, the current copyright

141. *Id.*

142. The current approach of protecting software through copyright and limited patent paradigms has been challenged recently by a number of commentators. See Symposium, *Toward a Third Intellectual Property Paradigm*, 94 COLUM. L. REV. 2307 (1994). The lead article argues that a third intellectual property paradigm is necessary in order to protect software; accordingly, simply protecting substantially similar code is ineffective and leads to under or overprotection and does not effectively address the market interest of creators of software. Samuelson, *supra* note 108, at 2371-78. A companion piece identifies other types of intellectual creations which suffer from similar problems of protection. See J.H. Reichman, *Legal Hybrids Between the Patent and Copyright Paradigms*, in Symposium, *supra*, at 2432. It is this author's belief that Professor Reichman's "legal hybrid" hypothesis actually extends farther than his article identifies. Original copyright paradigms were created to protect only books. However, when market interest was identified as important for various artistic creations, copyright law developed exclusive rights and provisions to deal with the nature of the value of the creation, as identified by this article. The clearest example can be the addition of the public performance right to accommodate songwriters' concerns under copyright law. Thus, perhaps a more unified theory which is more market-oriented, as suggested by Professor Samuelson, would be appropriate for all the legal hybrids which have developed. Samuelson, *supra* note 108, at 2378-2420.

143. See *supra* notes 61-142.

144. Coase, *supra* note 33, at 147-48.

145. See *supra* notes 69-70 and accompanying text.

paradigm fails to reward a creator based on market demand.

Furthermore, modern technology has made the unauthorized duplication of works in particular mediums of expression very easy.¹⁴⁶ The monitoring of such duplication remains exceedingly difficult,¹⁴⁷ yet access to duplication equipment is available to consumers who may readily exploit the easy method of unauthorized duplication that rental and lending provides.¹⁴⁸

With regard to rentals, Congress has addressed this concern on a case-by-case basis.¹⁴⁹ Congress has responded to unauthorized interference with an author's exclusive rights of reproduction and distribution by enacting legislation limiting software and record rental.¹⁵⁰ By prohibiting commercial rental of software and phonorecords, Congress has confined the application of the first sale doctrine and has expanded the distribution right of authors working in these mediums.¹⁵¹ Congress, however, has not taken action to limit video rentals and book lending (through a public lending right).¹⁵² In part, the lack of legislation is due to the difficulty and cost in copying literary works and because the nature of audiovisual and literary works do not lend themselves to repeated use.¹⁵³ Additionally, Congress has determined that the public interest in access to intellectual creation of these goods outweighs any substantial change in the first sale doctrine.

IV. CURRENT AND FUTURE CHALLENGES TO THE DISTRIBUTION RIGHT

A. *Resale Royalties or Droit de Suite for Visual Arts*

Unlike rentals, resales historically have not involved a signifi-

146. For instance, stereo systems often have features allowing taping directly from a CD player. Similarly, software can be copied from disk to disk in seconds.

147. Corsello, *supra* note 13, at 178.

148. *Computer Software Rental Hearings II*, *supra* note 113, at 16 (statement of Ralph Oman, Register of Copyrights).

149. *See supra* notes 61-142.

150. 17 U.S.C. § 109(b)(1) (Supp. V 1993).

151. *See* 17 U.S.C. §§ 109(b)(1), 117 (Supp. V 1993).

152. *See supra* notes 58-60 (public lending) and 90-94 (video rentals) and accompanying text.

153. *See supra* notes 58-60 and 94-99 and accompanying text.

cant interference with the exclusive rights granted to a copyright holder.¹⁵⁴ Despite this lack of interference, resale royalties are granted to visual artists in many European countries and in California.¹⁵⁵ A "work of visual art" includes paintings, drawings, sculptures, and, in certain cases, photographs.¹⁵⁶

The policy underlying resale royalties, or *droit de suite* rights, for visual artists is the belief that authors should share in the profitable disposition of their works.¹⁵⁷ Unlike books, computer programs, and musical compositions, the primary value of a work of visual art is in the original.¹⁵⁸ As such, artists are different from other creators and authors because artists can not generally rely on the sale of numerous copies of their original works for their financial or market success.¹⁵⁹ Additionally, the unique nature of the

154. See Opri, *supra* note 91, at 331 (discussing shifts in policy restraining uses of goods except for resales); Horowitz, *supra* note 22, at 67-68 (arguing for incorporating the concept of economic harm into copyright law because of the effect of resales). See also Richard P. Adelstein & Steven I. Peretz, *The Competition of Technologies in Markets for Ideas: Copyright and Fair Use in Evolutionary Perspective*, 5 INT'L REV. L. & ECON. 209, 224 (1985) (discussing the economic ramifications of competition between various forms of access). See generally L. RAY PATTERSON, COPYRIGHT IN A HISTORICAL PERSPECTIVE (1968) (describing the development of copyright to accommodate market interests).

155. GORMAN & GINSBURG, *supra* note 46, at 494. For example, the California resale law states:

Whenever a work of fine art is sold and the seller resides in California or the sale takes place in California, the seller or his agent shall pay to the artist of such work of fine art or to such artist's agent 5 per cent of the amount of such sale.

CAL CIV. CODE § 986 (West 1984).

Additionally, there is no uniformity among countries as to whether prints and reproductions of the original work are exempt from protection after the first sale of such a copy. California, for example, does not extend the resale royalty to resales of prints of a visual work. See also John E. McInerney, *California Resale Royalties Act: Private Sector Enforcement*, 19 U.S.F. L. REV. 1, 9 (1984) (examining California's system of resale royalties).

156. 17 U.S.C. § 101 (1988) (definition of "work of visual art").

157. Stewart, *supra* note 46, at 70.

158. Elliott C. Alderman, *Resale Royalties in the United States for Fine Visual Artists: An Alien Concept*, 40 J. COPYRIGHT SOC'Y 265, 270 (1992) (reproduction and adaptation of a work is highly unusual and occurs with only the most successful works).

159. *Id.* at 268; Neil F. Siegel, *The Resale Royalty Provisions of the Visual Artists Rights Act: Their History and Theory*, 93 DICK. L. REV. 1, 9 (1988).

market for visual arts is problematic. Often, financial exigency compels a visual artist to prematurely sell a work for less than its true value.¹⁶⁰ Since the true value of a work of visual art often goes unrealized until many years after the original sale or even after the artist has passed away, the artist is never adequately compensated because of the first sale doctrine.¹⁶¹ This substantial time lag in appreciation is considered unique to visual arts.¹⁶² The *droit de suite* is an attempt to compensate the visual artist for the fact that his reproduction and distribution rights are initially commercially insignificant.¹⁶³ Proponents of *droit de suite* legislation argue that it provides economic incentives for visual artists similar to those granted to authors and composers.¹⁶⁴

Finally, visual art is one of the few copyrightable items that does not necessarily deteriorate with use. Furthermore, the nature of the use of visual art is substantially different from other copyrightable works. "Use" of visual art, for example, is mere possession. "Uses" of other copyrightable goods, on the other hand, traditionally involve direct physical interaction with the good. Whereas a book's spine will get bent and a record will wear out, a picture will be kept on a wall. Particularly valuable art will ordinarily be protected with proper encasements and climate control. This controlled durability may contribute to the ability of art to appreciate in value over time.

French, German and Belgian laws present three different theories to justify the resale royalty for visual arts.¹⁶⁵ The French sys-

160. LILIANE DE PIERREDON-FAWCETT, *THE DROIT DE SUITE IN LITERARY AND ARTISTIC PROPERTY: A COMPARATIVE LAW STUDY* 18-20 (1991); Siegel, *supra* note 159, at 8.

161. Alderman, *supra* note 158, at 270.

162. Siegel, *supra* note 159, at 8.

163. DE PIERREDON-FAWCETT, *supra* note 160, at 18-20. See also P. Katzenberger, *The Droit de Suite in Copyright Law*, 4 INT'L REV. OF INDUS. PROP. & COPYRIGHT L. 361, 367-68 (1973) (stating that authors often sell their works before they have value and that originals are often the primary source of value for visual art).

164. See, e.g., Thomas M. Goetzl & Stuart A. Sutton, *Copyright and the Visual Artist's Display Right: A New Doctrinal Analysis*, 9 COLUM.-VLA J.L. & ARTS 15, 38 (1984) (evaluating rights of artists under Visual Artists Rights Act).

165. Paul Sherman, *Incorporation of the Droit de Suite into United States Copyright*

tem emerges from a *droit moral* theory which attaches the personality of the artist to the creation.¹⁶⁶ As a result of this close link, the artist should be compensated for the exploitation of the work.¹⁶⁷ This entitles the artist to share in the proceeds from resale.¹⁶⁸ Due to the nature of the right, the artist's claim to resale royalties is inalienable.¹⁶⁹

The German law assumes that the work of visual art has a latent, unrealized value.¹⁷⁰ That value exists at the time of initial sale and vests in the creator of the work.¹⁷¹ Thus, the artist has a right to claim a portion of the future profits as the latent value existed at the time of creation.¹⁷² When the work is sold, the creator is paid a portion of the increased price.¹⁷³

The Belgian system of resale royalties is premised on an unjust enrichment theory.¹⁷⁴ According to this approach, subsequent events and circumstances increase the value of the work of visual art.¹⁷⁵ Denying the artist the right to claim a resale royalty in lieu of changed circumstances provides unjust enrichment to the initial purchaser.¹⁷⁶ Thus, a resale royalty is granted to avoid such unjust enrichment.¹⁷⁷

California has enacted a statute providing for resale royalty, largely based upon French law.¹⁷⁸ The California law allows the artist to obtain a certain percentage of the sales price, as long as

Law, 18 *COPYRIGHT L. SYMP. (ASCAP)* 50, 58 (1970).

166. *Id.* at 58.

167. *Id.*

168. Note, *The Applicability of the Droit de Suite in the United States*, 3 *B.C. INT'L & COMP. L. REV.* 433, 437 (1980); McInerney, *supra* note 155, at 4.

169. Rita E. Hauser, *The French Droit de Suite: The Problem of Protection for the Underprivileged Artist Under the Copyright Law*, 6 *BULL. COPYRIGHT SOC'Y* 94, 103 (1959).

170. Sherman, *supra* note 165, at 58.

171. *Id.*

172. *Id.* at 59-60.

173. *Id.*

174. *Id.* at 62.

175. *Id.* at 63.

176. *Id.* at 63.

177. McInerney, *supra* note 155, at 4-5; Sherman, *supra* note 165, at 59.

178. Sherman, *supra* note 165, at 59.

the resale of the work of visual art exceeds the original sale price by a certain amount.¹⁷⁹ In order to be eligible to receive a resale royalty under the California law, the work must be sold in California or be created by a California resident.¹⁸⁰ California courts have considered and rejected the claim that the first sale doctrine preempts the resale royalties act.¹⁸¹ The courts have held that the royalties simply require a payment but do not limit the ability of the sellers to rent or sell the work to whomever they wish.¹⁸² As such, no restraint on alienation exists.

Enforcing *droit de suite* legislation has been difficult. The only country effectively enforcing the resale right is France.¹⁸³ France has enjoyed success because it provides a comprehensive artwork registration scheme, whereby a central organization—representing virtually all French visual artists—tracks all sales of artwork and collects royalties for its members.¹⁸⁴ By tracking the sales and collecting the royalties, the *droit de suite* rights are protected.¹⁸⁵ Some argue that a *droit de suite* system can only be effective when an adequate monitoring and collection system is in place.¹⁸⁶

179. *Id.*

180. McInerney, *supra* note 155, at 1-6 (citing CAL. CIV. CODE § 986 (West 1984)).

181. *Morseburg v. Balyon*, 621 F.2d 972, 978 (9th Cir. 1979), *cert. denied*, 449 U.S. 983 (1980) ("The work can be transferred without restriction. The fact that a resale may create a liability to the creator artist or a state instrumentality and, at the same time, constitute an exercise of a right guaranteed by the Copyright Act does not make the former a legal restraint on the latter."); Bob Jones, *Morseburg v. Balyon—The High Court Grants Royalty A Reprieve: Constitutional Challenges to the California Resale Royalties Act*, 3 COMM./ENT. L. J. 1 (1980) (evaluating Ninth Circuit holding that California resale royalty law is not preempted by federal Copyright law). *See also* Jay B. Johnson, Comment, *Copyright: Droit de Suite: An Artist is Entitled to Royalties Even After He's Sold His Soul to the Devil*, 45 OKLA. L. REV. 493 (1986) (discussing *Morseburg* and effect of resale royalty).

182. *Morseburg*, 621 F.2d at 977-78.

183. McInerney, *supra* note 155, at 13; Hauser, *supra* note 169, at 101.

184. McInerney, *supra* note 155, at 13.

185. Similar such societies have been advocated for the California Resale Act. *See, e.g.*, Hamish R. Sandison, *California Enacts a Droit Moral and a Droit de Suite*, 3 ART & L., Mar. 1977, at 1, 5 (discussing method for registering works and collecting based on resale); McInerney, *supra* note 155, at 19-21 (outlining California scheme for monitoring resales).

186. Siegel, *supra* note 159, at 14.

Historically, the United States has been reluctant to enact *droit de suite* legislation.¹⁸⁷ However, two recent events have signaled a reassessment of current United States policy. First, the United States became a member of the Berne Convention in 1989.¹⁸⁸ Article 14^{ter} of the Berne Convention formally recognizes an artists' *droit de suite*.¹⁸⁹ Article 14^{ter} does not require, however, that member states enact *droit de suite* legislation nor does it explicitly endorse or expand moral rights of authors. Rather, it only requires *droit de suite* in situations where both states have resale royalty laws.¹⁹⁰ Even though the United States is not bound to enact *droit de suite* legislation under the Berne Convention, its recognition of such a right represents a significant change in policy.

Second, in December of 1990, President Bush signed into law the Visual Artists Rights Act which created federal moral rights of attribution and integrity for visual artists.¹⁹¹ More importantly, the legislation required the Register of Copyrights, in conjunction with the Chair of the National Endowment for the Arts, to study the feasibility of implementing a resale royalty for the visual arts.¹⁹² On December 1, 1992, the Register of Copyrights, after conducting a feasibility study, declined to endorse resale royalties for visual artists.¹⁹³ The Register did provide, however, a suggested model

187. See, e.g., Visual Artists Rights Act of 1990, Pub. L. No. 101-650, 104 Stat. 5089 (1990). For further analysis of the bill, see Perlmutter, *supra* note 16, at 284-314. The most recent proposed legislation allowed the author to collect three to five per cent of the sale price. See generally Symposium, *Artists' Rights: The Kennedy Proposal to Amend the Copyright Law*, 7 CARDOZO ARTS & ENT. L.J. 227 (1989); Siegel, *supra* note 159, at 1 (discussing viability and efficacy of Visual Artists Rights Act).

188. Berne Convention, *supra* note 55.

189. Berne Convention, *supra* note 55, art. 14^{ter}. See also S. TREATY DOC. NO. 27, 99th Cong., 2d Sess. 37 (1986).

190. Lee D. Neumann, *The Berne Convention and Droit de Suite Legislation in the United States: Domestic and International Consequences of Federal Incorporation of State Law for Treaty Implementation*, 16 COLUM.-VLA J.L. & ARTS 157, 159 (1992).

191. Pub. L. No. 101-650, 104 Stat. 5089, 52128 (codified at 17 U.S.C. § 106A (1990)).

192. *Id.*; Carol Sky, *Report of the Register of Copyrights Concerning Droit de Suite, the Artists' Resale Royalty: A Response*, 40 J. OF COPYRIGHT SOC'Y 315 (1992) (challenging the Register of Copyrights' report against resale royalties); Alderman, *supra* note 158, at 266 (explaining the relevant provisions of the Visual Artists Rights Act).

193. Perlmutter, *supra* note 16, at 286.

for a *droit de suite* system which included a private collecting society to audit public sales of visual art.¹⁹⁴ There will continue to be concerns as to how to provide the proper incentives to visual artists consistent with international and national copyright law and the Visual Artists Rights Act.¹⁹⁵ At the very least, the recognition of a limited *droit de suite* right provides hope to proponents of expanding resale royalty rights that there is congressional support for future changes to existing policies.

B. Compact Disc Resales

The resale of compact discs poses the most recent and the most substantial threat to an author's distribution right.¹⁹⁶ Compact discs do not deteriorate with use. Since compact discs are durable goods, they can be redistributed among many consumers and will not deteriorate in quality. A consumer can then buy a CD, either copy it onto a tape or listen to it for a period of time, and then resell it. The second purchaser has the choice of buying the used CD at a discounted price or buying a new disc at full price.¹⁹⁷ Since the goods are virtually indistinguishable, most consumers will buy the used discs if they are available.¹⁹⁸ The first sale doctrine precludes any royalty from being paid to the copyright owner for resold compact discs.¹⁹⁹

In a recent study conducted by the National Association of Recording Merchandisers, 84% of CD consumers surveyed had never purchased a used CD.²⁰⁰ Out of this 84%, however, 83% said they expect to purchase a used CD in the future.²⁰¹ Seventeen

194. *Id.* at 310. The matter is still under consideration, and no changes have been made to the policy as yet.

195. *Id.* at 295.

196. See generally Carla M. Miller, Note, *New Technology and Old Protection: The Case for Resale Royalties on the Retail Sale of Used CDs*, 46 HAST. L.J. 217 (1994).

197. *Id.* at 224-25.

198. Ed Christman, *Both Retailer, Label Claims Backed by Used-CD Survey*, BILLBOARD, Oct. 2, 1993, at 4.

199. *Id.*; 17 U.S.C. § 109(a) (1988).

200. Ed Christman, *Distributors Offer Used CD Sellers Ad-Dollar Paybacks*, BILLBOARD, Feb. 26, 1994, at 4.

201. *Id.*

percent of the respondents said that if the used CD they purchased had not been available, they would have bought a new copy of that disc.²⁰² Furthermore, 57.3% of the respondents said that they would buy more new CDs if used CDs were generally unavailable.²⁰³ The study also noted that of stores selling new and used CDs, two-thirds of them had 25% or less of their total inventory in used CDs; 18% had 25-50% of their total inventory in used CDs; and an additional 18% had more than half their inventory represented by used CDs.²⁰⁴ Finally, 24.6% of the respondents said they purchase more used CDs because they can be resold, while 41.4% said resale is currently not a factor in their CD purchases.²⁰⁵ This survey is the only one of its kind conducted thus far, although many distributors in the music industry estimate that used CDs will amount to 20% of the total CD market by 1998.²⁰⁶

The findings of the survey confirm that the durability of used CDs interferes with an author's distribution right as it creates a resale market that is competitive with the initial one. While the prospect of resale has increased total CD sales, a large segment of the consuming population buys and resells CDs in subsequent markets. By stocking and selling large quantities of the used CDs, a large number of retailers are interfering with the copyright holder's market interest.²⁰⁷ Finally, a significant portion of consumers has acknowledged that if a used CD did not exist, they would buy a

202. *Id.*

203. *Id.*

204. *Id.* The study also found that 32% of the resales were promotional titles and 9% were from record clubs. *Id.* New titles were 14% of the total purchases and 86% were catalog titles. *Id.*

205. *Id.*

206. *Used CDs are Integral to Industry*, *BILLBOARD*, Aug. 14, 1993, at 4.

207. This interference has caused extensive disputes between resellers and music publishers. In 1993, for instance, a number of retailers announced their intention to promote resale markets by reselling CDs in their stores. Jane Birnbaum, *Without a Scratch, Used CDs Rise Again*, *N.Y. TIMES*, Sept. 6, 1993, at 35. The music industry responded with threats to remove various promotional allowances and refused to supply the retailers with new releases of certain musicians. The dispute ended in a stalemate and a settlement after retailers threatened an antitrust lawsuit. *See Wherehouse Entertainment, Inc. v. CEMA*, No. 93-4253 (C.D. Cal., filed July 19, 1993); Christman, *supra* note 200, at 6.

new one. When a consumer buys a used CD instead of a new one, the artist is uncompensated for his intellectual creation—resulting in a diminution of his distribution right.²⁰⁸

C. A Look to the Future

1. Videodiscs

The advent of videodiscs may prove to be a strong challenge to the commercial appeal of videocassettes.²⁰⁹ Videodiscs demonstrate many of the same principles as compact discs in that they are durable goods that do not deteriorate with use. Videodiscs are currently harder to produce, however, because they contain both sound and pictures, requiring considerably more storage space. Additionally, at the moment there is no standard videodisc format, so that few people are willing to invest thousands of dollars in a system that may become obsolete in a few years.²¹⁰ Since the videodisc industry is in its infancy, some argue that its potential for interference with an author's market interest is insubstantial.²¹¹ Such arguments are misguided. The primary market for a videodisc would be the rental market because of the nature of the product. Since a videodisc is more durable than videotape, the need for replacement is dramatically reduced. As such, purchase of replacement videodiscs would occur less frequently than purchase of replacement videotapes by commercial renters.²¹² The decrease in the frequency of

208. Any attempt to contractually limit the resale of CDs would invariably encounter the same problems as shrink wrap licensing agreements, and would most likely be unenforceable. See *supra* note 123. Furthermore, authors and creators do not have the bargaining power to limit resales or to require compensation from distributors.

209. Because each videocassette is not used indefinitely and because videocassettes have become firmly established in the market, the development of videodiscs presently poses less of a threat than other technological developments. Furthermore, videodisc popularity has been limited by its high cost and unwieldy size. The advent of CD-ROM technology, however, may lower the cost and decrease the size of videodiscs, thus resulting in a boon to its popularity and access.

210. See, e.g., Scott Hettrick, *Matsushita DVD Does Double Take: Sony's One-Sided Standard Adopted by Rivals*, HOLLYWOOD REP., Apr. 20, 1995 (discussing the current "format wars" in the development of digital video discs).

211. The effect is much the same as CD technology. See *supra* notes 61-80 and accompanying text.

212. The initial market for purchasers of videodiscs may increase, however, because

purchases to replace used and deteriorated copies will result in lower royalties to producers, and purchased copies will be even less indicative of market success than with videocassette rentals.

2. On-Line Services

Perhaps the greatest threat to the first sale doctrine is the advent of on-line services.²¹³ Soon, an individual will be able to obtain a song (without renting an actual copy), a television show, computer software, or a "soft copy" of a book through downloading or simply accessing the information from an on-line service.²¹⁴ Access will occur on a computer from a single copy in a central database. On an on-line network, copies are not necessarily made. On-line services make a tangible good completely durable and instantly available for an immeasurable period of time.²¹⁵

The exclusive rights/limited monopoly scheme collapses when a completely durable good with widespread public access, like an on-line service, is used in the market.²¹⁶ On-line services supply

of the possibility of reselling the videodiscs in a secondary market.

213. The developing system of electronic distribution is often referred to as the National Information Infrastructure or the "information superhighway."

214. For a brief discussion on the role of on-line services as an alternate distribution system, see James Daly, *Music by Modem: On-Line Services Provide a High-Tech Option to Music Distribution*, *ROLLING STONE*, July 14-28, 1994, at 31. Underground music organizations, such as the Internet Underground Music Archive ("IUMA"), are already putting music on-line via the internet. *Id.*

215. Jane C. Ginsburg, *Creation and Commercial Value: Copyright Protection of Works of Information*, 90 *COLUM. L. REV.* 1865, 1918-22 (1992); J.H. Reichman, *Electronic Information Tools—the Outer Edge of World Intellectual Property Law*, 17 *U. DAYTON L. REV.* 797, 823-25 (1992). See also L. RAY PATTERSON & STANLEY LINDBERG, *THE NATURE OF COPYRIGHT—A LAW OF USERS' RIGHTS* 159, 181-90 (1991).

216. *Cf.* *Playboy Enters. v. Frena*, 839 F. Supp. 1552 (M.D. Fla. 1993) (holding that the electronic distribution of pictures on an electronic bulletin board violated plaintiff's exclusive right to display its copy); *Advanced Computer Servs. of Mich., Inc. v. MAI Sys. Corp.*, 845 F. Supp. 356, 363 (E.D. Va. 1994) (holding that a program stored only in Random Access Memory ("RAM") is sufficiently fixed to constitute a copy and may have too much delay to be considered simultaneous fixation); *Sega Enterprises v. MAPHIA*, 857 F. Supp. 679 (N.D. Cal. 1994). *Playboy* and *MAI* placed liability on a party as a direct infringer of rights. In *MAI*, the copying into RAM was admitted by the defendant. However, through on-line systems, the person who places the creation on-line does not affirmatively or actively engage in any copying, reproduction, display, or distribution. In

information and services to a network of subscribers from a centrally maintained, continually updated database.²¹⁷ Such a service obviates the need for dissemination of tangible copies. Since there is technically no access to multiple copies, no royalty is required under existing copyright law, and the other exclusive rights arguably provide little extra protection.²¹⁸ Further, because a central database suffers no deterioration based on use, an infinite number of people can access the data base and extract information free of any royalty liability. In fact, with complete durability, the price of the product becomes independent of the number of suppliers.²¹⁹ This scenario increases the "number of individuals who will be provided with access to a work by one and the same copy, thus diminishing the number of sales and enabling third party exploiters to realize additional receipts."²²⁰ The entire distribution right scheme will collapse with the advent of on-line services unless a more market-oriented approach is taken with respect to the mediums of expression, access to these mediums, and the forms of ex-

order for the right to be infringed, a purchaser of the service must access it. Thus, no infringement occurs until a user of the on-line system makes a copy, which may be unknown to the provider and is out of the control of the provider. Thus, the *Playboy* and *MAI* holdings may not be viable. *Sega*, on the other hand, applied the correct analysis but reached an incorrect result. In *Sega*, *MAPHIA* was held liable as a contributory infringer because they provided the means for copying. This holding may stand in direct opposition to *Sony*, which held that simply providing equipment capable of copying was not sufficient to establish contributory infringement liability. 464 U.S. at 417. The sale of such equipment, according to the court, is not contributory infringement if the sale is widely used for legitimate, noninfringing purposes. *Id.* Furthermore, even presuming that infringement in these limited situations, the other exclusive rights are still left unprotected. See NII REPORT, *supra* note 44, at 41 ("It is clear that a Frena subscriber [in *Playboy*], at the end of a transaction possessed a copy of a *Playboy* photograph, but it is rather less clear whether, under current law, Frena 'distributed' that photograph or the subscriber 'reproduced' it. . . .") It is unclear whether if the subscriber had reproduced the photograph, whether current law clearly would have made Frena contributorily liable for the unauthorized reproduction.

217. Reichman, *supra* note 215, at 823.

218. *But see Playboy Enterprises v. Frena*, 839 F. Supp. 1552 (M.D. Fla. 1993) (finding that the electronic distribution of pictures violated plaintiff's display right).

219. Coase, *supra* note 33, at 144.

220. M. Thierry Desurmont, *The Author's Right to Control the Destination of Copies Reproducing His Work*, 12 COLUM.-VLA J. L. & ARTS 481, 482 (1988).

pression themselves.²²¹

The federal government has anticipated the problems of electronic distribution. In 1993, the President formed the Information Infrastructure Task Force ("IITF") to examine electronic distribution systems and recommend changes to existing laws to accommodate the developing electronic infrastructure.²²² The IITF report, released in July 1994, recommended several changes to existing copyright law. The working group conceived of electronic distribution as an infringement of the reproduction right but acknowledged that enforcement of the reproduction right is extremely problematic.²²³ The working group recommended changes to existing law to include electronic transmission as part of the distribution right.²²⁴ Further, the working group recommended that transmissions be

221. Samuelson, *supra* note 112, at 2365-70, 2378-94.

222. NII REPORT, *supra* note 44.

223. *Id.* at 54. The NII Report made the following observation:

The first sale doctrine's importance in the NII context should not be underestimated: if a transaction by which a user obtains a "copy" of a work is characterized as a "distribution" then, under the current law, the user may be entitled to make a like distribution without the copyright owner's permission (and without liability for infringement). . . . Indeed the system encompassed by Sections 106(3) and 109(a) appears to "fit" only "conventional" transactions in which possessory interests in tangible copies are conveyed. . . .

Id. at 39.

224. *Id.* at 121. The NII Report recommended that the Copyright Act be amended to recognize that copies can be distributed by transmission. The proposed changes would expand § 106(3) to include distribution by transmission. *Id.* The proposal also recommends amending the definition of transmit in § 101 by adding the following language:

To "transmit" a reproduction is to distribute it by any device or process whereby a copy or phonorecord of the work is fixed beyond the place from which it was sent. In the case when a transmission may constitute both a communication of a performance or display and a distribution of a reproduction, such transmission shall be considered a distribution of a reproduction if the primary purpose or effect of the transmission is to distribute a copy or phonorecord of the work to the recipient of the transmission.

Id. at 122. The report also expands the definition of publication to include publication by transmission. *Id.* at 123-24. Finally, the report recommends that section 109(a) be amended to specifically exempt the first sale doctrine when a copy is received by transmission. *Id.* at 125. It should also be noted that two Congressional Bills, H.R. 2576 and S. 1421, purport to add to the exclusive rights of a copyright owner in a sound recording the right to perform or authorize the performance of a sound recording by digital transmission.

excepted from the first sale doctrine.²²⁵

V. THE SOLUTION: COMPULSORY COMMERCIAL BLANKET LICENSING

Congress has acted to limit alienation and use of intellectual property when a durable good threatens the exclusive rights and market interest of the owner. The technological problems with imperishable intellectual creations—specifically resales and on-line access—have been insufficiently addressed by Congress and the IITF.

The recommendations of the IITF represent positive steps toward dealing with the problems of access and imperishable creations. The recommendations, however, do not address the underlying tensions inherent in durable secondary markets; nor do they create a viable system of enforcement.

First, the recommendations do not address the underlying problem of access. If a person pays an on-line service for access to a number of copyrightable works and only occasionally uses any one of them, the report does not clearly explain whether the use of such works for a temporary time constitutes any responsibility to pay a royalty.²²⁶ Additionally, the report does not address partial use of a copyrightable work. For instance, if only a short passage from a book is used, the recommendations do not establish a system of partial royalties based upon the nature and extent of use. The basis of royalties and rewards for creators should be based upon the use and demand for the product. The recommendations fail to fully address the uses which subject an intellectual creation to royalty payments.

Second, the recommendations do not provide any scheme for enforcement. They acknowledge that enforcing the reproduction of works is extremely difficult.²²⁷ Thus, the IITF concludes that mon-

225. *Id.* at 123.

226. This royalty liability is arguably enforceable under the public performance and public display rights. Such analysis seems strained because the use will vary and will typically be used in private environments.

227. NII REPORT, *supra* note 44, at 35-37, 65-72.

itoring distribution is a more effective solution.²²⁸ However, the ITF provides no scheme for enacting and enforcing such a scheme. This is particularly problematic since the on-line infrastructure is controlled mainly by a myriad of private actors.²²⁹ This lack of cohesion and rational development only hinders an effective enforcement mechanism. Unless an effective scheme for enforcement is provided, the recommendations will be ineffective.

One of the alternative options suggested by the Register of Copyrights ("Register") in its report to Congress was a commercial rental right, which would give an artist control over the commercial rentals of a work.²³⁰ The Register's alternative is instructive but shortsighted. To fully reflect the market demand for copyrightable works, a right or license should extend beyond that proposed in the Register's scheme and should include all subsequent markets of artistic works.²³¹ Since protecting against infringement in subse-

228. *Id.* at 38-42, 53-56, 120-25.

229. The NII Report also fails to recognize that the primary infringers are not necessarily the people who place the work on an on-line system. Rather, these actors at best induce, cause, or materially contribute to the infringing conduct of the users. See *Gershwin Publishing Corp. v. Columbia Artists Management, Inc.*, 443 F.2d 1159, 1162 (2d Cir. 1971) (holding that a management firm's authorization of clients' performance of copyrighted compositions to be contributory infringement). Despite the NII's theory that a contributory infringer may be liable based on the providing of services, see NII REPORT, *supra* note 44, at 75, the report does not address merely placing the copyrightable good on the system without any other action. Rather than affirmatively interfering with reproduction or distribution rights, the contributory infringer simply provides others with access. In such situations, extending contributory infringement claims may be considerably more difficult. See *Auvil v. CBS*, 800 F. Supp. 928 (E.D.Wa sh. 1992) (serving merely as a conduit for access does not establish contributory liability); *Cubby, Inc. v. CompuServe, Inc.*, 776 F. Supp. 135 (S.D.N.Y.) (holding that the operator of a bulletin board service was not contributorily liable for libelous material uploaded from the service); *Sony Corp. v. Universal City Studios, Inc.*, 464 U.S. 417 (1984) (holding that the manufacturer of videocassette recorders is not a contributory infringer facilitating unauthorized reproduction of copyrighted works); see also *Vault Corp. v. Quaid Software Ltd.*, 847 F.2d 255 (5th Cir. 1988) (seller of computer programs to defeat anti-copying protection is not liable as contributory infringer); but see *Sega Enterprises*, 857 F. Supp. at 679.

230. U.S. COPYRIGHT OFFICE, *DROIT DE SUITE: THE ARTIST'S RESALE ROYALTY* 149-51 (1992). The alternative was discussed in little detail beyond attempting to compensate authors through commercial rentals.

231. But see *Reichman*, *supra* note 215, at 825; *Ginsburg*, *supra* note 215, at 1919.

quent markets would be difficult for an individual artist, a national monitoring scheme would be the only effective means for preventing unauthorized use.²³² Such a scheme increases artists' incentives and furthers the underlying goals of copyright law.²³³ In order to protect the policy of freedom of alienation, the license granted should be compulsory.²³⁴

A. *The Structure of Blanket Licensing*

Currently, the largest and most developed system for blanket licensing in the United States involves the public performance right for music writers and publishers.²³⁵ The blanket license, authorized through various performing rights organizations, gives the consumer the right to perform any music at any time for which the license is effective.²³⁶

232. Maralee Buttery, Note, *Blanket Licensing: A Proposal for the Protection and Encouragement of Artistic Endeavor*, 83 COLUM. L. REV. 1245, 1246 (1983).

233. See Barry W. Tyerman, *The Economic Rationale for Copyright Protection for Published Books: A Reply to Professor Breyer*, 18 UCLA L. REV. 1100 (1971) (discussing economic incentives to create and protect market interest of authors). *But see* Stephen Breyer, *The Uneasy Case for Copyright: A Study of Copyright in Books, Photocopies and Computer Programs*, 84 HARV. L. REV. 281 (1970) (arguing against extra limitations on exclusive rights); Karjala, *supra* note 109, at 2594 (arguing against market oriented licensing regimes); Dennis S. Karjala, *Copyright and Misappropriation*, 17 U. DAYTON L. REV. 885 (1992) (arguing in favor of misappropriation theory for copyright protection). Professor Karjala asserts that the more effective paradigm is misappropriation theory. Although misappropriation is a viable alternative, it can lead to inefficiencies in the market. Under misappropriation theory, the claim for infringement arises after the taking of protectable material. Karjala, *supra* note 109, at 2601-08. Under this theory, protection will only arise once a lawsuit is filed. Rather than characterize the problem as adversarial in nature and raising the costs because of litigation, a more market-oriented, efficient market approach is necessary. Responding proactively through a licensing scheme similar to the one proposed in Samuelson, *supra* note 112, at 2413-20, 2426-29, may be a more effective and efficient solution.

234. *But see* Coase, *supra* note 33, at 148; Liebowitz, *supra* note 28 at 49; Benjamin & Kormendi, *supra* note 35, at 381.

235. Other countries also have collection society schemes. See *supra* notes 50-53 and accompanying text regarding Germany's system for public lending rights, and *supra* notes 154-195 and accompanying text for systems to protect visual artists. For a brief discussion of licensing techniques available, see NII REPORT, *supra* note 44, at 33.

236. SHEMEL & KRASILOVSKY, *supra* note 17, at 196-218. For a thorough discussion of performing rights organizations, see *Broadcast Music, Inc. v. Columbia Broadcasting*

The artist grants the performing rights organization the right to license her work in exchange for the benefits of membership.²³⁷ To avoid antitrust claims, the artist is also permitted to grant licenses for public performances.²³⁸ Nonetheless, once artist authorization is obtained, the performing rights organization issues blanket licenses to all parties using public performances of its members' works.²³⁹ These parties include radio stations, music halls, restaurants, and stores. Anyone seeking to perform the works publicly must obtain a blanket license from the performing rights organization or the individual artists.²⁴⁰ As part of the license, the performing rights organization retains the right to periodically audit the licensee's books to ensure fair payment.²⁴¹ The performing rights organization then takes the money it has obtained through the issuance of blanket licenses and disperses the funds between members based on frequency of public performance.²⁴²

B. *The Advantages of Blanket Licensing*

Blanket licensing has the benefit of administrative convenience.²⁴³ By consolidating all licenses into one, the system pro-

Sys., Inc., 441 U.S. 1 (1979).

237. SHEMEL & KRASILOVSKY, *supra* note 17, at 196-210.

238. See *Broadcast Music*, 441 U.S. 1, for a discussion of the antitrust issues involved in the music licensing business.

239. SHEMEL & KRASILOVSKY, *supra* note 17, at 196-218. A similar system is a compensation scheme for the so-called "mechanical right." The reproduction right for phonorecords is often called the mechanical right. *Id.* at 237. Compulsory mechanical licenses are required for audio recordings intended to be distributed to the public for private use. *Id.* at 239. The Harry Fox Agency serves as a clearinghouse for the licenses and supervises the collections from record companies and represents over 6,000 music publishers. *Id.* at 242. The license calls for quarterly accountings and requires payments for all records manufactured and distributed. *Id.* at 243. If the license payment is not received, the Agency will revoke the license. *Id.* at 243.

240. See, e.g., Robert Merges, *Of Property Rules, Coase & Intellectual Property*, 94 COLUM. L. REV. 2655, 2662-71 (1994); Robert Coasler, *Copyright Compulsory Licenses—Are They Coming or Going?*, 37 J. COPYRIGHT SOC'Y 231 (1990) (discussing the advent of compulsory licenses and their viability); Stanley Besen, et al., *An Economic Analysis of Copyright Collectives*, 78 VA. L. REV. 385 (1992).

241. SHEMEL & KRASILOVSKY, *supra* note 17, at 200-02.

242. *Id.* at 202-12.

243. The notion of licensing as a means for protecting intellectual creations has

vides substantial economic efficiencies.²⁴⁴ The consumer is not required to find every copyright owner and obtain a license from that owner.²⁴⁵ Commercial entities do not have to predict whose music will be played and can instead rely on the blanket license.

An additional benefit is that blanket licensing facilitates the prevention of copyright infringement.²⁴⁶ A large collecting society has the resources of a large number of people, whereas a single artist would have extremely limited resources. Societies such as ASCAP and BMI can use their own resources to track infringing uses of their member's works so as to remedy any problems in an efficient and timely manner. Also, the auditing function of the performing rights organizations ensures artists that they are receiving their fair share of performance royalties.²⁴⁷

C. Limiting the Blanket License System

The United States has yet to recognize a public lending right. The actions of Congress reflect a strong commitment to noncommercial lending and free access to such facilities. Thus far, Congress has indicated that it does not consider public lending to impose a great threat to the market interest of the author. As such, noncommercial use of copyrighted work should not require blanket licensing.²⁴⁸ If the lending institution obtains no pecuniary benefit from the use, the author should not be entitled to impose an extra tax upon that body. Thus, in order to accommodate noncommercial interests, a blanket license should be limited to all commercial actors using the work for their own pecuniary benefit.

gained further support as a potential solution. Samuelson, *supra* note 112, at 2413-20. Such a scheme, it is argued, more effectively protects the market interests of authors and creators. *Id.*

244. Buttery, *supra* note 232, at 1259.

245. Sigmund Timberg, *The Antitrust Aspects of Merchandising Modern Music: The ASCAP Consent Judgment of 1950*, 19 LAW & CONTEMP. PROBS. 294, 298 (1954).

246. Buttery, *supra* note 232, at 1259.

247. *Id.* at 1261.

248. Noncommercial on-line access may present a problem in the future, however, because of ease of access and duplication from such sources. Cf. NII REPORT, *supra* note 44, at 79.

Another important limitation is that the collecting society should not be able to award licenses selectively. Allowing the society to do so would interfere with an individual's right to freedom of alienation, as a seller may decide not to vend to people unable to obtain licenses. Since such a restriction is a significant concern, the collecting society should be compelled to give a license to anyone who requests one but at a high enough cost that monopolistic prices can be extracted. The scheme for royalties shall be determined in much the same fashion as the current ASCAP or BMI scheme to avoid claims of any price discrimination. Compulsory licensing will thus protect the interest of the public by ensuring free alienability of consumer goods.²⁴⁹

D. Implementing the Scheme

Compulsory commercial blanket licensing should apply to uses of copyrightable subject matter. Whenever goods are resold or rented, a royalty should be paid to a collection society organized in much the same way as ASCAP or BMI. The royalties will be determined by a comprehensive formula similar to the formulas used by ASCAP or BMI.²⁵⁰ Any challenge to the royalty formulas would be appealable to the Copyright Office. In order to effectuate these goals, Congress must expand the exclusive rights to include access royalties or royalties based on the nature of use. Additionally, specific legislation permitting collection societies will be necessary to avoid antitrust liabilities.

Before implementing a compulsory commercial blanket licensing scheme, appropriate tests should be conducted. The first test could involve the current issue of compact disc resales and its effect on the market for new compact discs. Through the issuance

249. *See supra* notes 22-24.

250. ASCAP and BMI work in tandem with the Copyright Royalty Tribunal, an agency established by the federal government to adjust royalty rates as required. SHEMEL & KRASILOVSKY, *supra* note 17, at 158. The Copyright Royalty Tribunal is empowered to establish reasonable terms and rates based upon the nature and type of use (i.e. public performances, cable broadcasts, and jukeboxes). *See* 17 U.S.C. §§ 801-804 (1988); GORMAN & GINSBURG, *supra* note 46, at 453-56.

of a compulsory commercial resale license by a collection society, the artist can be compensated for the resales without unduly interfering with the alienability of the compact disc or rental of videocassettes.²⁵¹ If such a system proves effective, the licensing could be expanded to include rental of compact discs. If that system proves effective, the licensing scheme could continue to expand until it covered all copyrightable subject matter.

CONCLUSION

Durability of copyrightable goods presents a serious challenge to the distribution right and the first sale doctrine. Congressional efforts have been effective thus far with partially durable goods but do not effectively address the underlying problems of durability and access. Due to the lack of effort in this area, copyright holders will continue to be plagued by many problems if an alternative scheme is not created. A viable alternative to the existing system is the more malleable compulsory commercial blanket licensing scheme. Compulsory commercial blanket licensing vitiates the concern for the interference with the distribution right caused by imperishable intellectual creations. The proposed system recognizes that an author's market interest is not fully reflected in the first sale and instead rewards the author based on access and use of a product while attempting to minimize transaction costs. The commercial blanket license will more effectively serve long-term consumer interests by providing proper incentives to authors and creators, thus striking a proper balance between the public's interest in access to these works and an author's interest in being remunerated for her efforts.

251. Such a license would invariably increase the cost of rental.

