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ECJ allows resale of ‘used’ software licences in landmark case and extends the principle of exhaustion even to downloaded (non-physical) copies

9 July 2012

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In a landmark judgment delivered by its Grand Chamber on 3 July 2012 (Case C-128/11), the European Court of Justice (ECJ) has effectively declared the second-hand sale of physical copies and downloaded copies of software to be legal. The ECJ explains that the principle of exhaustion of the distribution right applies not only where the copyright holder markets copies of his software on a material medium (CD-ROM or DVD) but also where he distributes them by means of downloads from his website. This decision which markedly extends the scope of the principle of exhaustion beyond what has been the understanding to date has a potentially significant impact on the way software is sold and consumed.

The Parties and the Facts

Oracle provides customers with downloadable computer programs functioning as ‘client-server software’. The user right for such a program includes the right to store a copy of the program permanently on a server and to allow up to 25 users to access it by downloading it to the main memory of their workstation computers. The licence agreement gives the customer a non-transferable user right for an unlimited period of time.

The German company UsedSoft markets licences acquired from customers of Oracle. Customers of UsedSoft, who are not yet in possession of the software, download it directly from Oracle’s website after acquiring a ‘used’ licence. Customers who already have the software can purchase a further licence or part of a licence for additional users.

Oracle brought proceedings against UsedSoft in the German courts, seeking injunctive relief, among others. The first instance court and the Court of Appeals held for Oracle. The German Federal Supreme Court (Bundesgerichtshof) referred the matter to the ECJ asking it to interpret, in this context, the directive on the legal protection of computer programs*.

The Judgment

The ECJ rejected Oracle's arguments. It ruled that the right of software developers to control *distribution* of a specific piece of software is exhausted once the developer has been paid for it. It makes no difference, according to the court, whether the copy of the computer program was made available by means of a download or on a DVD/CD-ROM. Consequently, the software developer cannot prohibit ***any*** type of second hand sale.

Furthermore, the court stated that the directive authorises any reproduction that is necessary for the use of the computer program by the lawful acquirer in accordance with its intended purpose. Such reproduction may not be prohibited by contract, in particular by using EULAs.

However, the Court made it clear that an original acquirer of a tangible or intangible copy of a computer program for which the copyright holder's right of distribution is exhausted must make the copy downloaded onto his own computer unusable at the time of resale. If he continued to use it, he would infringe the copyright holder's exclusive right of reproduction of his computer program. In contrast to the exclusive right of distribution, the exclusive right of reproduction is not exhausted by the first sale. In this context, the court also pointed out that the copyright holder may use technical protective measures such as product keys in order to make sure that the original acquirer of the software in fact makes its copy unusable.

Key Questions

Software vendors often argue that software is "licensed, but not sold". This claim is in tension with the European doctrine of copyright exhaustion, known as 'first sale doctrine' in the United States. The key to understanding the judgment is to keep in mind that under EU copyright law there are separate rights of *distribution* and of *reproduction*.

The first question was whether the initial sale of the piece of software amounts to a 'first sale' of that software. If this was the case, the right of distribution would be *exhausted*.

According to the ECJ a 'sale' is an agreement by which a person, in return for payment, transfers to another person his right of ownership in an item of tangible or intangible property belonging to him. It follows that the commercial transaction giving rise, in accordance with Article

4(2) of Directive 2009/24, to exhaustion of the right of distribution of a copy of a computer program must involve a transfer of the right of ownership in that copy.

Oracle had submitted in contrast that there is no right of ownership transferred to its customers, and therefore no "first sale" of its software at all, because it makes its software available for free download and separately enters into a licence agreement. Such a licence would give the customers a non-exclusive and non-transferable user right for an unlimited period for that program and it thus would be a licence arrangement, not a sales arrangement.

The court disagreed by taking a remarkably clear position. It noted that:

> *"if the term 'sale' within the meaning of Article 4(2) of Directive 2009/24 were not given a broad interpretation as encompassing all forms of product marketing characterised by the grant of a right to use a copy of a computer program, for an unlimited period, in return for payment of a fee designed to enable the copyright holder to obtain a remuneration corresponding to the economic value of the copy of the work of which he is the proprietor, the effectiveness of that provision would be undermined, since suppliers would merely have to call the contract a 'licence' rather than a 'sale' in order to circumvent the rule of exhaustion and divest it of all scope."* (at para. 49)

And further:

> *"In this respect, it must be observed that the downloading of a copy of a computer program and the conclusion of a user licence agreement for that copy form an indivisible whole. Downloading a copy of a computer program is pointless if the copy cannot be used by its possessor. Those two operations must therefore be examined as a whole for the purposes of their legal classification."* (at para. 44)

A second key question was whether software developers retain an exclusive right to control reproduction under Article 5(1) of Directive 2009/24. Following the arguments regarding the right of distribution the court held that, since the copyright holder cannot object to the resale of a copy of a computer program for which the rightholder's distribution right is exhausted, a second acquirer of that copy and any subsequent acquirer are 'lawful acquirers' of it.

However, the court did place important limits on customers' rights to resell used software licences. Firstly, in case of block licences it is not permitted to split the licence up into parts and sell them off individually. Secondly, the 'first acquirer' must, at the moment of the resale, make unusable any copy of the software.

Implications

At first glance, this appears to be a somewhat surprising and revolutionary, but pragmatic, judgment of the ECJ coming down on the side of the second-hand sales of software. Many had argued before that it would be inappropriate to distinguish between tangible and intangible copies of software, in particular with a view to current commercial practices and user habits. The court now appears to have followed this route.

As EU Member States and their domestic courts are bound by EU law and its interpretation by the ECJ, any contradictory domestic law as well as jurisprudence will have to be struck down following this judgment. It will therefore be harder for rightholders to prohibit second hand sales of software by legal means.

However, the judgment raises a number of interesting further questions:

- As the ECJ strongly emphasized the fact that Oracle licences were perpetual, it is worth considering whether a time-limited licence may be preferable from an industry perspective. The current shift to cloud services may even be strengthened as this concept typically relies on non-perpetual licences.

- The court suggests that rightholders could impose technical restrictions on the software. It is not clear so far what it would mean if such technical measures physically or factually prevent second-hand sales. For mobile apps this is the case already. Mobile platforms as well as the gaming and telecoms industry should therefore also take this into consideration.

- It remains to be seen whether the judgment will have an indirect impact on other jurisdictions, in particular in the United States. There seems to be no clear answer to the question as to how second-hand software sales should be treated across the United

States. The ECJ case law might therefore have an influence on further discussion in the United States.

- If such measures are considered, one will also have to analyse which technical measures will be the most appropriate ones. This question will have to be asked, in particular, in light of the fact that software protection dongles are considered to be illegal in some countries in certain scenarios.

While the impact on the software industry appears to be serious at first glance, there may be approaches in our view which will at least alleviate the effects of this most recent decision from the Luxembourg court. Creative lawyering should make it possible to find solutions which will enable the software industry to comply with the ECJ case law while maintaining its interests.

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* Directive 2009/24/EC of the European Parliament and of the Council of 23 April 2009 on the legal protection of computer programs (OJ 2009 L 111, p. 16).