

# **Copyright and Property in the Digital Era: Achieving Functional Equivalence between Digital Property and Physical Property**

by

**Raez Ahmed Moosa**

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Supervisor : Mrs Sylvia Papadopoulos

Annexure G

University of Pretoria

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Full names of student:

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## Abstract

This thesis examines the concepts of copyright law and property within a digital setting, whilst focusing on the way that technology and law have influenced both copyright law and property law. In examining the relationship between copyright and property law, this thesis focuses on the effects of Digital Rights Management (“**DRM**”) and End User License Agreements (“**EULAs**”), specifically their impact on the property rights of consumers who have purchased digital property.

Due to advances in technology, copyright holders have begun to sell copyrighted works through digital channels. The threat of digital piracy has resulted in copyright holders in adopting stringent DRM systems and EULAs in order to safeguard their works, which subsequently has resulted in consumers’ property rights being adversely affected as a result thereof.

To further complicate matters, as the doctrine of first sale only applies to a consumer who has acquired ownership of a work, copyright holders have utilised EULAs in order to bypass the application of the doctrine of first sale to transactions with consumers through digital means. Thus, this thesis examines whether it is possible to find a way where the doctrine of first sale could possibly apply to digital property, in spite of the existence of DRM and EULAs.

The aim of this thesis is to seek a solution to the problem of the imbalance that exists between physical and digital property, in other words, the achievement of parity or functional equivalence between the two types of property.

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# CHAPTER 1: INTRODUCTION

## 1. Copyright

### 1.1 Background

Copyright is a legal doctrine, originating in the 18<sup>th</sup> century, which seeks to, amongst others, achieve a balance between the rights of authors of protected works and the rights of the public to access and utilise such works. In the digital era, technology is transforming the manner in which copyrighted works can be accessed, distributed and reproduced.<sup>1</sup> In the digital era, copyright owners have begun to distribute their works directly to the public, bypassing the traditional intermediaries, and are utilising technology to implement and control the distribution of their works.<sup>2</sup>

Copyright enforcement and protection has been traditionally achieved through legislation, with international treaties such as the World Intellectual Property Organisation Copyright Treaty (“**WCT**”), and the national laws of different jurisdictions implementing the WCT and other international treaties.<sup>3</sup>

### 1.2 DRM & EULAs

Due to the ease, speed and low cost of reproducing copyrighted content digitally, Digital Rights Management (“**DRM**”) and End User License Agreements (“**EULAs**”) have become the only effective technological security mechanisms that content providers can use in order to protect the content that they distribute.<sup>4</sup>

DRM<sup>5</sup> and EULAs<sup>6</sup> are both mechanisms utilised by content providers to protect copyrighted works distributed in both physical and digital formats. There is an

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<sup>1</sup> Van der Merwe *Information and Communications Technology Law* (2008) 239.

<sup>2</sup> Dusollier “DRM at the Intersection of Copyright Law and Technology: a Case Study for Regulation” in Brousseau, Merzouki & Méadel (Eds) *Governance, Regulation and Powers on the Internet* (2012) 302.

<sup>3</sup> Pistorius “Developing Countries and Copyright in the Information Age” (2006) *Potchefstroom Electronic Law Journal* 2, see also Wendland “The Digital Agenda” (1997) *Juta’s Business Law* 143.

<sup>4</sup> Dusollier (2012) 298. See also Pistorius (2006) 9 – 10.

<sup>5</sup> Kutiš “Digital Rights Management Systems and Digital Piracy – Archrivals or Unintended Allies?” (2012) *Masaryk University Journal of Law and Technology* 102.

<sup>6</sup> Akins “Conversion of Digital Property: Protecting Consumers in the Age of Technology” (2010) *Loyola Consumer Law Review* 223.

assumption that both DRM and EULAs (also known as contracts of adhesion)<sup>7</sup> are arbitrary and do not allow for the use of copyrighted works in accordance with the legally recognised exceptions, such as the doctrine of first sale and fair use.<sup>8</sup>

## 2. Doctrine of First Sale

### 2.1 General

The doctrine of first sale is an American legal doctrine, which serves as an exception to the copyright holder's exclusive bundle of rights in relation to a protected work.<sup>9</sup> No such an exception exists in South African law and no provision is made for such a doctrine in the Copyright Act.<sup>10</sup> The South African Copyright Act does make provisions for the concepts of "fair dealing" and "fair practice" within section 12 of the Copyright Act, which deals with the exceptions to copyright in relation to literary and musical works.<sup>11</sup> Section 19B(2)(a) allows a person, who is in lawful possession of a computer program, to create copies of such a program, to the extent that it is reasonably necessary for back-up purposes.

The doctrine of first sale, allows the purchaser of a particular copy of a copyrighted work to freely alienate that specific copy without any interference or exercise of control from the original copyright holder.<sup>12</sup> The doctrine of first sale also seeks to limit the statutorily created monopolies that are granted to copyright owners.<sup>13</sup> This doctrine is applicable to copyrighted works that are tangible, and there is uncertainty

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<sup>7</sup> Akins (2010) 218, see Snail "Electronic Contracting in South Africa (e-contracts)" in Papadopolous and Snail (Eds) *Cyberlaw @SA III* (2012) 53 where the various forms of contracts of adhesion are discussed in further detail.

<sup>8</sup> Ackerman "An Online Gamer's Manifesto: Recognizing Virtual Property Rights by Replacing End User Licensing Agreements in Virtual Worlds" (2012) *Phoenix Law Review* 142.

<sup>9</sup> Smith IV "Digital First Sale: Friend or Foe?" (2005) *Cardozo Arts and Entertainment Law Journal* 853. See also Mencher "Digital Transmissions: To Boldly Go Where No First Sale Doctrine Has Gone Before" (2002) *UCLA Entertainment Law Review* 49, the doctrine of first sale is found in the US Copyright Act of 1976 under Title 17 of the United States Code, section 109(a).

<sup>10</sup> No 98 of 1978 (South Africa).

<sup>11</sup> Sections 12 – 19 of the Copyright Act provides for special (section 14) and general exceptions applicable to the various different types of works that are afforded copyright protection. It must be noted that the Copyright Act does not expressly define the terms "fair dealing" or "fair practice" within the definitions found within section 1 of the Copyright Act.

<sup>12</sup> Davis "Reselling Digital Music: is there a Digital First Sale Doctrine?" (2009) *Loyola of Los Angeles Entertainment Law Review* 364.

<sup>13</sup> Richardson "The Monopoly on Digital Distribution" (2014) *McGeorge Global Business & Development Law Journal* 170.



as to whether this doctrine applies to intangible copyrighted works, such as digital content provided online.<sup>14</sup>

### **3. Digital Property**

#### **3.1 Property**

In South Africa, and in other jurisdictions worldwide, physical property has been given legal recognition and protection. Due to the advancement of both technology and high speed internet access, digital property has risen in prominence and it remains to be determined whether digital property enjoys the same legal recognition and protection in comparison to physical property.<sup>15</sup>

Due to the legal concept of copyright and its various enforcement mechanisms, there is a disparity between digital property, purchased online, and physical property, despite being priced similarly and having equal utility.<sup>16</sup> What can be done, legally or otherwise, to either eliminate or reduce this disparity and achieve functional equivalence<sup>17</sup> between digital property and physical property? In other words, in what way can parity between digital property and physical property be achieved?

### **4. Structure**

This thesis will consist of 5 chapters. This first chapter serves as the introductory chapter, and sets out the basic structure of the thesis. Chapter 2 will focus on the issue of DRM and EULAs, in relation to copyright and property rights. Chapter 3 will concentrate on the doctrine of first sale. Chapter 4 will deal with the issue of digital property, specifically whether digital property is legally recognised in South Africa. The conclusion and recommendation will be contained in Chapter 5.

### **5. Conclusion**

The link between copyright and the use of DRM and EULAs have been introduced earlier in this chapter, subsequently; Chapter 2 will focus on a detailed exposition of both DRM and EULAs.

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<sup>14</sup> Davis (2009) 363.

<sup>15</sup> Ackerman (2012) 159.

<sup>16</sup> Richardson 156.

<sup>17</sup> Pistorius (2006) 14.

# **CHAPTER 2: DIGITAL RIGHTS MANAGEMENT & END USER LICENSE AGREEMENTS**

## **1. Background**

### **1.1 Technological Protective Measures**

As a response to the rapid growth of technology, in which piracy posed a substantial threat to content creators, they began to use technological protective measures in order to safeguard their copyrighted works.<sup>18</sup> The use of such technologies was supported by the WCT, as it contains provisions<sup>19</sup> that seek to protect technological protective measures, by regulating the circumvention of such technological protective measures.<sup>20</sup>

During the 1980s, the music industry started distributing music in a digital format, physically contained in a format known as compact discs, which did not include any copy protection for the digital sound recordings on the discs. Consequently, this led to consumers using software applications to create copies of the digital files of the sound recordings from the compact discs, which is a form of copyright infringement. Additionally, after the creation of these digital files, consumers then distributed these files to other users across the internet.<sup>21</sup>

### **1.2 DRM**

Only a single copy of a compact disc is required for a consumer to, through the process of ripping and distribution via the internet, distribute the digital music files globally with negligible cost involved. In response to such actions, the music industry began implementing DRM systems within their compact discs which limited the consumer's use of the compact disc; either by preventing the copying of the digital

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<sup>18</sup> Pistorius (2006) 2.

<sup>19</sup> Article 11 of the WCT.

<sup>20</sup> Pistorius (2006) 2 – 3.

<sup>21</sup> Whaley "Mandatory Labelling for Digital Rights Management: A Least Restrictive Means for Balancing Rights between Content Owners and Consumers" (2007) *Journal of Technology Law and Policy* 376. For further reading regarding the threat that peer-to-peer sharing network posed to copyright holders, see *A&M Records, Inc. v Napster, Inc.* 239 F.3d 1004 (9<sup>th</sup> Circuit 2001) and *MGM Studios, Inc. v Grokster, Ltd* 380 F.3d 1154 (9<sup>th</sup> Circuit 2005).

file to the consumer's hard drive or preventing the distribution of the digital file if it was saved to the consumer's hard drive.<sup>22</sup>

DRM guarantees that content owners receive proper remuneration for the creation of content that is distributed online, whilst DRM also affords content owners a pioneering level of control over both the distribution of digital content and the usage thereof.<sup>23</sup> Content owners also turn to EULAs to protect both their content as well as the DRM system that protects such content.<sup>24</sup>

## 2. DRM

### 2.1 Definition

DRM can be defined as a system or mechanism used by content creators to enforce copyright. It is a system which is privately administered whereby computer programming code regulates the acts or functions that consumers are allowed to perform.<sup>25</sup> DRM has also been described as a collective term encompassing various access control and rights management techniques.<sup>26</sup>

DRM has been defined by Dusollier as being technological measures that have the aim of managing the licensing of usage rights and the provision of works in accordance to such usage rights. DRM identifies and describes the intellectual property rights applicable to digital content and utilises technology to enforce the usage rights that were created by the content owner.<sup>27</sup>

DRM has been defined by Trivedi as a general term which refers to technology that enables content owners to control the access and use of digital content through the placement of predetermined restrictions on the digital content file itself. The control afforded to content owners is often exercised through the use of various licensing

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<sup>22</sup> *Idem* 376.

<sup>23</sup> Bechtold "Digital Rights Management in the United States and Europe" (2004) *The American Journal of Comparative Law* 324.

<sup>24</sup> *Idem* 341.

<sup>25</sup> Samuelson "DRM {and, or, vs.} the Law" (2003) *Communications of the ACM* 41 - 42. Samuelson states that the term "DRM" is inaccurate as these systems are not concerned with the regulation of rights but rather the regulation of certain permissions.

<sup>26</sup> Whaley (2007) 381.

<sup>27</sup> Dusollier (2012) 298.

models, as selling the digital content outright to a consumer would negate the content owner's control over the digital content under the doctrine of first sale.<sup>28</sup>

The Digital Millennium Copyright Act<sup>29</sup> (“**DMCA**”) defines a “technological protective measure” as a measure that effectively controls access to a work if the measure requires application of information, with the authority of the creator, to gain access to the work.<sup>30</sup>

## 2.2 Purpose of DRM

The underlying purpose of DRM systems is the objective of making the circumvention thereof challenging for a majority of consumers and, alongside anti-circumvention legislation, create awareness amongst consumers that it is illegal to circumvent such DRM systems.<sup>31</sup> In its basic form, DRM systems utilise various technological protection methods to restrict digital content being distributed without the content owner's permission.<sup>32</sup>

## 2.3 Types of DRM

The most frequently used DRM systems are “offline key-based authentication” (“**OKBA**”) and “phone home online authentication” (“**PHOA**”).<sup>33</sup> OKBA-based DRM systems are one of the oldest types of DRM systems in existence, and they are mainly used for computer software and document access, and are dependent on the consumer providing a key to access the content.<sup>34</sup> This system does not verify whether a specific key is being used elsewhere, nor does it authenticate whether the user's access rights and privileges are still valid or not.<sup>35</sup>

PHOA-based DRM systems were developed as a response to the many flaws inherent in the OKBA-based DRM systems, as this system compares a user

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<sup>28</sup> Trivedi “Writing the Wrong: What the E-Book Industry can Learn from Digital Music's Mistakes with DRM” (2010) *Journal of Law and Policy* 931.

<sup>29</sup> Digital Millennium Copyright Act of 1998 105 Pub L No 304 112 Stat 2660 (USA).

<sup>30</sup> Pistorius (2006) 4.

<sup>31</sup> Kutiš (2012) 104.

<sup>32</sup> Bechtold (2004) 325.

<sup>33</sup> Dubbelde “A Potentially Fatal Cure: Does Digital Rights Management Ensure Balanced Protection of Property Rights?” (2010) *University of Illinois Journal of Law, Technology & Policy* 413.

<sup>34</sup> *Idem* 414, these keys are either information-based or hardware-based. The OKBA system will, in its simplest form, compare the provided key with database of all acceptable values and will either accept or reject the access attempt.

<sup>35</sup> *Idem* 421.

provided key with a central authority, via the internet, to verify that the key is in fact valid and that the privileges associated with the specific key is not being utilised by someone else. Although PHOA-based DRM systems provide much more substantial protection to digital content, their reliance on the internet, in order to facilitate authentication, has the effect of where such access to the internet is unavailable, consumers will be unable to use such content, which they acquired legitimately.<sup>36</sup>

### 3. Legislation

#### 3.1 General

Despite the high level of technological protection that DRM systems afford to content owners, no DRM system can be considered as being completely technologically secure. DRM systems have been hacked in the past, and they will be hacked in the future, thus in order to expand the overall effectiveness of DRM systems, a range of legal regulations have been promulgated that forbids the circumvention of DRM systems and the production (and distribution) of devices which are used to circumvent DRM systems.<sup>37</sup>

#### 3.2 DMCA

The DMCA was passed by the US Congress in 1998 as a response to the issue of DRM systems being susceptible to hacking.<sup>38</sup> The DMCA contains provisions<sup>39</sup> that prohibit the circumvention of DRM systems, as well as prohibiting the manufacturing and distribution of technologies designed to circumvent such systems.<sup>40</sup>

The basis of the creation and passing of the DMCA was that initially DRM systems were implemented by affected industries, but the circumvention (or the creation of circumventing devices) of such systems was legal. For DRM to succeed as an effective method of protection, the DRM system itself had to be legally protected. The WCT provided the foundation for the legal protection afforded to DRM systems,

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<sup>36</sup> *Idem* 415.

<sup>37</sup> Bechtold (2004) 331.

<sup>38</sup> Samuelson (2003) 42.

<sup>39</sup> Sections 1201(a)(1)(A), 1201(a)(2) and 1201(b)(1) of the DMCA.

<sup>40</sup> Samuelson (2003) 42.

and the DMCA is the result of the USA implementing the WCT within its national laws.<sup>41</sup>

### 3.3 European Union

The WCT's provisions were adopted by the European Union (“**EU**”), through the promulgation of the European Directive on Copyright and Related Rights in the Information Society<sup>42</sup> (the “**Copyright Directive**”), which has been implemented in all EU Member States.<sup>43</sup>

### 3.4 Legislative Effect

Both the DMCA and the EU Copyright Directive provide that technological measures triumph over the fair use exception and other copyright exceptions, whereas the WCT states these technological measures are used by content owners together with the exercise of their rights in terms of copyright law, thus content owners do not gain any additional protection through any anti-circumvention provisions.<sup>44</sup>

These anti-circumvention provisions have no actual connection to established copyright law as these provisions are regarded by Bechtold as being a “paracopyright” law, which regulates the use and access to data which may or may not be subject to copyright protection. In contrast to traditional copyright law, which focuses on the regulation of individual conduct, the focal protection point of anti-circumvention provisions is controlling the production of devices that seek to bypass DRM systems.<sup>45</sup>

### 3.5 South Africa

South Africa has not implemented the WCT in its copyright law, thus the South African Copyright Act does not regulate the effects of digital technology in respect of copyright law. However, Pistorius argues that portions of the WCT have been

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<sup>41</sup> Whaley (2007) 381 – 382.

<sup>42</sup> Directive 2001/29/EC, L167.

<sup>43</sup> Dusollier (2012) 299.

<sup>44</sup> *Idem* 307.

<sup>45</sup> Bechtold (2004) 339.

adopted by the Electronic Communications and Transactions Act<sup>46</sup> (“ECTA”), more specifically by section 86 of the ECTA, regulating cyber-crime in South Africa.<sup>47</sup>

The content of section 86 is very similar to the overall approach used by the DMCA, as section 86(1) contains anti-circumvention provisions, whilst sections 86(3) – (4) contain provisions regulating the use of devices which facilitate the circumvention of security measures in order to gain access or intercept protected data.<sup>48</sup> However, the ECTA states that is an offence for a person to intentionally access or intercepts any data, without any authority thereto.<sup>49</sup> Thus, the ECTA specifically focuses on the terms “data” and “access” within the provisions of section 86.

Data is defined as the “electronic representations of information of any form”,<sup>50</sup> and Latter argues that this definition is extensive so as to include various types of copyrighted works in digital format, such as e-books and digital music. The definition of the term “access”<sup>51</sup> is much more problematic, as the definition thereof is circular in nature, thus leading to the situation where the ECTA has failed to provide a proper definition for an essential term which forms the foundation of the anti-circumvention provisions contained within section 86 of the ECTA.<sup>52</sup>

## 4. EULAs

### 4.1 Definition

Within a DRM environment, content owners are not only protected by technology and anti-circumvention provisions, but content owners frequently utilise EULAs to compel consumers to use digital content under fixed conditions. With the use of EULAs between content owners and consumers, consumers enter into a contractual agreement with the content owner either at the moment that they obtain DRM-

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<sup>46</sup> No 25 of 2002 (South Africa).

<sup>47</sup> Pistorius (2006) 7.

<sup>48</sup> Latter *Copyright Law in the Digital Environment: DRM Systems, Anti-Circumvention Legislation and User Rights* (Unpublished LLM Thesis: University of Rhodes 2010) 189

<sup>49</sup> Section 86(1) of the ECTA.

<sup>50</sup> Section 1 of the ECTA.

<sup>51</sup> “Access” is defined in section 1 of the ECTA as the “actions of a person who, after taking note of any data, becomes aware that he or she is not authorised to access that data and still continues to access that data”.

<sup>52</sup> Latter (2010) 189 – 190.

enabled hardware/software or at the moment that they wish to access digital content subject to protection by DRM.<sup>53</sup>

Prior to a consumer using the content provided by a content owner, consumers are often required to enter into several contractual agreements with the content owner. These contracts are often referred to as “Terms of Service”, “Software License Agreement” or “Usage Rules”. These contracts explicitly prohibit a consumer from performing certain acts in relation to the content, such as copying, modifying and distributing the protected content.<sup>54</sup> Thus through the use of EULAs, consumers are in reality only paying for a license to use digital content and because they do not legally own such content, they cannot legally alienate it under the doctrine of first sale.<sup>55</sup>

## 4.2 Contractual Relationship

Content providers make use of EULAs with consumers in order to establish a legally recognised and enforceable contractual relationship in a mass market environment. In theory, the EULA binds only the content owner and the consumer, however due to the fact that all consumers must agree to the EULA before accessing such content, this results in all consumers being in a contractual relationship with the content provider. The cumulative effect of these multiple EULAs affords the content owner a level of protection, based in contract law, which is indistinguishable from that of copyright law.<sup>56</sup>

Due to the fact that EULAs are standardised contracts which are imposed on consumers at a mass market level, an individual consumer does not have any control or influence over the actual contractual terms within the EULA, thus consumers only have the option of either accepting the unilateral agreement or rejecting it.<sup>57</sup> Furthermore, due to the confusing language contained in the terms and

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<sup>53</sup> Bechtold (2004) 339.

<sup>54</sup> *Idem* 339 - 340.

<sup>55</sup> Friedman “Nine Years and Still Waiting: While Congress Continues to Hold Off on Amending Copyright Law for the Digital Age, Commercial Industry Has Moved On” (2010) *Villanova Sports and Entertainment Law Journal* 676.

<sup>56</sup> Bechtold (2004) 341 & 355.

<sup>57</sup> *Idem* 355.



conditions in the EULA, many consumers do not actually read them at all.<sup>58</sup> As a result of this, a consumer could peruse many EULAs applicable to various types of digital content and still not understand how the purchasing of a license differs from purchasing the content outright.<sup>59</sup>

### 4.3 Purpose

The motivation behind the adoption and use of EULAs can be explained by two reasons. Firstly, digital content owners and distributors use EULAs in order to prevent and discourage widespread piracy. Secondly, the principle reasoning behind the use of EULAs is due to the fear of content owners and distributors of being undercut by a potential secondary market for digital media, as a successful and flourishing secondary market for digital could be financially damaging to content owners and distributors.<sup>60</sup>

### 4.4 Enforceability

The enforceability of EULAs is problematic as there are a number of factors which could nullify the protection afforded by EULAs. Such factors include whether the consumer had a proper opportunity to read the license terms, the parties to the EULA, whether the EULA terms infringe public policy and the applicable laws governing the EULA. However there exists no prohibition for content owners to utilise EULAs to contractually protect their content, thus in tandem with DRM systems, it is possible to protect content contractually as well.<sup>61</sup>

### 4.5 *Vernor v Autodesk*

A case illustrating the use and effect of EULAs is *Vernor v Autodesk*<sup>62</sup> (“**Vernor**”). During 2005, Timothy Vernor, a registered seller on the website eBay, acquired a copy of Autodesk’s AutoCAD software at a garage sale and thereafter listed it for sale on eBay. Autodesk sent eBay a take-down notice regarding Vernor’s listing, and

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<sup>58</sup> Trivedi (2010) 958 – 959, Trivedi also mentions that online retailers make use of click-wrap licenses which prohibit the consumer from completing the transaction unless they agree to the license, and as a consequence of the confusing wording of these click-wrap licenses, they are regularly accepted without being read by consumers.

<sup>59</sup> *Idem* 960.

<sup>60</sup> Mattioli “Cooling-Off & Secondary Markets: Consumer Choice in the Digital Domain” (2010) *Virginia Journal of Law & Technology* 243.

<sup>61</sup> Bechtold (2004) 344.

<sup>62</sup> *Vernor v Autodesk* 621 F.3d 1102 (9<sup>th</sup> Circuit 2010).

this notice was based on the claim that Vernor would be infringing Autodesk's copyright through the sale of the AutoCAD software.<sup>63</sup>

When eBay removed Vernor's auction, Autodesk notified Vernor that he only obtained a license to use the AutoCAD software for certain contractually stated purposes, and because he did not obtain full rights to the copy of AutoCAD, reselling such software would be classified as copyright infringement due to the fact that a license is not safeguarded by the doctrine of first sale.<sup>64</sup>

After a series of exchanges between the parties, Vernor instituted legal action against Autodesk and filed for a declaratory judgement to declare that the resale of AutoCAD was protected by the doctrine of first sale and thus did not infringe the copyrights of Autodesk.<sup>65</sup>

The basis of Autodesk's copyright infringement claim was the EULA that users of AutoCAD must agree to before installing the software. The EULA declared that Autodesk retained the title to all copies of the software and that the user has a non-exclusive, non-transferable license to use AutoCAD.<sup>66</sup>

The question that was posed in *Vernor* was whether Autodesk sold copies of its software to consumers or if Autodesk licensed consumers to use the software. The court in *Vernor* recognised the fact that EULAs are commonly tied to digital content such as software and that depending on the content of these agreements, EULAs have the potential to augment the content owner's copyright and lessen the rights of the consumer.<sup>67</sup>

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<sup>63</sup> *Idem* 1105.

<sup>64</sup> *Idem*.

<sup>65</sup> *Idem* 1105 - 1106, shortly after Vernor received the notification regarding the license attached to the AutoCAD software, Vernor filed a counter-notice based on the DMCA in order to contest Autodesk's copyright infringement claim. Autodesk did not respond to the counter notice, and thus eBay reinstated Vernor's listing and the software was sold. During 2007, Vernor tried to sell 4 copies of AutoCAD on eBay that he had acquired at an office sale. The sale of the first 3 copies of AutoCAD was subject to the same take-down notice and counter-notice procedure as in 2005. Once Vernor tried to sell the fourth copy, his eBay account was suspended due to the continuous disputes with Autodesk. Vernor then notified Autodesk, in writing, that he had the right to resell the software under the doctrine of first sale, and Autodesk responded by informing Vernor to cease selling the software. Vernor then proceeded to file another counter-notice, to which Autodesk did not respond to. Vernor's eBay account was reactivated but Vernor did not sell any additional copies of AutoCAD as he feared that his eBay account would be deactivated again.

<sup>66</sup> *Idem* 1104.

<sup>67</sup> Humphrey "Digital Domino Effect: The Erosion of First Sale Protection for Video Games and the Implications for Ownership of Copies and Phonorecords" (2013) *Southwestern Law Review* 455.

The *Vernor* court looked at the case of *United States v Wise*<sup>68</sup> and crafted a three-part test to determine whether a content owner created a license through an agreement. Firstly, the agreement must expressly state that it grants the user a “license”. Secondly, the agreement must impose significant restrictions on the consumer’s ability to transfer the software. Finally, the agreement must impose notable use restrictions on the consumer, a requirement which is interlinked with the second part of this test.<sup>69</sup> An example of a notable use restriction would be where the EULA or the DRM system would only allow the consumer to install the software a certain number of times or on a restricted number of personal computers.<sup>70</sup>

## 5. Effects of DRM & EULAs

### 5.1 General

The main use of DRM and EULAs is for content creators to protect their works from unauthorised use. The consequence of using such measures is that, even though content creators protect their works against unauthorised access, DRM and EULAs restricts legitimate consumers from accessing such works. As a result of the use of DRM and EULAs, the balance between public and private copyright rights has been weighted in favour of content creators.<sup>71</sup>

The use of DRM and EULAs is a double-edged sword; although they restrict the illegal copying and distribution of copyrighted works, these measures also prevent the copying and distribution of copyrighted works that are in the public domain.<sup>72</sup> DRM systems may also prevent the use of works in a manner that is socially beneficial.<sup>73</sup>

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<sup>68</sup> *United States v Wise* 550 F.2d 1180 (9<sup>th</sup> Circuit 1977), where the Ninth Circuit Court of Appeals determined whether copyright owners had actually executed sales when they transferred motion pictures to third parties subject to written distribution agreements.

<sup>69</sup> *Vernor* 1111.

<sup>70</sup> Humphrey (2013) 456.

<sup>71</sup> Pistorius (2006) 9 - 10.

<sup>72</sup> Samuelson (2003) 42.

<sup>73</sup> Dusollier (2012) 306, an example being where an e-book allows the content owner to prohibit the display of the text in a bigger font or size, which would have a negative effect for the users of such an e-book who are visually impaired.

## 5.2 Physical & Digital Content

Another consequence is the disparity that exists between the protections afforded to digital content as opposed to the protection, or lack thereof, afforded to physical content. With digital property, the content owner can utilise DRM and EULAs to regulate the access to such content, whether to allow fair use of such content and if so, to what extent. In contrast, when dealing with physical content, under the doctrine of first sale, after the sale of an individual physical copy of a work, the content owner has no power to control the use or access of that copy.<sup>74</sup>

DRM influences the use and enjoyment of content as well as the distribution of the work to the public at large, shifting the focus from copyright to that of controlling the overall business model, achieved through technology, of the distribution of content to consumers.<sup>75</sup>

## 5.3 Layers of Protection

The use of DRM has resulted in copyrighted works being subject to multiple layers of protection. These works are firstly protected by copyright law. Secondly, these works may be protected by a form of technology that regulates the use thereof. If this second form of protection is present, this protection is effectively duplicated by law such as the DMCA provisions that prohibit the circumvention of such technological measures.<sup>76</sup>

As a result of the multiple layers of protection that encompasses digital content, content owners have a wide monopoly of control over their works. DRM provides the content owner with actual control over the digital content, and the DRM system is protected by the anti-circumvention provisions in national and international legislation.<sup>77</sup>

## 5.4 Consumer Impact

Stringent DRM systems have had the result of causing a number of products to fail on the market, whereby resulting in such DRM systems having a positive influence

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<sup>74</sup> Pistorius (2006) 10 - 11.

<sup>75</sup> Dusollier (2012) 310.

<sup>76</sup> *Idem* 300.

<sup>77</sup> *Idem*.

on the increase of digital piracy. Due to the strict regulation of consumers' rights by these DRM systems, legitimate consumers may at times seek to obtain illegal copies of such content, without any form of DRM protection applied to such content.<sup>78</sup>

Due to the fact that most, if not all, DRM systems are based on complex algorithms, these DRM systems do not allow the consumers to exercise legitimate copyright limitation uses in respect of copyrighted content. This inflexibility to allow consumers to make use of copyright limitations leads to frustration on the consumer's side and a rejection of the content protected by such DRM systems.<sup>79</sup>

A majority of consumers have a negative view towards DRM and the main complaints against DRM are the lack of interoperability and the lack of the ability to create copies of files for backup purposes. Consumers also view DRM as an obstacle which unfairly restricts legitimate purchasers from using content as they wish, whilst allowing those who downloaded the content illegally to use the same content in any manner they want.<sup>80</sup>

Prior to the advent of the widespread adoption and implementation of DRM systems, consumers were able to exercise substantial control over their purchased digital content. Mulligan states that DRM has resulted in the creation of a "permission culture"; where consumers are forced to obtain the permission of the copyright holder in order to use digital copyrighted works outside the boundaries as defined by the copyright holder. Additionally, the presence (and effects) of these DRM systems are not disclosed to consumers, thus consumers are unable to understand the restrictions imposed by DRM systems.<sup>81</sup>

## 5.5 Information Distribution

DRM systems may affect the distribution of information within society, thus DRM may potentially having a sociological effect on the flow of information, and in essence power.<sup>82</sup> This is highlighted by actions of Amazon.com ("**Amazon**") in July 2009, where Amazon remotely deleted copies of George Orwell's *1984* and *Animal*

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<sup>78</sup> Kutiš (2012) 103.

<sup>79</sup> *Idem* 105.

<sup>80</sup> Trivedi (2010) 934.

<sup>81</sup> Gross "Is DRM Good or Bad for Consumers?" *PCWorld* 8 November 2006 available at <http://bit.ly/1LbXSOt> (accessed 14 September 2015).

<sup>82</sup> Bechtold (2004) 325.

*Farm* from consumers' Kindle devices, without any prior notification or refund to these consumers, upon learning that the digital publisher of these titles acted illegally in the publication thereof.<sup>83</sup>

Amazon remotely deleted these e-books that consumers had purchased through the use of DRM software which enabled Amazon to issue a “delete” command to all their customers' Kindles through its wireless network. As a result of Amazon's “Big Brother”-like actions, consumers turned to boycotts and in August 2009 a class action lawsuit was filed against Amazon.<sup>84</sup>

## 6. Property Rights

### 6.1 Ownership & Licensing

With content moving from physical distribution to digital distribution, consumers still have the expectation that they will be afforded the same rights and privileges that they have traditionally enjoyed in respect of content in a physical format.<sup>85</sup>

Amazon's actions in respect of the remote deletion of e-books have raised a number of concerns, though the main concern is focused on the issue of “owning” an e-book. In comparison to a physical book, which can be possessed indefinitely, resold or borrowed without legal consequences, with an e-book, the consumer does not actually have any title thereto but merely has a license to the use of the e-book.<sup>86</sup>

In reality the consumer is actually purchasing a license in respect of the e-book and not the e-book itself, and even though Amazon's EULA states that the consumer has the right to retain permanent copies of purchased e-books, the EULA does allow Amazon to suspend or discontinue the service at any time.<sup>87</sup>

Consumers have the perception that DRM systems infringe on their property rights, where in reality they do not actually have these rights as they have purchased licenses to digital content. This perception exists and persists because consumers

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<sup>83</sup> Friedman (2010) 667 – 668, shortly after taking such action Amazon's CEO Jeffery Bezos issued an apology, alongside free legal copies of the titles, to consumers and made a promise that Amazon would never again remotely delete e-books in the future.

<sup>84</sup> Mattioli (2010) 228 - 229.

<sup>85</sup> Whaley (2007) 389.

<sup>86</sup> Friedman (2010) 669.

<sup>87</sup> *Idem*, see footnote 171.

are not properly informed by the content owners that they are not purchasing such content, but actually purchasing a license to the use of such content.<sup>88</sup>

The use of any type of DRM system has a significant impact on the consumer; more specifically the use of DRM system affects a consumer's freedom of disposition as well as the freedom of restraint on alienation.<sup>89</sup> Where a PHOA-based DRM system is utilised to protect digital content and such a system fails to complete the authentication procedure (due to internet connectivity issues as an example), this is an example of an act of infringement of the consumer's right to choice of disposition as the consumer cannot use the content for any intended purpose whilst such access is denied.<sup>90</sup>

## 7. Conclusion

Having established the scope and ambit of both DRM and EULAs, one of the most far-reaching consequences of these measures are their effect on the doctrine of first sale. Chapter 3 will provide a detailed analysis on the doctrine of first sale, and the relevance thereto in respect of digital property.

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<sup>88</sup> Trivedi (2010) 958.

<sup>89</sup> Dubbelde (2010) 423.

<sup>90</sup> *Idem* 426 - 427; PHOA-based DRM systems are also problematic where the content owner is liquidated or neglects to maintain the authentication servers, as access to all digital content requiring periodic authentication would be terminated, leaving consumers with no possible means to access content which they have legitimately acquired.



## **CHAPTER 3: DOCTRINE OF FIRST SALE**

### **1. Background**

#### **1.1 History**

The concept of copyright developed at a time where different forms of media were distributed and acquired in physical form and content owners were compensated based on physical sales. In essence, a copyright is a secured property right which affords a bundle of exclusive rights, including the rights of reproduction and distribution, to the creator of the work.<sup>91</sup> The cornerstone of copyright is that it exists in order to promote social progress by giving authors control over their created works.<sup>92</sup>

There are limitations to copyright, and the most important limitation, for the purpose of this thesis, is the doctrine of first sale.<sup>93</sup> The doctrine of first sale is a codification of the common law principle relating to copyright exhaustion, which aims to harmonise the restrictions of copyright law with property law in order to avoid restraints on the alienation of property.<sup>94</sup>

#### **1.2 *Bobbs-Merrill v Macy & Co***

The doctrine of first sale was created through the process of judicial interpretation in the case of *Bobbs-Merrill v Macy & Co*<sup>95</sup> ("**Bobbs-Merrill**") The US Supreme Court had to determine whether a copyright owner's exclusive right of distribution included the power of the copyright owner to restrict subsequent sales of the copyrighted work. The US Supreme Court held that the copyright owner's distribution right did not extend beyond the first sale of the copyrighted work, and if this was the case it would result in the extension of the copyright owner's right beyond the legislative

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<sup>91</sup> Davis (2009) 363 - 364.

<sup>92</sup> Humphrey (2013) 469.

<sup>93</sup> Davis (2009) 364.

<sup>94</sup> Abelson "An Emerging Secondary Market for Digital Music: the Legality of ReDigi and the Extent of the First Sale Doctrine" (2012) *Entertainment and Sports Lawyer* 8.

<sup>95</sup> *Bobbs-Merrill Co v R.H. Macy & Co* 210 U.S. 339 (1908). The facts in *Bobbs-Merrill* are as follows; the Appellant, Bobbs-Merrill, owned the copyright to a book and attempted to prohibit subsequent sale of the books through placement of a notice inside the book stating "*The price of this book at retail is one dollar net. No dealer is licensed to sell it at a less price, and a sale at a less price will be treated as an infringement of the copyright.*" Macy & Co, the Respondent, purchased Bobbs-Merrill's books from a wholesaler and purposely disregarded Bobbs-Merrill's retail restriction notice and thereafter sold the books for 89 cents each.



boundaries.<sup>96</sup> A year after the *Bobbs-Merrill* decision, US Congress codified the doctrine of first sale under the US Copyright Act of 1909.<sup>97</sup>

According to Mattioli, the decision in *Bobbs-Merrill* was based on the Supreme Court's interpretation of the purpose of copyright found in the US Constitution, that purpose being "*to promote the progress of Science and useful Arts*". The creation of secondary markets for copyrighted works would be in line with this constitutional objective by promoting and encouraging the free flow of creative expression.<sup>98</sup>

### 1.3 Property Rights

Through the codification of the doctrine of first sale, US Congress sought to protect consumers from the restraints on the alienation of physical property that consumers own, however the doctrine of first sale does have limitations of its own. The doctrine is not applicable where the consumer has acquired a copyrighted work through a lease, rental or loan without actually acquiring ownership of the work.<sup>99</sup>

As a consequence of this limitation, where a consumer only possesses a work without any ownership right over it, contractual agreements such as EULAs could allow copyright holders to bypass the doctrine of first sale completely and effectively control the distribution of their works.<sup>100</sup>

It is important to note that the property protected by copyright law is *intellectual* property, thus laws safeguarding intellectual property should not be restricted to the physical embodiment of such property.<sup>101</sup> Traditionally, the application of the doctrine of first sale has been limited to physical copies of copyrighted works.<sup>102</sup> Humphrey notes that laws regulating the transfer of physical property are simple to comprehend as they deal directly with the transfer of possession from one person to another.<sup>103</sup>

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<sup>96</sup> *Idem* 351.

<sup>97</sup> Mencher (2002) 51.

<sup>98</sup> Mattioli (2010) 241.

<sup>99</sup> Humphrey (2013) 445.

<sup>100</sup> *Idem*.

<sup>101</sup> Abelson (2012) 9.

<sup>102</sup> Mencher (2002) 47.

<sup>103</sup> Humphrey (2013) 460.

## 2. Definition

### 2.1 General

The doctrine of first sale states that the owner of a particular copy (a copy of a tangible copyrighted work) is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy.<sup>104</sup> Subsequent to the first sale of the legitimate copyrighted work, the copyright holder does not have the right to regulate any future sale or alienation of their work.<sup>105</sup>

An important *caveat* in respect of the doctrine of first sale is that the copyright holder maintains and retains ownership of the copyrights in respect of the work, even where the copyright holder no longer has ownership of the work itself. Thus, where copyright holders sell their works to consumers, the actual copyright is not transferred to the consumer, therefore the copyright holder retains ownership thereof subsequent to any resale of the work thereafter.<sup>106</sup>

The doctrine of first sale is found within section 109 of the US Copyright Act,<sup>107</sup> and it is known as the “first sale” exception. This exception places a limit on copyright holders’ exclusive right to distribute copies of their works. The doctrine of first sale has resulted in legitimising the resale of copyrighted works in the secondary market, and as a result of such legitimisation, the doctrine has had a profound influence in the creation of secondary markets for copyrighted works.<sup>108</sup>

There are four elements which are integral to the doctrine of first sale. Firstly the copy of the work must have been lawfully produced or manufactured. Secondly, the copy must be transferred to the consumer under the content owner’s authority. Thirdly, the consumer must be the lawful owner of the copy. Lastly, the consumer must have simply distributed that specific copy to another person.<sup>109</sup>

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<sup>104</sup> Smith IV (2005) 854.

<sup>105</sup> Davis (2009) 364.

<sup>106</sup> Hamilton “It’s My Copy and I’ll Sell it if I Want To: *Capitol Records, LLC v. ReDigi Inc*” (2015) *Journal of the Patent and Trademark Office Society* 239.

<sup>107</sup> United States Copyright Act of 1976, 17 U.S.C.

<sup>108</sup> Serra “Rebalancing at Resale: *ReDigi*, Royalties, and the Digital Secondary Market” (2013) *Boston University Law Review* 1767.

<sup>109</sup> Davis (2009) 372, these elements were identified by Nimmer, whom Davis refers to at 372.

## 2.2 *Independent News Co v Williams*

In the case of *Independent News Co v Williams*<sup>110</sup> (“**Williams**”) the court held that the copyright owner’s control over his work terminated when a lawful transfer of the copyrighted work is made to the first purchaser. The court had to determine whether a second-hand purchaser of copyrighted works could sell those copies, if the wholesaler who sold those copies was under a contractual duty to destroy the unsold copies.<sup>111</sup>

The court stated that the contractual relationship had no bearing and held that where the publisher has relinquished its title to the copyrighted work, despite the existence of a contractual restriction in respect of its use, this restriction does not prevent subsequent purchasers in distributing the copyrighted work free from those contractual restrictions.<sup>112</sup>

## 2.3 Balancing of Rights

The doctrine of first sale is an example of a balance which is struck to reach a middle ground between the content owner’s exclusive right of distribution and the public’s right to have access to copyrighted works. Consequently, the doctrine of first sale places a limit on the exclusive right of distribution, thereby creating downstream markets for copyrighted works.<sup>113</sup>

The principle reason as to why content owners object to the doctrine of first sale is that the content owner only receives compensation from the first sale of the work, and therefore the content owner does not receive any compensation from any future sales of the work.<sup>114</sup>

This results in the creation of a secondary market for some media formats, such as console games, where consumers can purchase used or second-hand games without any compensation being paid to the content owner. Consumers trade in old

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<sup>110</sup> *Independent News Co v Williams* 293 F.2d 510 (3rd Circuit 1961). The facts in *Williams* are as follows; Williams, a second-hand comic book dealer legitimately purchased copies of obsolete comics from a wholesaler who was ordered to destroy the obsolete comics. The wholesaler was under a contractual duty to the comic publisher to destroy all comic books which remained unsold after a certain period, a fact that was unknown to Williams.

<sup>111</sup> *Idem* 510.

<sup>112</sup> *Idem* 517.

<sup>113</sup> Abelson (2012) 9.

<sup>114</sup> Davis (2009) 366 – 367.

games with a retailer, for a price below what the consumer originally paid and the retailer then sells these used console games at a significant mark-up, with the gaming companies and publishers receiving no compensation from such a practice.<sup>115</sup>

## 2.4 EULAs

Under the doctrine of first sale, which was developed in respect of copyright law, it could be interpreted to enable a consumer to install computer software and subsequently borrow or lease it to another person who would then install it. This type of system would prove to be fatal to software developers financially, as according to the doctrine of first sale; the first purchaser of the developer's software would be entitled to distribute it to other users for free.<sup>116</sup>

In order to avoid such a financially disastrous situation, software developers migrated away from the legal protection offered by copyright law and began implementing and utilising EULAs in order to protect (and control) their intellectual property.<sup>117</sup>

## 3. Legislation

### 3.1 USA Copyright Act

In terms of the US Copyright Act, specifically section 102(a)(2), in order for a work to be protected, it must be original and fixed in any tangible medium of expression. A copyright owner has the exclusive right to reproduce the work as well as the exclusive right to distribute copies of such a work, and these rights are afforded to them in order to act as an incentive for content creators to continue creating works which benefits society as a whole.<sup>118</sup>

### 3.2 EU Position

In stark comparison to the position in the US regarding the doctrine of first sale, in the EU, European legislators have emphatically rejected the principle that

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<sup>115</sup> Humphrey (2013) 444 & 447.

<sup>116</sup> Ackerman (2012) 160.

<sup>117</sup> *Idem*.

<sup>118</sup> Davis (2009) 363.

consumers have the right to resell digital media. The EU has issued certain directives<sup>119</sup> which follow the approach of the WIPO Copyright Treaty where digital property is deemed to be “communications” or “transmissions” rather than actual property. As a result of this approach, European consumers thus have no legal right to resell digital media.<sup>120</sup>

## 4. Effects

### 4.1 Digital Property

The doctrine of first sale is of great importance to the digital media industry as the implementation of this doctrine to digital property would result in redefining the copyrights afforded to content owners. US Congress has been pressured in the past decade to extend the doctrine of first sale to digital property as more consumers spend money on purchasing digital files. Congress has so far decided against such an extension and this could potentially lead to consumers feeling deceived when they find out that they cannot freely alienate any digital property that they have purchased.<sup>121</sup>

In its 2001 DMCA Section 104 Report, the US Copyright Office noted that were physical copies of a work deteriorates with use and the passing of time, digital property does not. Digital property can be copied and duplicated flawlessly and it can be instantly distributed globally at very little, or no cost.<sup>122</sup>

Due to the fact that the doctrine of first sale is focused on physical and tangible property, Humphrey opines that the attempt to fit digital property within this doctrine is akin to fitting round pegs into a square hole. The main issue of concern, with the problem of applying the doctrine of first sale to digital property, is the nature of transferring of digital copies of the property compared to the nature of transferring physical copies of such property. A digital transfer of digital property implicates two exclusive rights assigned to copyright owners; the distribution right and the

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<sup>119</sup> Directives such as the European Union Copyright Directive, Council Directive 2001/29, the Harmonisation of Certain Aspects of Copyright and Related Rights in the Information Society, 2001 O.J (L 167).

<sup>120</sup> Mattioli (2010) 248 & 250.

<sup>121</sup> Smith IV (2005) 853 & 859.

<sup>122</sup> *Idem* 854.

reproduction right whereas a physical transfer only involves the exclusive distribution right.<sup>123</sup>

## 4.2 Legal Effects

The doctrine of first sale terminates a content owner's distribution right once the content owner has received compensation for a work, as the guaranteed once-off compensation paid to the content owner for the work is viewed by the law as providing enough incentive to encourage creativity.<sup>124</sup>

Using the music industry as an example, the doctrine of first sale limits the payable royalties to the first sale of a musical compact disc, thus any subsequent sale of such a compact disc through a second-hand dealer does not generate any royalties for the content owner.<sup>125</sup> Therefore a transfer of digital property conducted through digital means would in effect result in copyright infringement due to the violation of the copyright owner's exclusive reproduction right.<sup>126</sup>

The principle reasoning for not extending the application of the doctrine of first sale to digital property relates to the actual digital files which contains digital media. A particular copy of a digital file on a consumer's hard drive is not identical to a copy which is created if the consumer were to sell such a digital file to another person, as the latter copy is unlawful as the digital file was copied (or reproduced), stored and distributed without the copyright holder's consent.<sup>127</sup> The doctrine of first sale acts as an exception only to the content owner's distribution right and not the right to reproduce such works, thus the creation of a new copy of a work in digital form by a consumer is illegal.<sup>128</sup>

## 4.3 Secondary Market

While a secondary market for "used" digital media would certainly have an effect on the sales of "new" digital media, a secondary market has the potential to increase the amount of new purchases. Without a legitimate secondary market for digital property,

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<sup>123</sup> Humphrey (2013) 460.

<sup>124</sup> Davis (2009) 366.

<sup>125</sup> Mencher (2002) 56.

<sup>126</sup> Humphrey (2013) 460.

<sup>127</sup> Smith IV (2005) 855.

<sup>128</sup> Davis (2009) 371.

this creates a situation where the content owners have a monopoly on digital media, and any monopolisation attempt designed to prohibit others from competing is against the statutory purpose of copyright, being the promotion of creativity.<sup>129</sup>

Throughout modern history, there has always been a secondary market for physical media, and this has not led to decrease in the sales of new physical media.<sup>130</sup> As noted by Mencher, an increase in market competition should not impede the application of the doctrine of first sale, but rather facilitate it.<sup>131</sup>

## 5. Property Rights

### 5.1 Intellectual Property

The doctrine of first sale ensures that there is a balance between the copyright holders' interests in their intellectual property and the consumers' right to freely dispose of their property. In the digital age, content owners utilise DRM systems and EULAs in order to maintain this balance and to regulate the copying and distribution of their intellectual property, which is embodied in digital files.<sup>132</sup>

An important aspect of the doctrine of first sale is that it makes a clear distinction between ownership of the copyright and a tangible copy of a work which embodies the copyrighted intellectual expression.<sup>133</sup> In essence, the doctrine of first sale is an extension of the principle that the ownership of a physical object is separate from the ownership of the copyright embodied in the object.<sup>134</sup>

### 5.2 Physical & Digital Property

Before the advent of the internet, the balance between the ownership of the copyright and its expression in a tangible form was maintained due to the exclusive and restricted nature of physical property, as the expenses that are tied to the

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<sup>129</sup> Abelson (2012) 9.

<sup>130</sup> *Idem* 10.

<sup>131</sup> Mencher (2002) 62.

<sup>132</sup> Smith IV (2005) 854 & 860.

<sup>133</sup> *Idem* 854.

<sup>134</sup> Davis (2009) 366.

copying and duplication of physical property served as a deterrent against infringement.<sup>135</sup>

Another reason for the non-extension of the doctrine of first sale to digital property is that in order for the doctrine to be applicable, it requires a consumer to have lawful ownership of the digital property. Almost all digital media and software is not actually “sold” to the consumer, but the consumer merely obtains a license to the use of such content, therefore limiting the level of “ownership” that the consumer acquires.<sup>136</sup>

The restriction of the consumer’s property right to freely alienate his property has been justified based on the necessity to protect the incentive of creativity which is a driving force behind development, and on the theory which states that, despite any loss that occurs from the non-extension of the doctrine of first sale to digital property, this loss can be counterbalanced by lower costs and an extensive collection of digital media being supplied by content owners.<sup>137</sup>

## 6. Digital Property

### 6.1 General

The restrictions that are applicable to physical property, in relation to the copying and duplication thereof, are insignificant in the digital era, as the digital era has unsettled the balance offered by the doctrine of first sale. This imbalance has been caused by the fact that digital code, which is the essence of all digital property, can be easily modified, copied, distributed and transferred at negligible cost.<sup>138</sup>

### 6.2 Secondary Market

Any legal analysis of a secondary market for digital property is complicated due to the fact that it must be determined exactly which copy of the digital file is being resold by consumer, especially if there is an intermediary service involved.<sup>139</sup> ReDigi

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<sup>135</sup> Smith IV (2005) 854, in order for someone to copy and duplicate a physical copy of a work, such a person would be required to expend time, labour and money in order to physically replicate a tangible copy of the work.

<sup>136</sup> Davis (2009) 371, see also Mattioli (2010) 242.

<sup>137</sup> Smith IV (2005) 855.

<sup>138</sup> *Idem* 854.

<sup>139</sup> Abelson (2012) 8 - 9, see also <http://www.redigi.com//site/index-invite.html> (accessed 21 March 2015), the website of ReDigi where the service is currently in a private beta stage (a process



positions itself as an online marketplace where “used” digital goods are allowed to be bought and sold by users of the service, in a manner analogous to that of ordinary consumers purchasing or trading in traditional used physical goods at certain brick and mortar stores.<sup>140</sup>

Critically, ReDigi only allows its users to resell digital goods that were lawfully acquired, and the service prohibits users from uploading pirated versions of digital goods unto ReDigi’s servers. In order to verify the authenticity of a particular digital file, ReDigi uses metadata indicators in order to verify the source of the digital file, additionally; the indicators also confirm the file’s eligibility to be sold to other users. Once the verification process has been successful, the digital file is then transferred to ReDigi’s cloud server, whilst an application on the user’s PC deletes any remaining duplicates of that digital file.<sup>141</sup>

Using ReDigi as an example, it is uncertain as to whether the copy of the digital music file on the consumer’s hard drive is the file being transferred to the purchaser or whether it is the intermediate copy of the digital music file that was uploaded to ReDigi’s servers by the consumer that is transferred to the purchaser.<sup>142</sup>

The application of the doctrine of first sale to digital property faces a problem when it comes to the transferring of such files from one consumer to another. In terms of the doctrine of first sale, a copyright holder cannot restrict the distribution of a work after the resale thereof. However, with the transfer of a digital, the exclusive reproduction right of the copyright holder is also affected, as the process of transferring a digital file from one location to another inevitably involves reproducing such a file.<sup>143</sup>

### **6.3 *Capitol Records v ReDigi***

ReDigi’s contravention of a copyright holder’s reproduction right was the subject of the case *Capitol Records, LLC v ReDigi Inc*<sup>144</sup> (“**ReDigi**”), a judgement arising from

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where a service is confidentially tested by a small number of consumers) and potential users require an invite in order to participate in the private beta.

<sup>140</sup> Serra (2013) 1756 – 1757.

<sup>141</sup> *Idem* 1757.

<sup>142</sup> Abelson (2012) 8 – 9.

<sup>143</sup> Serra (2013) 1763.

<sup>144</sup> *Capitol Records, LLC v ReDigi Inc* 934 F.Supp. 2d 640 (S.D.N.Y 2013).

the Southern District of New York.<sup>145</sup> At the outset, Hamilton notes that the doctrine of first sale only acts as a defence in the situation where the copyright holder's distribution right is infringed; the doctrine does not excuse the infringement of a copyright holder's reproduction right. The court's reasoning in *ReDigi* focused on both the distribution and reproduction rights, as both rights are implicated in respect of the transfer of digital files.<sup>146</sup>

In *ReDigi*, Judge Sullivan noted that the courts have never reached a conclusion to the question of whether an illegal distribution, via the internet, qualifies as a "reproduction" where only one digital file remains after such transfer.<sup>147</sup> After looking at the meaning of the term "reproduction right", the court held that the embodiment of a digital music file on a new hard drive qualifies as reproduction in accordance with the US Copyright Act. Despite the fact that only one file remained after such transfer, the court held that ReDigi's action amounted to the infringement of Capitol's reproduction rights.<sup>148</sup>

Consequently, the court held that the doctrine of first sale would not be applicable, and the court offered two reasons for this finding. Firstly, the doctrine of first sale cannot act as a defence where the copyright holder's reproduction right was infringed. Lastly, and in relation to the first reason, the doctrine of first sale would not act as defence as the digital files offered for sale by ReDigi were not lawfully produced in accordance with the requirements of the doctrine as stated in 17 U.S.C section 109(a) of the US Copyright Act.<sup>149</sup>

## 7. DRM & EULAs

### 7.1 DRM

As noted above, the doctrine of first sale is perfectly suited to physical property as it is exhaustible, finite and it has a limited lifespan. Where digital property is intangible

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<sup>145</sup> *Idem*, the facts are as follows; Capitol Records lodged a complaint against ReDigi, alleging that ReDigi wilfully violated their copyrights by enabling users to sell digital music files (over which Capitol Records owned a number of copyrights in) through ReDigi's PC Software. ReDigi responded to Capitol Record's complaint by stating that its actions were justified and thereby defensible under the doctrine of first sale.

<sup>146</sup> Hamilton (2015) 242 – 243.

<sup>147</sup> *ReDigi* 648.

<sup>148</sup> *Idem* 649 - 650.

<sup>149</sup> *Idem* 655.

and thus inexhaustible and infinite, DRM can impose the traits of physical property on digital property as the DRM system can restrict the number of digital copies that could be created and also control the distribution thereof through the use of defined parameters determined by the content owner.<sup>150</sup>

In the absence of the application of the doctrine of first sale to digital media, this could potentially lead to the situation where different types of digital media, such as e-books or music, could have completely different use restrictions implemented within them by their governing DRM system, thus requiring consumers to sift through complicated and confusing use restrictions in order to determine exactly what they are allowed and not allowed to do with such content and whether it is possible to resell it after the purchase thereof.<sup>151</sup>

## 7.2 EULAs

EULAs are primarily used by content owners to attach usage licensing rights to digital property, instead of transferring ownership of the content to consumers, which so far has been viewed as a practical workaround to bypass the doctrine of first sale. As the doctrine of first sale is only applicable to a consumer that has ownership over a copyrighted work, a consumer who has been given a license to use such a work in terms of an EULA is merely a licensee, with no right to resell his copy of the work.<sup>152</sup>

The usage of such licensing terms was considered in the case of *United States v Wise*<sup>153</sup> (“*Wise*”). The court referred to economic terms when determining the issue of ownership, with the court refusing to enforce the alleged “licenses” in question. Instead, the court looked at the fundamental economic realities of the transaction and held that where a recipient of property was under no legal obligation to return such property, that transaction was deemed to be a sale. The *Wise* decision serves

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<sup>150</sup> Smith IV (2005) 856.

<sup>151</sup> Humphrey (2013) 473.

<sup>152</sup> *Idem* 242.

<sup>153</sup> *United States v Wise* 550 F.2d 1180 (9<sup>th</sup> Circuit 1977). The facts, briefly, are as follows; Mr Wise was indicted on the charge of criminal copyright infringement for selling copyrighted film reels to film collectors. The film reels were distributed by Warner Brothers Studios to military bases, television studios and distinguished members of the film industry. The US government argued that the doctrine of first sale did not apply to Wise as the film studios did not “sell” the film reels, but had instead distributed them under licenses which prohibited the reselling of the films.

an important limitation to the situation where content owners utilise EULAs in order to contractually bypass the doctrine of first sale.<sup>154</sup>

## 8. Conclusion

The doctrine of first sale has been found to apply only to physical property, as per the *ReDigi* judgement. The question whether such a doctrine should apply to digital property remains a contentious issue, and thus Chapter 4 will now focus on the issue of “digital property” in more detail.

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<sup>154</sup> *Idem* 1191.

# **CHAPTER 4: DIGITAL PROPERTY**

## **1. Background**

### **1.1 Power Imbalance**

With Amazon's action in deleting e-books, consumers were in the position where they could no longer access the e-books that they had legitimately purchased, additionally, any personal notes that were added to these e-books by consumers were also deleted as well. Amazon's action in this respect illustrates the considerable scope of power that digital retailers retain over their products after the sale of such products to a consumer.<sup>155</sup> This is conflict with the doctrine of first sale, which provides that after the first sale of a copyrighted work, the copyright holder can no longer exercise any control over the work.

Amazon's action in 2009 highlighted the transformation of the nature of transactions between digital retailers and consumers, due to the fact that high speed WiFi and ADSL internet has become more widely available to consumers, along with more digital products being offered by various digital distribution platforms. This transformation has resulted in a clear power imbalance between consumers and digital retailers, as there is an informational imbalance which impedes the accuracy of a consumer's expectation in relation to the true nature and the legality of their digital purchases.<sup>156</sup>

## **2. Definition**

### **2.1 Property**

The term "property" provides a logical starting point in order to understand the concept of "digital property", and thus property is often defined as a bundle of rights in relation to a tangible object or asset which is capable of being physically possessed or controlled.<sup>157</sup> Even though consumers of digital property would, at first

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<sup>155</sup> Akins (2010) 215 - 216.

<sup>156</sup> *Idem* 218, Akins mentions that this expectation concerns the bargaining imbalance between the consumer and a digital retailer; even if the consumer is well-informed, such a consumer has no influence on the terms and conditions (EULAs) that they agree to whilst completing their digital transaction.

<sup>157</sup> Ackerman (2012) 143, such rights being the right to transfer, the right exclude, the right to use and the right to destroy.

glance, seem to possess this bundle of rights, this is actually not the case, as digital retailers (such as software developers or e-book retailers) have traditionally utilised EULAs when transacting with consumers and thus *licensing* their digital products to consumers instead of *selling* it to them.<sup>158</sup>

Licensed digital property differs from their physical counterpart due to the fact that, historically, the sale and use of intellectual property over the internet has resulted in copyright holders adopting a staunch protectionist stance in respect of their copyrighted works. This aggressive protectionist attitude has led to copyright holders adopting and implementing DRM systems and EULAs in respect to digital products made available to consumers through the internet.<sup>159</sup>

## 2.2 Conversion Theory

A significant theory in respect of digital property, the so-called “conversion” theory, was applied in *Kremen v Cohen*<sup>160</sup> (“**Kremen**”) which concerned a dispute over a domain name.<sup>161</sup> In terms of this theory, which is based on the law of tort, a plaintiff bears the onus of proving either ownership or a right to possession of property, that there was a wrongful disposition of such a property right and that the plaintiff suffered damages.<sup>162</sup>

The *Kremen* court utilised a three part test in establishing whether or not an item qualified as “property”. Firstly, there must be an item or interest that can be precisely defined; secondly, this item or interest must be capable of being exclusively possessed or controlled, and lastly, the alleged owner must have proven a lawful claim to possess or control such an interest exclusively. The court in *Kremen* also looked at an additional factor; stating that whilst the interest *in casu* satisfied the three abovementioned factors, the court held, similar to different kinds of property, that digital property is valuable, as it is bought and sold for a considerable amount of money on the open market.<sup>163</sup>

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<sup>158</sup> *Idem* 144.

<sup>159</sup> Akins (2010) 221 – 223.

<sup>160</sup> *Kremen v Cohen* 337 F.3d 1024 (9<sup>th</sup> Circuit 2003).

<sup>161</sup> *Idem* 1026.

<sup>162</sup> *Idem* 1029.

<sup>163</sup> *Idem* 1030.

## 2.3 Functional Equivalence

Even though digital property is intangible, and despite modest marketing, manufacturing and shipping costs, digital goods are still priced at amounts that are either equal to, or in most cases, more expensive than their physical counterparts. Due to the lack of secondary markets for digital goods, which would lead to lower prices on digital goods, consumers are at the disadvantageous position of having to accept inflated prices being placed on digital goods.<sup>164</sup>

The author is of the opinion that this is where the concept of “functional equivalence” is relevant; as stated by Pistorius, whichever requirements are applicable to or for paper-based transactions (in this case, physical property), the same requirements should be applicable for online transactions (in this case, digital property).<sup>165</sup> The author believes that this concept of functional equivalence is malleable, and it could be adapted in achieving parity between digital and physical property, as the crux of the concept, in the author’s opinion, is to treat digital transactions in the same way as their physical equivalent.

## 2.4 Digital Asset

Hopkins defines digital property by using the term “digital asset”. Hopkins states that a digital asset can be widely described as any asset that exists in the form of numerical coding, which is expressed in a binary format, which in essence entails that digital assets includes any electronically stored information. Accordingly, information stored on a digital device, such as a tablet or phone, will qualify as digital assets, however the electronic devices themselves will not qualify as such. Hopkins also states that all digital assets have to be stored in a particular physical location, be it with the owner of such assets, a third party or through a cloud storage system.<sup>166</sup>

Unlike computer software, which if it were visible to a consumer, it would only consist of lines of numerical and alphabetical code, digital property (such as e-books) have

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<sup>164</sup> Richardson (2014) 161 – 162.

<sup>165</sup> Pistorius (2006) 14.

<sup>166</sup> Hopkins “Afterlife in the Cloud: Managing a Digital Estate” (2013) *Hastings Science and Technology Law Journal* 211 - 212.

nearly an identical appearance (and function) to their physical counterparts when they are activated and used on the appropriate device.<sup>167</sup>

### 3. DRM & EULAs

#### 3.1 General

As was discussed earlier in this thesis,<sup>168</sup> through the use of DRM and EULAs, digital content providers are in the position where they are able to use these tools in order to gain an advantage over consumers, thereby exploiting the resultant power imbalance that is present between a consumer and a digital retailer.<sup>169</sup>

Akins mentions that as a consequence of this power imbalance, it may lead to consumers accepting the fact that digital retailers may exercise some form of control over digital products already sold (as was demonstrated by Amazon in 2009), which leads to consumers losing their freedom in exercising control over purchased digital products, as well as having a negative impact on e-commerce as consumers would be reluctant to utilise online transactions to purchase digital goods.<sup>170</sup>

#### 3.2 EULAs

In addition to the use of DRM systems to safeguard digital products, many digital retailers also utilise EULAs as a means to exercise control over the digital product which has already been sold to a consumer. This is achieved due to the fact that the consumer (knowingly or in most cases unknowingly) agrees to an EULA which provides that the digital retailer may exercise this very form of control.<sup>171</sup>

Richardson argues that the doctrine of first sale should be interpreted in a manner that it overrules any EULAs, thus removing any restriction on the transferability of digital property.<sup>172</sup> This author opines that if Richardson's approach is followed, it would negate the effect that EULAs would have on a consumer's property rights in respect of digital property, as such goods would no longer be licensed to a

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<sup>167</sup> Akins (2010) 247.

<sup>168</sup> See Chapter 2 of this thesis for a more detailed exposition of DRM and EULAs.

<sup>169</sup> Akins (2010) 220 – 221.

<sup>170</sup> *Idem* 221.

<sup>171</sup> *Idem* 226.

<sup>172</sup> Richardson (2014) 159.



consumer, but instead sold to them, with all the accompanying rights of ownership being transferred to the consumer.

### 3.3 DRM

Akins argues that the market has the potential of rewarding the digital retailer who offers the best and most consumer-friendly post-sale warranties to consumers. Markets may encourage digital retailers to voluntarily remove DRM or if this is not possible, to restrict their ability to interfere with a consumer's digital purchase after the initial sale has taken place.<sup>173</sup>

An example of this type of situation is that of GOG.com, an online distributor and publisher of digital PC games, which was launched as an online platform free of any DRM attached to the digital games offered for sale. As evidenced by statements by GOG.com's managing director, Guillaume Rambourg, one of the objectives underlying GOG.com is offering for sale digital games free of any DRM. As a result of GOG.com's anti-DRM outlook, and their consumer-centric approach, it has enjoyed considerable growth and success since its launch in 2008,<sup>174</sup> highlighting the argument that Akins puts forward; that the market will reward the digital retailer that offers the best post-sale warranties to consumers of digital products.<sup>175</sup>

## 4. Property Rights

### 4.1 Definition

Lim states that the term "property" is a legal construct, and cites Gray who states that "property" is a legally endorsed cluster of power over things, rather than the traditional perception that "property" itself is a thing. Essentially, when looking at the term "property", a focus must be drawn, not on the thing itself, but to the socially approved power relationship in relation to socially valued things. There are two principle features in respect of property; firstly, the right to exclude others and lastly, the freedom of exploitation of a thing.<sup>176</sup>

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<sup>173</sup> Akins (2010) 240.

<sup>174</sup> Makuch "GOG Celebrates Six Years of Advancing the 'DRM-Free Movement'" *GameSpot*, 8 September 2014, available at <http://l.gamespot.com/1150veF/> (accessed 2 July 2015).

<sup>175</sup> Akins (2010) 240.

<sup>176</sup> Lim "Virtual World, Virtual Land But Real Property" (2010) *Singapore Journal of Legal Studies* 316.

At the outset, an important distinction must be made when dealing with ownership of property and the rights attached thereto; namely the separation of the ownership of a thing and the ownership of intellectual property contained within a thing. Using a book as an example, Fairfield states that the ownership of a book does not equate to ownership of the intellectual property contained within the book. In the very same manner, ownership of digital property is separate from the intellectual property embedded within it, which is owned by the creator of such property.<sup>177</sup>

Richardson uses an example where a person creates a document digitally (on a computer) and in a physical format (on a piece of paper). In the former instance, such a person only acquires a copyright in respect of the work that was created digitally, and because the work is intangible, the author of the work does not acquire any common law property rights to the digital file. In the latter instance, the author acquires both a copyright and common law property rights to the created work, as the work exists on a tangible medium.<sup>178</sup>

As a result of this disparity outlined above, a digital author is afforded significant control over the supply of the copyrighted work in the digital market, as this work could never be transferred or resold under the doctrine of first sale. Due to the fact that there are no property rights attached to such a work, a digital consumer is at a considerable disadvantage when it comes to digital goods, as there are no secondary markets that would drive the prices of these goods down.<sup>179</sup>

This author opines that if a functional equivalence approach is adopted, the disparity mentioned above by Richardson would, in theory, disappear if digital property is recognised as property in terms of the law, which would lead to the creation of secondary markets for digital goods.

## 4.2 Consumer-Retailer Relationship

Richardson states the current relationship in existence between digital retailers and consumers have the traits of a feudalistic landlord-tenant relationship. The USA's property system expressly rejects the concept of feudalism in favour of a common

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<sup>177</sup> Ackerman (2012) 183, Fairfield as cited by Ackerman at 183.

<sup>178</sup> Richardson (2014) 158 - 159.

<sup>179</sup> *Idem* 159, Richardson also states that even if the doctrine of first sale was applicable to digital property, EULAs would prevent the transferring and reselling of digital property, as these goods are licensed, and not sold, to consumers in terms of EULAs.

law system based on the free alienation of property within a free market setting. With feudalism, ownership of property (more specifically land) was not equally distributed amongst people, but vested in a king or a lord based on hierarchy.<sup>180</sup>

Thus, only the king or a lord had the ability to dictate the terms and conditions on which other people would be entitled to access such property. In a similar manner, digital retailers, as a result of DRM and EULAs, have the power to control a consumer's access to digital property, and most importantly, such consumers do not have any ownership rights to such property.<sup>181</sup>

Due to the fact that consumers who purchase digital property online merely obtain a license to the use of such property, and not outright ownership, as a result of digital retailers utilising EULAs to contractually state that such consumers only possess such a license, these consumers have limited property rights in relation to their purchased digital property.<sup>182</sup>

### 4.3 Licensing

There is one factor that could potentially prevent digital property from being classified as full personal property; the fact that most, if not all, digital property is not actually sold to consumers but in fact only licensed to them.<sup>183</sup> Digital retailers and software developers often classify their digital products as licenses, rather than being sold outright to a consumer, in order to benefit from the lack of the application of the doctrine of first sale to their products.<sup>184</sup>

Through the use of licenses when selling digital property, the digital retailer thus maintains ownership of the digital property and may unilaterally impose restrictive measures on the licensee (the consumer who has purchased the digital property). Richardson also states that the use of EULAs has not been limited to digital property only; copyright holders and publishers have also adopted and implemented the use of EULAs to physical property.<sup>185</sup>

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<sup>180</sup> *Idem* 164.

<sup>181</sup> *Idem*.

<sup>182</sup> Akins (2010) 226.

<sup>183</sup> *Idem* 245.

<sup>184</sup> Ackerman (2012) 168.

<sup>185</sup> Richardson (2014) 154.

Although this may pose a problem, Akins argues that because ownership (in relation to digital property) may be partially defined as the right to exclude others, despite the fact that digital property is licensed to consumers, due to this right to exclude others, consumers may obtain full title to digital property.<sup>186</sup>

#### 4.4 *SoftMan v Adobe*

In a decision which could prove to be revolutionary, the court in *SoftMan Products Co. LLC v Adobe Systems Inc*<sup>187</sup> (“*SoftMan*”) held that an ordinary software distribution qualified as a sale and not a license. *SoftMan Products*, the defendant, claimed that the doctrine of first sale was applicable *in casu* as they had purchased the software from Adobe’s distributors, thus negating any effect that the EULA had, as this EULA was only in effect between Adobe and its various distributors.<sup>188</sup> Adobe argued that as the software was only licensed to their distributors; these distributors could only transfer a license to *SoftMan* therefore Adobe argued that the doctrine of first sale was not applicable *in casu*.<sup>189</sup>

The court in *SoftMan* looked at Adobe’s distribution methods and held that, in view of all the surrounding circumstances in respect of the transaction at hand, the transaction is actually a sale, and not a license. In reaching this conclusion, the court examined the nature of the transaction; the purchaser receives a single copy of the software for a single price, which is paid by the purchaser at the time of the transaction (with the payment forming the entire amount for the “license”). Additionally, the court also found that the duration of the license was for an indefinite period of time, which did not provide any provisions relating to the renewal thereof. In view of the abovementioned factors, the court in *SoftMan* held that a software

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<sup>186</sup> Akins (2010) 245.

<sup>187</sup> *SoftMan Products Co. LLC v Adobe Systems Inc* 171 F. Supp. 2d 1075 (C.D Cal. 2001). The facts are summarised as follows; Adobe distributed a software bundle which was priced at a lower amount compared to what the bundles would cost if each software program was sold separately. The EULA in force between Adobe and its distributors declared that the software could only be sold as a bundle and not separately. *SoftMan Products* purchased the software bundle from one of Adobe’s distributors and proceeded to sell the software programs separately at a higher price.

<sup>188</sup> *Idem* 1080.

<sup>189</sup> *Idem* 1083.

distribution transaction is in fact a purchase and sale transaction and not a license.<sup>190</sup>

#### 4.5 *UsedSoft v Oracle*

The European Court of Justice (“**ECJ**”) has, in a recent decision of *UsedSoft GmbH v Oracle International Corporation*<sup>191</sup> (“**UsedSoft**”) put forward an equitable and more efficient alternative to the issue concerning the transferring of digital property.<sup>192</sup> The ECJ held that once a software developer has been paid by the consumer for a piece of software, the software developer’s right to control the distribution of that specific software ceases to exist.<sup>193</sup> More importantly, the ECJ held that this principle applies irrespective of the fact whether the software was sold to the consumer digitally or in a physical format such a CD/DVD disc.<sup>194</sup>

Additionally, the ECJ also held, more significantly, that a software developer is restrained from prohibiting, through the use of EULAs, second-hand sales of their software, which evidently indicates that a software developer cannot restrict the distribution of their software after the initial sale to a consumer has taken place.<sup>195</sup>

There is an important *caveat* to the above ruling; the ECJ held that a consumer who intended to exercise his to right to effect a second-hand sale transaction concerning software, purchased from a software developer, must ensure that the software (be it

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<sup>190</sup> *Idem* 1085. See also Ackerman (2012) 170, Ackerman states that the *SoftMan* judgement is an example of a court decision which goes against the traditional norm of courts stating that the sale of software are ordinarily licenses and not purchase and sale.

<sup>191</sup> Case C – 128/11 *UsedSoft GmbH v Oracle International Corporation* 2012 E.C.R (3 July 2012). The facts are as follows; Oracle, an American software developer, distributes a vast majority of its software to consumers via the internet. In the distribution of its software in this manner, consumers acquire a “user right” stemming from an accompanying licence agreement (EULA) which allows consumers to permanently store such software onto a server and allow a fixed number of other users to access and download such software. In terms of the licence, a particular copy of software may only be used by a maximum of 25 users. UsedSoft markets used software licences and obtained a number of Oracle licences from customers who had initially purchased Oracle’s software (the software in issue in *UsedSoft* was databank software) where the maximum number of users for a particular copy of software was not reached. In October 2005, UsedSoft marketed “already used” licences for sale in relation to Oracle’s databank software. In their marketing, UsedSoft stated that the licences were still valid and verified the legality of the original sale transaction with a notarial certificate. Consumers who had purchased such licences offered by UsedSoft subsequently downloaded the databank software directly from Oracle’s website.

<sup>192</sup> Richardson (2014) 168.

<sup>193</sup> *UsedSoft* paragraph 72, this statement by the court supplements the USA’s doctrine of first sale, which also imposes the same consequence once a consumer has purchased a work from a copyright holder.

<sup>194</sup> *Idem* paragraphs 75 & 79.

<sup>195</sup> *Idem* paragraphs 76 - 77.

in a tangible or intangible format) is no longer present and usable on their computer or other hardware device at the time that the software is resold to another.<sup>196</sup>

If the consumer neglects to ensure that this step is followed upon the resale of the software, it would result in the consumer infringing upon the copyright holder's exclusive reproduction right in respect of the software. Intriguingly, the ECJ also held that copyright holders may utilise technical protective measures, such as DRM, in order to ensure that the consumer renders his copy unusable on his device at the time of the resale of the software.<sup>197</sup>

The *UsedSoft* decision represents a restoration of parity between the consumer and digital retailers as it enables the doctrine of first sale to apply to digital property, therefore allowing such property to be traded irrespective of any inadvertent copying. Richardson highlights the test, whilst also modifying it for an American context, used by the ECJ in *UsedSoft* in reaching their decision, which consisted of examining multiple factors concerning the transaction *in casu*.<sup>198</sup>

Where a transaction involves intangible digital property, a court must look at three different aspects of the transaction. Firstly, the court must determine whether or not ownership has been transferred by looking at the type of product that was sold. Secondly, the court must examine the type of payment structure surrounding the transaction, in order to determine whether it is a one-time, once-off payment or a series of continuous payments. Lastly, the court must look at the length of time regarding the use of the digital product concerned, in order to determine whether it is indefinite or temporary, and in doing so, the court must ignore any contractual language present in any EULA regarding ownership or lease.<sup>199</sup> Through the use of the ECJ's approach, we can achieve functional equivalence between digital and physical property.

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<sup>196</sup> *Idem* paragraphs 70 & 78.

<sup>197</sup> *Idem* paragraphs 70 & 73. See also Serra (2013) 1762, where he states that the *UsedSoft* decision may make it possible for ReDigi's business model (as discussed in Chapter 3 of this thesis) to become established within the European market.

<sup>198</sup> Richardson (2014) 169.

<sup>199</sup> *UsedSoft* paragraphs 84 – 88.

## 5. Functional Equivalence

### 5.1 General

Richardson argues that in applying the doctrine of first sale to digital property, thereby nullifying the effect of EULAs, it would consequently result in achieving functional equivalence between digital and physical property. This disparity currently exists due to the fact that, historically, digital products have not been recognised, in terms of property law, as being “things”.<sup>200</sup> This author opines that in order to further eliminate this disparity, many of the processes and rights (such as the right to obtain a refund) that are available to consumers of physical products should also be made available to consumers of digital goods.

### 5.2 Consumer Protection Act

According to the Consumer Protection Act<sup>201</sup> (“CPA”), more specifically section 20 of the CPA; a consumer has the right to return goods for a full refund of the purchase price. The CPA has a very wide definition of the term “goods”, and significantly, “goods” includes “any...data, software, code or other intangible product written or encoded on any medium, or a licence to use any such intangible product”.<sup>202</sup> Section 20(2) of the CPA states that a consumer may return goods for a full refund to a supplier, if the supplier has delivered the goods in any of the ways listed in section 20(2)(a) – (d).

The instances listed in section 20(2)(a) – (d) appear, in the author’s opinion, to only apply to tangible goods, as there is no express provision under section 20(2) dealing with the supply of digital goods.<sup>203</sup> Even though the CPA includes intangible digital goods under the definition of the term “goods”, there is no express provision within the CPA dealing with a consumer’s right to obtain a refund in respect of digital goods. As a result of this gap within the CPA, South African consumers would then

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<sup>200</sup> Richardson (2014) 155 - 157.

<sup>201</sup> Act 68 of 2008 (South Africa).

<sup>202</sup> Section 1 of the CPA, more specifically subparagraph (c) of the definition of “goods”.

<sup>203</sup> For example, in terms of section 20(2)(b), a consumer may request a refund where the supplier has delivered goods where the consumer did not have an opportunity to examine these goods before delivery, and subsequently rejects the goods for any reason listed under section 19(5) of the CPA. Due to their intangible nature, a consumer would not have the opportunity to inspect digital products beforehand, thus, logically, section 20(2)(b) can only apply to goods of a tangible nature.



have to rely on the digital distribution platforms, such as Steam, where they purchase digital goods from, to provide and implement refund systems.

### 5.3 Steam Refund

Steam, the online digital distribution platform developed and run by Valve Corporation, have, as of June 2015, started to offer full refunds to users of their platform.<sup>204</sup> Significantly, Steam offers this refund to users based on any reason, however there are two conditions that must be met; firstly the request for a refund must be made within fourteen days after the title was purchased, and lastly, the user has played the title for a time period not exceeding more than two hours.<sup>205</sup> Even if a user does not meet the abovementioned conditions, a refund request may be sent to Steam, who will then exercise their discretion in determining whether or not to offer a refund to such a user.<sup>206</sup>

The Steam refund option is also available in cases where the user has purchased downloadable content, gaming bundles and pre-ordered games.<sup>207</sup> However, with purchases relating to anything other than software applications and games, there are a number of requirements that must be met before Steam will issue a refund to a user.<sup>208</sup> In order to prevent users from abusing the refund system, Steam has undertaken not offer refunds to any users it has deemed to have been abusing the refund system.<sup>209</sup>

### 5.4 *Batman: Arkham Knight* Steam Effect

In a further example of functional equivalence, Steam's newly implemented refund system appears to have had a positive effect in achieving parity between physical and digital property in respect of a consumer's right to obtain a refund with regards to

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<sup>204</sup> Schreier "Steam is Now Offering Refunds" *Kotaku* 2 June 2015 available at <http://bit.ly/1SWXpCu> (accessed 10 July 2015).

<sup>205</sup> Steam "Steam Refunds" available at <http://bit.ly/1lcYXow> (accessed 10 July 2015).

<sup>206</sup> *Idem*.

<sup>207</sup> Schreier (2015).

<sup>208</sup> Details of these conditions attached to the refunding of downloadable content and in-game purchases are set out on the Steam Refunds page available at <http://bit.ly/1lcYXow> (accessed 10 July 2015).

<sup>209</sup> Schreier (2015). According to the Steam Refunds webpage, Valve will not classify a user's action in requesting a refund on a title, purchased immediately prior to the same title being placed on sale at a lower price, with the user purchasing the title again thereafter, as abuse of the refund system.



defective goods.<sup>210</sup> *Batman: Arkham Knight* (“**BAK**”) was released (physically and digitally) on 23 June 2015, on PC and consoles, developed by British studio Rocksteady and published by Warner Brothers Interactive (“**WBI**”).<sup>211</sup>

The PC release of *BAK* was marred by a number of serious technical issues, a trend that has begun to develop over the years in the gaming industry concerning new releases of gaming titles, with developers often releasing new titles which contain various technical and performance issues, often without fixing them immediately thereto.<sup>212</sup>

However, due to the implementation of Steam’s refund system earlier in the same month, many users opted to claim a refund in respect of the technically defective *BAK* PC game. Consequently, due to the serious nature of the technical issues (and perhaps the high number of users obtaining refunds), WBI took the unprecedented step to suspend sales of *BAK* on PC whilst these performance problems were being fixed, with this suspension affecting both physical and digital copies of *BKA* for the PC.<sup>213</sup>

*BAK* serves as a fine example of achieving functional equivalence between physical and digital property, as due to Steam’s refund system, consumers now have a right to claim a refund in respect of a defective digital product, whereas in the past this would not have been the case. Previously, before the implementation of the Steam refund system, a consumer in this very same situation would have been left without any remedy in the case of a defective digital product. At best, a consumer could hope that the developer would issue a patch that would fix such defects.<sup>214</sup>

Due to Steam’s refund system (and other refund systems implemented by other digital distribution platforms such as GOG.com and Electronic Art’s *Origin* platform),

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<sup>210</sup> Kuchera “Batman: Arkham Knight is Why Steam Refunds Were So Necessary” *Polygon* 23 June 2015 available at <http://bit.ly/1SwENGI> (accessed 13 July 2015).

<sup>211</sup> Purchase “Warner Suspends Batman: Arkham Knight PC Sales” *Eurogamer* 25 June 2015 available at <http://bit.ly/1JloVa3> (accessed 13 July 2015).

<sup>212</sup> Good “Warner Bros. Apologizes for Batman: Arkham Knight’s Defective PC Port, Says DLC Delayed” *Polygon* 11 July 2015 available at <http://bit.ly/1lebads> (accessed 13 July 2015). See also Purchase (2015); these technical issues were allegedly caused due to the fact that the PC porting of the game was not performed by Rocksteady (the original developer) but by another third party developer, Iron Galaxy, who were allegedly under-staffed and had insufficient time to effectively complete the PC port.

<sup>213</sup> Purchase (2015).

<sup>214</sup> Kuchera (2015).

consumers are no longer saddled with the risk of purchasing digital goods, without the option of returning them for a refund should they turn out to be defective.<sup>215</sup>

Using the CPA as authority, a South African consumer who had purchased a physical copy of *BAK* for the PC, which turned out to be defective, would be entitled to a refund in terms of section 56 of the CPA, which makes provision for a consumer to obtain a refund in relation to any defective goods.<sup>216</sup> However, as explained above, the CPA does not provide for the right of a consumer to return digital goods, even though the term “goods” under the CPA includes digital products. Fortunately, the competitive market, with Steam being an example, has stepped up and filled the gap left by the CPA in respect of digital refunds, thus there is now, when looking at the refund option available to consumers, parity between physical and digital property.

## 6. Conclusion

As evidenced by the decisions in *SoftMan* and *UsedSoft*, it seems that digital property is gradually attaining the legal recognition that it deserves in different jurisdictions worldwide. These two decisions are commendable; as they both look past the effects of EULAs on digital property, and such decisions could pave the way to the creation of legitimate secondary markets for digital goods.

It remains to be seen how the issue of digital property would be approached in South Africa. Although the CPA applies to digital goods, some of its provisions are not explicitly clear in the application thereof to digital goods. Additionally, South Africa’s Copyright Act should be amended in order to make provisions for works in digital format, and to provide clarity to the various issues surrounding digital property.

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<sup>215</sup> *Idem*.

<sup>216</sup> Section 56(2)(b) of the CPA.

## **CHAPTER 5: CONCLUSION**

### **1. Conclusion**

#### **1.1 DRM & EULAs**

The sale of intellectual property has led to copyright holders in embracing a resolute protectionist attitude in relation to their copyrighted works. As digital piracy still poses a substantial threat to copyright holders, the use of DRM and EULAs to safeguard and protect copyrighted works will always be a contentious issue, as copyright holders are legally entitled, through various legislation and common law contractual principles, to use such protective measures.

However, the use of DRM and EULAs do not only guarantee that copyright holders receive remuneration for their creative endeavours, these protective mechanisms also provide copyright holders with a formidable scope of control over both the distribution and usage of digital content. The use of EULAs is even more problematic, as it forces consumers to use digital content under conditions to which consumers have no influence over.

Critically, EULAs have the effect where consumers only obtain a license to use digital content, and since they do not obtain any ownership rights over such content, it cannot be legally alienated under the doctrine of first sale. Since consumers are restricted by such EULAs, consequently there are no secondary markets for digital content, due to the fact that digital is licensed to consumers, and not sold to them.

#### **1.2 Doctrine of First Sale**

The doctrine of first sale is one of the most important limitations in respect of copyright, as it serves as a conduit in the creation of secondary markets for copyrighted works. Crucially, the doctrine of first sale serves as a reminder that ownership of a physical object must be kept separate from ownership of intellectual property embodied in the very same physical object.

The doctrine of first sale also maintains the balance between a copyright holder's exclusive distribution rights with the public's right to access copyrighted material.

Through this limitation of a copyright holder's distribution right, the doctrine of first sale has created the downstream secondary markets for copyrighted works.

However, historically, the application doctrine of first sale has been limited to physical property, as it was developed in *Bobbs-Merrill* during a time period where digital property did not yet exist. As such, there has been considerable difficulty in dealing with the question whether to extend the application of the doctrine of first sale to digital property, due to the differing nature of transferal when comparing physical and digital property.

Copyright holders have, especially within the modern digital era, recognised the financial danger that the doctrine of first sale could potentially pose, should it be recognised as being applicable to digital property. Consequently, copyright holders have utilised EULAs in order completely bypass the application of the doctrine of first sale, as the doctrine only applies where a copyrighted work has been sold to a consumer, and not in the case where it has been licensed to a consumer.

As a result of the use of DRM and EULAs, copyright holders have created a situation where they hold a monopoly over the distribution of digital property, due to the fact that there are no viable secondary markets for digital property, while also imposing an imbalance of power between consumers of digital content and digital retailers.

### **1.3 Digital Property**

When looking at the concept of "property", one must always focus on the bundle of rights in relation to a thing, and not focus on the thing itself. In doing so, it is then possible to achieve functional equivalence between physical and digital property, as this concept is concerned with achieving parity in respect of rights afforded to a consumer, regardless of the fact whether property is in a physical or digital form.

The one obstacle that stands in the way of achieving parity between physical and digital property is the fact that digital property is licensed to consumers; thus full title to such property is not transferred to a consumer, and through the use of licenses, digital retailers bypass the application of the doctrine of first sale. Consumers are, due to use of EULAs, legally unable to alienate their digital property.

## 2. Recommendation

### 2.1 General

The recent Steam refund system has had a positive effect in achieving parity between physical and digital property, especially in light of the release (and subsequent technical deficiencies) of *BAK*. This is a potentially revolutionary event, as previously in the past, obtaining a refund for a defective digital product was practically unheard of. This is perhaps one of the first signs that lead to the possibility that in the future, there will be total functional equivalence between physical and digital property.

The CPA does, through its definition of “goods”, legally recognise the concept of digital property within South Africa. However, the CPA is found to be lacking in respect of a consumer’s right to return digital goods for a refund where such goods turn out to be defective. The CPA’s extensive provisions regarding the return of physical goods which are defective should be adapted to apply to digital goods as well. Additionally, South Africa’s Copyright Act should also be amended and updated in order to provide for the regulation of works in digital format.

EULAs remain an obstacle in achieving parity between physical and digital property. The methodology adopted in *SoftMan* and *UsedSoft* are commendable, and should be followed by more courts in the future, as both these decisions, in the author’s opinion, adopt favourable approaches towards the recognition of digital property as full personal property, whilst also diminishing the effect that EULAs have on consumers of digital property

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