

No. 08-55998

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

UMG Recordings, Inc.,

Appellant,

v.

Troy Augusto,

Appellee.

On Appeal from the United States District Court
for the Central District of California
No. 2:07 CV 3106 SJO (AJWx)
Honorable S. James Otero

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TABLE OF CONTENTS

	<u>Page</u>
I. Introduction.....	1
II. Argument	1
A. The first sale doctrine permits the owner of a copy to resell that copy.	3
B. Because Augusto was the owner of the CDs he bought, he was entitled to resell them.	6
1. Courts examine the economic realities of an exchange, rather than labels used by the parties, to determine whether a first sale has occurred.....	6
2. The economic realities of the promo CD transaction point to a transfer of ownership.	10
3. The label on the CD does not affect ownership of the CD.....	13
a. One can be a party to a licensing contract while also being the owner of a particular copy.....	14
b. Mere labels do not prevent transfer of ownership.....	16
4. The computer software cases are not to the contrary.	17
a. This Court’s cases dealing with 17 U.S.C. § 117 do not affect the analysis.	17
b. The district court cases cited by UMG base their holdings on the unique nature of distributing software.....	20
5. Augusto has sufficiently demonstrated a chain of title derived from a first sale.	23
a. It is undisputed that Augusto was a good faith purchaser of the CDs.	23
b. Requiring a showing of a full chain of title would lead to absurd results.	25

TABLE OF CONTENTS
(cont'd)

	<u>Page</u>
C. Even if the label creates a licensing contract that would otherwise affect ownership of the CD, the CD may be treated as a gift under § 3009 notwithstanding the contract.....	27
1. The CDs were “merchandise.”	28
2. The CDs were “mailed without the prior express consent or request of the recipient.”	31
III. Conclusion	32

TABLE OF AUTHORITIES

	<u>Page(s)</u>
Federal Cases	
<i>Adobe Sys., Inc. v. One Stop Micro, Inc.</i> 84 F. Supp. 2d 1086 (N.D. Cal. 2000).....	20, 21
<i>Am. Int’l Pictures v. Foreman</i> 576 F.2d 661 (5th Cir. 1978).....	14, 24, 25
<i>Apple Computer Inc. v. Formula Intern., Inc.</i> 725 F.2d 521 (9th Cir. 1984).....	19
<i>Applied Info. Mgt. Inc. v. Icart</i> 976 F. Supp. 149 (E.D.N.Y. 1997).....	7
<i>BedRoc Ltd., LLC v. United States</i> 541 U.S. 176 (2004).....	29
<i>Bobbs-Merrill Co. v. Straus</i> 210 U.S. 339 (1908).....	3, 4
<i>Columbia Pictures Indus., Inc. v. Prof’l Real Estate Investors, Inc.</i> 866 F.2d 278 (9th Cir. 1989).....	29
<i>Comm. for Creative Non-Violence v. Reid</i> 490 U.S. 730 (1989).....	9
<i>DSC Commc’ns Corp. v. Pulse Commc’ns, Inc.</i> 170 F.3d 1354 (Fed. Cir. 1999).....	14
<i>Great Am. Music Mach., Inc. v. Mid-South Record Pressing Co.</i> 393 F. Supp. 877 (M.D. Tenn. 1975).....	28
<i>In re Ferrell</i> 539 F.3d 1186 (9th Cir. 2008).....	29, 30
<i>ISC-Bunker Ramo Corp. v. Altech, Inc.</i> 765 F. Supp. 1310 (N.D. Ill. 1990).....	20
<i>Kashelkar v. Rubin & Rothman</i> 97 F. Supp. 2d 383 (S.D.N.Y. 2000).....	28
<i>Kipperman v. Acad. Life Ins. Co.</i> 554 F.2d 377 (9th Cir. 1977).....	28
<i>Krause v. Titleserv, Inc.</i> 402 F.3d 119 (2d Cir. 2005).....	7, 8, 9, 15

TABLE OF AUTHORITIES
(cont'd)

	<u>Page(s)</u>
<i>MAI Sys., Inc. v. Peak Computer, Inc.</i> 991 F.2d 511 (9th Cir. 1993)	17, 19, 21
<i>Matrix Essentials v. Cosmetic Gallery</i> 870 F. Supp. 1237 (D.N.J. 1994)	16
<i>Matrix Essentials v. Quality King Distribs.</i> 522 F. Supp. 2d 470 (E.D.N.Y. 2007)	16
<i>Microsoft Corp. v. DAK Indus., Inc.</i> 66 F.3d 1091 (9th Cir. 1995)	7, 10
<i>Microsoft Corp. v. Software Wholesale Club, Inc.</i> 129 F. Supp. 2d 995 (S.D. Tex. 2000)	20
<i>Microsoft Corp. v. Harmony Computers & Electronics, Inc.</i> 846 F. Supp. 208 (E.D.N.Y. 1994)	20, 21
<i>Morris v. Business Concepts, Inc.</i> 259 F.3d 65 (2d Cir. 2001)	14
<i>Novell, Inc. v. Unicom Sales, Inc.</i> No. C-03-2785, 2004 WL 1839117 (N.D. Cal. Aug. 17, 2004)	7, 19
<i>Parfums Givenchy, Inc. v. Drug Emporium, Inc.</i> 38 F.3d 477 (9th Cir. 1994)	3
<i>Polymer Tech. Corp. v. Mimran</i> 841 F. Supp. 523 (S.D.N.Y. 1994)	16
<i>Quality King Distribs., Inc. v. L'Anza Research Int'l, Inc.</i> 523 U.S. 135 (1997)	3, 23, 24
<i>Sanford v. Memberworks, Inc.</i> No. 02CV0601, 2008 WL 4482159 (S.D. Cal. Sept. 30, 2008)	28
<i>Softman Prods. Co. v. Adobe Sys., Inc.</i> 171 F. Supp. 2d 1075 (C.D. Cal. 2001)	7, 9, 10, 24
<i>Storm Impact, Inc. v. Software of the Month Club</i> 13 F. Supp. 2d 782 (N.D. Ill. 1998)	20
<i>Travelers Prop. Cas. Co. of Am. v. ConocoPhillips Co.</i> 546 F.3d 1142 (9th Cir. 2008)	30

TABLE OF AUTHORITIES
(cont'd)

	<u>Page(s)</u>
<i>Triad Sys. Corp. v. Se. Express Co.</i> 64 F.3d 1330 (9th Cir. 1995)	17, 19
<i>Tripoli Co. v. Wella Corp.</i> 425 F.2d 932 (3d Cir. 1970)	16
<i>United States v. Atherton</i> 561 F.2d 747 (9th Cir. 1977)	7, 12
<i>United States v. Wise</i> 550 F.2d 1180 (9th Cir. 1977)	<i>passim</i>
<i>Vernor v. Autodesk, Inc.</i> 555 F. Supp. 2d 1164 (D. Wash. 2008)	10
<i>Wall Data Inc. v. Los Angeles County Sheriff's Dep't</i> 447 F.3d 769 (9th Cir. 2006)	17, 18
<i>Walsh v. Nev. Dep't of Human Res.</i> 471 F.3d 1033 (9th Cir. 2006)	30
<i>Walt Disney Prods. v. Basmajian</i> 600 F. Supp. 439 (S.D.N.Y. 1984)	5, 8
<i>Wisniewski v. Rodale, Inc.</i> 510 F.3d 294 (3d Cir. 2008)	27
State Cases	
<i>Blakemore v. Superior Court</i> 129 Cal. App. 4th 36 (2005)	27
<i>Clairol, Inc. v. Cody's Cosmetics, Inc.</i> 353 Mass. 385 (1967)	16
Federal Statutes	
17 U.S.C. § 106(3)	3
17 U.S.C. § 109	<i>passim</i>
17 U.S.C. § 117	17, 18, 19, 21
17 U.S.C. § 202	14
17 U.S.C. § 504(c)(2)	22
39 U.S.C. § 3009	<i>passim</i>

TABLE OF AUTHORITIES
(cont'd)

Page(s)

Books & Treatises

2 NIMMER & NIMMER, NIMMER ON COPYRIGHT § 8.12 (2008)..... *passim*

2 PAUL GOLDSTEIN, GOLDSTEIN ON COPYRIGHT § 7.6.1 n.4 (3d ed. 2008)5

4 WILLIAM F. PATRY, PATRY ON COPYRIGHT § 13:15 (2008).....4

MARK A. LEMLEY, PETER S. MENELL, ROBERT P. MERGES & PAMELA SAMUELSON,
SOFTWARE AND INTERNET LAW 314 (3d ed. 2007)13

RAYMOND NIMMER, THE LAW OF COMPUTER TECHNOLOGY § 1.18[1] (1992).....7

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Appellee’s Brief, *Wall Data Inc. v. Los Angeles County Sheriff’s Dep’t*,
No. 03-56559 (9th Cir.) 18

John A. Rothchild, *The Incredible Shrinking First Sale Rule: Are
Software Resale Limits Lawful?*, 57 RUTGERS L. REV. 1, 18 (2004) 12, 21

Joseph P. Liu, *Owning Digital Copies: Copyright Law and the Incidents
of Copy Ownership*, 42 WM. & MARY L. REV. 1245, 1289-94 (2001)5

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Expand*, 87 CAL. L. REV. 17, 34-40 (1999) 21

Randall Roberts, “Confessions of a Promo-CD Junkie: Who Will Stop
The Music Industry Gravy Train?,” LA WEEKLY, Sept. 24, 2008..... 2, 22

Ryan Paul, *Studio Makes Redbox an Offer It Can’t Refuse, Redbox Sues*,
ARS TECHNICA, Oct. 28, 2008.26

I. Introduction

Appellant UMG Recordings, Inc. (“UMG”) asks this Court to endorse a bald and unsupportable fiction: that when it mails free promotional CDs to third parties who never ordered them; never asks for them back; never receives them back; has no idea where they are; and claims them as expenses rather than as assets on its tax returns, it is nonetheless actually only “loaning” those discs to recipients, and thus can dictate, forever, the further disposition of each copy. The law does not elevate form over substance in this way. Instead, courts examine the economic realities of the exchange. And where those realities indicate that ownership in a particular physical copy has changed hands, copyright’s “first sale” doctrine steps in to cut off the copyright holder’s ability to restrain further alienation of the copy.

Measured against this metric, the undisputed facts establish that UMG’s rights to control alienation of these objects are exhausted by UMG’s initial distribution, and cannot be resurrected by the flimsy fiction of stamping the words “Not For Sale” on them. As the leading commentator on copyright law explains: “Toni Morrison, in short, cannot stymie the aftermarket for *Beloved* by wrapping all copies in cellophane and insisting that her readers obtain only a ‘license’ over the books in which they read her words.” 2 NIMMER & NIMMER, NIMMER ON COPYRIGHT (hereafter “NIMMER”) § 8.12[B][1][d][ii] (2008). The judgment of the district court should be affirmed.

II. Argument

The relevant facts are undisputed. Appellee Troy Augusto makes his living selling collectible merchandise on the eBay internet auction site. ER 1139 ¶ 11.

UMG's copyright infringement claim against Augusto is based on his offering 26 promo CDs for sale on eBay. ER Tab 34. It is undisputed that the 26 eBay auctions at issue involved authentic CDs lawfully made and distributed by UMG. It is also undisputed that Augusto purchased the CDs from retailers in the Los Angeles area or on eBay, as is his general practice when acquiring collectibles for resale. ER 1007. Augusto is able to eke out a living buying these collectibles and reselling them on eBay because while Los Angeles secondhand shops are awash in "promo CDs," collectors in other parts of the country cannot purchase those CDs locally. *See* Randall Roberts, "Confessions of a Promo-CD Junkie: Who Will Stop The Music Industry Gravy Train?," LA WEEKLY, Sept. 24, 2008, *available at* <http://www.laweekly.com/2008-09-25/music/who-will-stop-the-music-industry-gravy-train-confessions-of-a-promo-junkie/> ("[F]lip through the used-CD racks at any record store and you'll soon discover the volume of promo product unleashed on the entertainment world—and in no city is this bounty as great as in L.A. Rows and rows of CDs with the words, 'For Promotional Use Only. Not for Sale.'").

At issue here, as it was below, is whether UMG's copyright infringement claim against Augusto is barred by copyright's first sale doctrine. In the words of the district court:

Did UMG transfer title to the music industry insiders when it mailed them the Promo CDs? If the answer is yes, then UMG transferred ownership of the CDs and Augusto lawfully owned the CDs at the time he sold them, which permitted Augusto to sell the CDs under the first sale doctrine. If the answer is no, then UMG retained title to, and ownership of, the CDs and Augusto was not the lawful owner of those CDs at the time he sold them, which excludes Augusto's actions from the protection of

the first sale doctrine.

UMG Recordings, Inc. v. Augusto, 558 F. Supp. 2d 1055, 1059-60 (C.D. Cal. 2008).

A. The first sale doctrine permits the owner of a copy to resell that copy.

The Copyright Act grants to copyright owners the exclusive right to “distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership.” 17 U.S.C. § 106(3).¹ This distribution right, however, is subject to an important limitation:

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

17 U.S.C. § 109(a). “Section 109(a) thus provides a defense to liability under § 106(3) for lawful purchasers of copies of copyrighted materials, so long as the copies were ‘lawfully made under this title.’” *Parfums Givenchy, Inc. v. Drug Emporium, Inc.*, 38 F.3d 477 (9th Cir. 1994).

The Supreme Court has recognized that the first sale doctrine has a “broad scope.” *Quality King Distribs., Inc. v. L’Anza Research Int’l, Inc.*, 523 U.S. 135, 152 (1997). The *Quality King* case reaffirmed a century-old Supreme Court decision, *Bobbs-Merrill Co. v. Straus*, 210 U. S. 339 (1908)—the case whose holding was later codified in § 109. In *Bobbs-Merrill*, a book publisher had placed a label on a bestseller stating that the book’s retail price was \$1.00, and that “no dealer is **licensed** to sell it at a less price.” *Bobbs-Merrill*, 210 U.S. at 341

¹ This case involves only the § 106(3) distribution right. UMG has not alleged that

(emphasis added). Macy’s department store put the book on sale for \$0.89, in contravention of this label, and the publisher sued for infringement of the copyright holder’s exclusive right of distribution—the same right asserted by UMG here. *Id.* at 342. This led the Court to examine copyright’s distribution right:

Was it intended to create a right which would permit the holder of the copyright to fasten, by notice in a book or upon one of the articles mentioned within the statute, a restriction upon the subsequent alienation of the subject-matter of copyright after the owner had parted with the title to one who had acquired full dominion over it and had given a satisfactory price for it?

* * *

In our view, the copyright statutes, while protecting the owner of the copyright in his right to multiply and sell his production, do not create the right to impose, by notice, such as is disclosed in this case, a limitation at which the book shall be sold at retail by future purchasers, with whom there is no privity of contract.

210 U.S. at 350-51.² Thus, for more than a hundred years, the Supreme Court has held that a copyright owner may not restrict the “subsequent alienation” of copies, even when the copyright holder has affixed a “notice” that purports to dictate whether or not resale is “licensed.”

Although this statutory limitation is known as the “first sale” doctrine, it does not require a “sale”—it is triggered by the “first authorized disposition by which title passes.” 2 NIMMER § 8.12[B][1][a]; *accord* 4 WILLIAM F. PATRY,

Augusto infringed any other exclusive right protected by the Copyright Act.

² UMG attempts to distinguish *Bobbs-Merrill* on the ground that the price restriction was “imposed *after* the sale and transfer of a work.” Blue Br. at 34 (emphasis in original). But the same is true here: just as in *Bobbs-Merrill*, in which the purported license appeared inside the book on its title page, the label language here appears on the CD itself, in an attempted after-the-fact restriction.

PATRY ON COPYRIGHT § 13:15 (2008) (“Since the principle [of first sale] applies when copies are given away or are otherwise permanently transferred without the accoutrements of a sale, ‘exhaustion’ is the better description.”). There is uniform agreement among courts and commentators that § 109 applies to gifts as well as sales. *See, e.g., Walt Disney Prods. v. Basmajian*, 600 F. Supp. 439, 442 (S.D.N.Y. 1984) (“Title may be transferred by gift.”); 2 NIMMER § 8.12[B][1][a] (“[A]lthough the initial disposition of that copy may be a sale, the identical legal conclusion applies to a gift or any other transfer of title in the copy.”); 2 PAUL GOLDSTEIN, GOLDSTEIN ON COPYRIGHT § 7.6.1 n.4 (3d ed. 2008) (“[A] gift of copies or phonorecords will qualify as a ‘first sale’ to the same extent as an actual sale for consideration.”).

The first sale doctrine serves a critical function in the copyright scheme, balancing the intangible property interests of copyright owners with the tangible property interests of purchasers. *See* Joseph P. Liu, *Owning Digital Copies: Copyright Law and the Incidents of Copy Ownership*, 42 WM. & MARY L. REV. 1245, 1289-94 (2001). Were it not for the first sale doctrine, the everyday activities of lending libraries, video rental shops, and secondhand bookstores would all infringe a copyright owner’s distribution right, as would selling a book at a garage sale or loaning a DVD to a friend.

While copyright owners may complain about the effect that these “competitors” have on their primary markets, Congress and the courts have repeatedly rejected efforts to extend the rightsholder’s control over the distribution of material objects beyond the first transfer of ownership. *Id.* at 1293-94

(describing failed legislative efforts by copyright holders to obtain control over the lending of books and the sale of used CDs). As described in more detail below, UMG and its affiliated *amicus*, the Recording Industry Association of America,³ ask this Court to find that a mere label can trump the first sale doctrine, an end-run that is not only impermissible in this instance, but that would threaten to open a Pandora's Box of use restrictions (*e.g.*, “this textbook for use during one semester only” or “personal use only, not for library lending”) that would render the first sale doctrine a dead letter.

B. Because Augusto was the owner of the CDs he bought, he was entitled to resell them.

UMG does not argue that a factual dispute precludes summary judgment, instead arguing that, as a matter of law, Augusto was not an “owner” of the CDs he bought. But looking to the economic realities of the transaction, the district court correctly concluded that Augusto did own the CDs, and was entitled to exercise his rights as an owner under § 109(a).

1. Courts examine the economic realities of an exchange, rather than labels used by the parties, to determine whether a first sale has occurred.

In evaluating whether there has been a “first authorized disposition by which title passes” triggering the first sale doctrine, courts look behind the form to the

³ The RIAA's *amicus* brief does not mention that UMG is a member of that trade group. This is particularly surprising given that UMG is the *largest* member of the RIAA, and controls five seats on its Board of Directors. *See* http://www.riaa.com/aboutus.php?content_selector=who_we_are_board (listing two directors affiliated with “Universal Music Group” and one each from UMG subsidiaries Interscope Records, Island Records, and Universal Motown Republic

substance of a transaction. “Because we look to the economic realities of the agreement, the fact that the agreement labels itself a ‘license’ . . . does not control our analysis.” *Microsoft Corp. v. DAK Indus., Inc.*, 66 F.3d 1091, 1905 n.2 (9th Cir. 1995) (finding a transfer of ownership where the recipient of a copy of the copyrighted work “received all of its rights under the agreement when the term of the agreement commenced”). “It is well-settled that in determining whether a transaction is a sale, a lease, or a license, courts look to the economic realities of the exchange.” *Softman Prods. Co. v. Adobe Sys., Inc.*, 171 F. Supp. 2d 1075, 1084 (C.D. Cal. 2001) (concluding that distribution of software triggered first sale, notwithstanding plaintiff’s claim that software was only “licensed”). “In determining whether a transaction is a sale or license, the Court reviews the substance of the transaction, rather than simply relying on the plaintiff’s characterization of the transaction.” *Novell, Inc. v. Unicom Sales, Inc.*, No. C-03-2785, 2004 WL 1839117 at *9 (N.D. Cal. Aug. 17, 2004). “Ownership of a copy should be determined based on the actual character, rather than the label, of the transaction by which the user obtained possession.” *Applied Info. Mgt. Inc. v. Icart*, 976 F. Supp. 149, 154 (E.D.N.Y. 1997) (quoting RAYMOND NIMMER, THE LAW OF COMPUTER TECHNOLOGY § 1.18[1] (1992)).

In a line of cases extending back more than thirty years, this Court and its sister Courts of Appeals have applied that rule to find that the first sale doctrine applied even in cases where the copyright holder maintained that there had been no transfer of ownership because of a “licensing agreement.” *See, e.g., United States*

Group).

v. Wise, 550 F.2d 1180, 1190-92 (9th Cir. 1977) (holding that a transaction denominated as a “licensing agreement” nonetheless amounted to a first sale); *United States v. Atherton*, 561 F.2d 747, 750 (9th Cir. 1977) (same); *Krause v. Titleserv, Inc.*, 402 F.3d 119, 124 (2d Cir. 2005) (examining substance of software “licensing” transaction and concluding that defendant was the owner of a copy).

This Court’s decision in *United States v. Wise* is particularly instructive. At issue in *Wise* were transactions in which movie studios sent prints of certain films to industry insiders. *Wise*, 550 F.2d at 1192. This Court looked most closely at a contract entered into between Warner Brothers and actress Vanessa Redgrave. *Id.* The studio gave Ms. Redgrave a print of the movie *Camelot* in return for a payment of \$401.59⁴ and a promise to use the print only for “personal use and enjoyment,” and not to sell, lease, license, or loan the print. *Id.* In adjudicating the defendant’s first sale defense, this Court found that the substance of the transaction was a “sale with restrictions on the use of the print,” and that there had been a transfer of ownership to Ms. Redgrave. *Id.* This Court distinguished another such contract in which a print of the movie *Paper Moon* was given to its director Peter Bogdanovich with the express condition that the print be returned upon the studio’s request; with such a restriction, the court found that there had been no transfer of ownership. *Id.*

In *Krause v. Titleserv*, the Second Circuit followed the *Wise* rule, holding

⁴ UMG makes much of the presence of a payment in *Wise*, attempting to distinguish that case on the ground that the “promo CDs” at issue here were free. Blue Br. at 22. But as noted above, the presence or absence of a payment is irrelevant in determining whether the first sale doctrine applies. *See, e.g., Walt*

that a person is an “owner” for purposes of the first sale doctrine when their “degree of ownership of a copy is so complete that he may lawfully use it and keep it forever, or if so disposed, throw it in the trash.” 402 F.3d at 123. The court noted that allowing the first sale inquiry to turn on state law idiosyncrasies regarding the transfer of formal title in a chattel “would contradict the Copyright Act’s ‘express objective of creating national, uniform copyright law by broadly preempting state statutory and common-law copyright regulation.’” *Id.* (quoting *Comm. for Creative Non-Violence v. Reid*, 490 U.S. 730 (1989)). The court concluded:

We conclude for these reasons that formal title in a program copy is not an absolute prerequisite to qualifying for § 117(a)’s affirmative defense. Instead, courts should inquire into whether the party exercises sufficient incidents of ownership over a copy of the program to be sensibly considered the owner of the copy for purposes of § 117(a). The presence or absence of formal title may of course be a factor in this inquiry, but the absence of formal title may be outweighed by evidence that the possessor of the copy enjoys sufficiently broad rights over it to be sensibly considered its owner.

Id. at 124. Thus, where there are sufficient “incidents of ownership” of a copy, such as the right to “use it and keep it forever,” one is an “owner” of a copy, notwithstanding “the presence or absence of formal title.” *Id.* at 123-24.

Numerous district courts have followed the *Wise* rule. For example, in *Softman Products Co. v. Adobe Systems, Inc.*, 171 F. Supp. 2d 1075 (C.D. Cal. 2001), the court vacated its previous grant of preliminary injunction against the distribution of certain licensed software in contravention of the terms of the license. The copyright holder, Adobe, had asserted that because its software was

Disney Prods., 600 F. Supp. at 442.

licensed, there was no transfer of ownership, and the first sale doctrine did not apply. The court rejected Adobe's argument, holding that "the substance of the transaction at issue here is a sale and not a license." 171 F. Supp. 2d. at 1087. In analyzing the question, this Court looked to "the circumstances surrounding the transaction," finding that they "strongly suggest[] that the transaction is in fact a sale rather than a license." *Id.* at 1085 (citing *Microsoft Corp.*, 66 F.3d at 1091). For example, the court observed that "the license runs for an indefinite term without provisions for renewal," that Adobe had received "full value for the product," and that Adobe had passed on to the software's recipients all "risk that the product may be lost or damaged." *Id.* See also *Vernor v. Autodesk, Inc.*, 555 F. Supp. 2d 1164 (D. Wash. 2008) (applying the *Wise* rule and adopting the same analysis as the *Softman* court).

2. The economic realities of the promo CD transaction point to a transfer of ownership.

With respect to the "promo CDs" at issue here, the facts surrounding the "economic realities" of the transactions are not in dispute—at issue is the legal consequence that flows from those facts. Taken together, the following facts indicate that ownership of the CDs passed from UMG to their initial intended recipients:

- "Promo CDs" are mailed unsolicited to recipients, ER 960 ¶ 21;
- UMG has never made any efforts to retrieve "promo CDs" from recipients, ER 956 ¶ 12;
- UMG has no plans to ask any recipients to return "promo CDs," ER

954 ¶ 10; *see* RIAA Br. at 16 (“Nor are Insiders requested to physically return Promotional CDs.”);

- UMG has no knowledge of any “promo CD” of the kind at issue here ever being returned after having been received by an intended recipient, ER 955 ¶ 11; *see* RIAA Br. at 11 (“Promotional CDs are virtually never refused or returned by the intended addressee.”);
- Nothing on the packaging of “promo CDs” intimates that they must ever be returned to UMG, ER 961 ¶ 23;
- UMG does not keep permanent records of who received any particular “promo CD,” ER 956 ¶ 13; RIAA Br. at 16 (“records are not kept as to which particular Promotional Copy was received by which specific Insider”);
- UMG does not take any steps to mark the “promo CDs” for later tracking, *see* RIAA Br. at 16 (“Individual copies are not watermarked, coded, or otherwise individually labeled[.]”);
- There is no indication on the “promo CDs” that the recipient will be responsible for any loss or destruction of the “promo CDs,” ER 962 ¶ 24;
- UMG does not insure “promo CDs” in the possession of intended recipients against loss or damage, ER 962 ¶ 25;
- UMG acknowledges that “promo CDs” have no value to UMG other than for their promotional impact in the hands of intended recipients (ER 962 ¶ 26)—and accordingly, once they have been received, UMG

has received full value for them;

- UMG treats the “promo CDs,” for tax purposes, as expenses—that is, as if it no longer owns them. ER 1513 & 1524.

In short, those to whom UMG mails “promo CDs” enjoy all the principal hallmarks of ownership: their possession is unlimited in time, they are under no obligation to promote—or even listen to—the CDs, they need never return the CDs, and there is no indication of any consequence to them should the CDs be lost, damaged or destroyed. UMG, for its part, also behaves as though it has parted with ownership: it does not keep records regarding the whereabouts of the CDs, nor has it ever sought their return from the recipients. UMG, moreover, is guaranteed no recurring benefit from the recipients’ continued possession of the CDs, and does not account for them as corporate assets. ER 1513 & 1524.

The district court below considered all of these “economic realities,” and concluded that “title to the CDs is transferred to the insiders.” 558 F. Supp. 2d at 1062. UMG is therefore mistaken when it argues that the district court “focused on the single element of whether the recipient’s right to possession of the work is indefinite.” Blue Br. at 19. The district court expressly considered all of the factors described above in examining the “economic realities” behind UMG’s promo CD distribution program.

The district court’s ruling is also entirely consistent with the precedents of this Court, which have concluded in similar circumstances that a conveyance of a film with use restrictions, but without any obligation to return it, triggers the first sale doctrine. *See Atherton*, 561 F.2d at 750-51 (even a “sale to a purchaser with

restrictions that are subsequently breached constitutes a first sale”); *Wise*, 550 F.2d at 1190-92; *accord* MARK A. LEMLEY, PETER S. MENELL, ROBERT P. MERGES & PAMELA SAMUELSON, *SOFTWARE AND INTERNET LAW* 314 (3d ed. 2007) (“almost all courts and commentators to have considered the issue have concluded that a shrinkwrap license transaction involving software is a sale of goods”); John A. Rothchild, *The Incredible Shrinking First Sale Rule: Are Software Resale Limits Lawful?*, 57 RUTGERS L. REV. 1, 18 (2004) (arguing that the “statute requires” an analysis in which “sales-with-restrictions” are deemed to “constitute a first sale”).

3. The label on the CD does not affect ownership of the CD.

Ignoring the array of undisputed facts that establish that title passes upon its initial distribution of promo CDs, UMG instead insists that the “promotional use only” legend affixed to “promo CDs” operates as a talisman to ward off the first sale doctrine in perpetuity. But these labels cannot carry the legal weight UMG has asked them to bear.

As an initial matter, nine of the 26 “promo CDs” at issue bore only the following legend: “Promotional Use Only—Not for Sale.”⁵ Thus, with respect to fully one-third of the CDs at issue, there is no evidence that they were the subject of *any* contractual “license agreement” when received from UMG by their initial recipients. The remaining 17 CDs Augusto listed on eBay bore a more lengthy legend:

This CD is the property of the record company and is licensed for the intended recipient for promotional use only. Acceptance of this CD shall

⁵ See ER 646, 648, 650, 652, 662. Augusto sold multiple copies of some of these CDs, totaling nine auction listings at issue.

constitute an agreement to comply with the terms of the license. Resale or transfer of possession is not allowed and may be punishable under federal and state laws.⁶

But this legend does nothing to change the substance of the transaction: UMG gives the CDs away, never to be returned. Here, as in *Wise*, the substance of the transaction is a transfer of ownership: recipients are given these CDs unsolicited, and are entitled to keep the CDs forever without any future payment or further obligation to UMG. UMG, for its part, receives the full promotional value it sought to achieve from these “promo CDs,” has no mechanism for tracking or replacing lost or damaged “promo CDs,” and treats them for tax purposes as if it no longer owns them.

a. One can be a party to a licensing contract while also being the owner of a particular copy.

UMG responds with the assertion that the labels affixed to promo CDs create a “license,” and that “licenses” render the first sale doctrine a nullity. UMG’s argument fundamentally misapprehends the relationship between contractual licenses and ownership of a particular phonorecord: the two are not, as UMG contends, mutually exclusive. As the Federal Circuit has explained, “a party who purchases copies of software from the copyright owner can hold a license under the copyright while still being an ‘owner’ of a copy of the copyrighted software[.]” *DSC Commc’ns Corp. v. Pulse Commc’ns, Inc.*, 170 F.3d 1354, 1360

⁶ See ER 641, 643, 654, 656, 657, 660, 665, 668, 671, 673. Augusto sold multiple copies of some of these CDs, totaling seventeen auction listings at issue.

(Fed. Cir. 1999).⁷ “Even if the copyright holder places restrictions on the purchaser in a first sale . . . , the buyer’s disregard of the restrictions on resale does not make the buyer or the person who buys in the secondary market liable for infringement.” *Am. Int’l Pictures v. Foreman*, 576 F.2d 661, 664 (5th Cir. 1978).

It is axiomatic that “ownership of a copyright . . . is distinct from ownership of any material object in which the work is embodied.” 17 U.S.C. § 202.⁸ The first sale doctrine is solely concerned with ownership of the material object: if ownership in a particular copy or phonorecord has changed hands, a copyright owner’s exclusive right of distribution over that particular copy or phonorecord is exhausted. 17 U.S.C. § 109. The relevant question for purposes of § 109 is not whether something is denominated a “license,” but rather whether, considering the “economic realities” of the transaction, the recipient “exercises sufficient incidents of ownership over a copy . . . to be sensibly considered an owner of the copy.” *Krause v. Titleserv*, 402 F.3d at 124.

UMG asks this court to “transform a contractual term that [record companies] unilaterally include in their contracts into a binding provision on the

⁷ In support of the contrary proposition, UMG cites *Morris v. Business Concepts, Inc.*, 259 F.3d 65, 70 (2d Cir. 2001). But the holding of *Morris*—that a licensee of a copyright does not own *the copyright*—has nothing to do with the question of whether a licensee can own *a particular physical copy*.

⁸ For example, an aspiring author might give a copy of his book to a movie producer, simultaneously entering into a license agreement that authorizes the creation of a screenplay based on the book (something that would, in the absence of a license, implicate the author’s exclusive right to prepare derivative works). There is no question that the movie producer owns the particular copy of the book and is free to resell it thanks to the operation of the first sale doctrine, notwithstanding the existence of a license to the underlying copyrighted work.

world—even on parties who are not in privity of contract—and one that, moreover, undoes the dictates of Congress by undermining an essential feature of the Copyright Act!” 2 NIMMER § 8.12[B][1][d][i]. As discussed above, the undisputed facts here establish that the recipients of promo CDs enjoy all the hallmarks of ownership. Accordingly, whether or not they are subject to some contractual “license agreement,” the first sale doctrine bars an infringement action against downstream purchasers like Augusto. The Court should reject this unprecedented effort by UMG to stage an end-run against the statutory command of § 109.

b. Mere labels do not prevent transfer of ownership.

In analogous circumstances, courts have consistently found that label notices like UMG’s do *not* prevent transfer of ownership. For example, makers of hair care products frequently place prominent labels on their products stating “Professional Use Only – Not To Be Sold at Retail,” or words to that effect. None of the numerous courts that have considered such labels has found them to prevent transfer of ownership. *See, e.g., Tripoli Co. v. Wella Corp.*, 425 F.2d 932, 941 (3d Cir. 1970) (enforcement of legend on products “marked ‘for professional use only’ not to be sold retail” would be “a serious restriction on freedom of trade and competition”); *Matrix Essentials v. Quality King Distribs.*, 522 F. Supp. 2d 470, 478-79 (E.D.N.Y. 2007) (finding that the trademark first sale doctrine barred enforcement of “professional use only” restriction); *Matrix Essentials v. Cosmetic Gallery*, 870 F. Supp. 1237, 1241 (D.N.J. 1994) (refusing to enforce a legend stating “For professional use. Not for retail sale.”); *Polymer Tech. Corp. v.*

Mimran, 841 F. Supp. 523, 529-30 (S.D.N.Y. 1994) (no valid claim for unauthorized distribution despite plaintiff’s “expression of intent so to restrict sales by labeling its products ‘For Professional Use Only.’”).

Nor will label notices create an “implied equitable servitude upon the chattel,” that runs with the property, such restraints on alienation being disfavored at common law. *Clairol, Inc. v. Cody’s Cosmetics, Inc.*, 353 Mass. 385, 393 (1967) (finding labels stating “For Professional Use” to have no legal significance).

4. The computer software cases are not to the contrary.

In attempting to support its view that a simple “not for sale” notice on a CD precludes the operation of the first sale doctrine, UMG relies exclusively on cases dealing with computer software. Each is wholly distinguishable from this case.

a. This Court’s cases dealing with 17 U.S.C. § 117 do not affect the analysis.

UMG principally relies on three computer software cases: *Wall Data Inc. v. Los Angeles County Sheriff’s Department*, 447 F.3d 769 (9th Cir. 2006), *Triad Systems Corp. v. Southeast Express Co.*, 64 F.3d 1330 (9th Cir. 1995), and *MAI Systems, Inc. v. Peak Computer, Inc.*, 991 F.2d 511, 518-519 (9th Cir. 1993).

In *Wall Data*, this Court considered whether the district court committed an abuse of discretion by declining to instruct the jury regarding the defense set forth in 17 U.S.C. § 117, which is only available to defendants who own a copy of software. In considering the question, the Court indicated in *dicta* that the district court had not erred because the applicable license agreement “imposed severe

restrictions” on the defendant. *Id.* at 785.

Nothing in *Wall Data* supports UMG’s Manichean view of a world divided into “licensees” and “owners.” The *Wall Data* panel’s reliance on the “severe restrictions” to which the licensee was subject suggests that it was focused on the substance of the transaction, rather than on the simple fact of a license agreement between the parties. As *Wall Data* itself argued in its brief on appeal:

The licenses granted LASD less rights than an “owner” would enjoy — among other things, the licenses expressly state that: Wall Data owns the software, and all associated patents, copyrights, trade secrets and other proprietary rights; no title or ownership of the software is transferred to the licensee by the license; the licensee can only use the software on a Single Designated Computer; while the software can be transferred, such transfer can only take place once every thirty (30) days; and, the licensee cannot sell, rent, license, lend or otherwise transfer the software.

Appellee’s Brief in *Wall Data Inc. v. Los Angeles County Sheriff’s Dep’t*, No. 03-56559 (9th Cir.), *available at* 2004 WL 3389284. As discussed in more detail above, the substance of the transaction in the instant appeal could hardly be more different from that at issue in *Wall Data*. Far from imposing “severe restrictions” on the recipients of promo CDs, UMG imposed no restrictions on them at all (other than attempting to override the first sale doctrine). Every recipient was free to keep the CDs in perpetuity, with no obligation to pay for or return them, nor even to listen to the CDs.

Moreover, this court’s discussion of the issue of ownership in *Wall Data* was dicta, and the opinion expressly stated that its ultimate holding was based entirely on another ground. In *Wall Data*, the appellant maintained that the district court had abused its discretion by failing to instruct the jury regarding its defense under

17 U.S.C. § 117. *Id.* at 784. That defense would have required the appellant to prove (1) that it was the owner of a copy of the relevant software, and (2) that its copying had been an essential step in the utilization of that software. *Id.* This Court held that the copying was not an essential step, so the § 117 defense was inapplicable, and any error was harmless. *Id.* at 785-86. After briefly discussing the other element—whether the appellant was an owner of a copy—this Court recognized that the discussion was not necessary for its decision, stating, “the Sheriff’s Department’s ‘essential step’ defense fails for a more fundamental reason—that hard drive imaging was not an essential step of installation—and thus any error is harmless.” *Wall Data*, 447 F.3d at 786 n.9.

In *Triad*, the court found that there was no transfer of ownership in a situation where the recipient of the relevant software had the ongoing obligation to pay a “license transfer fee” to the copyright holder each time the computer on which the software ran was resold. *Triad Sys. Corp.*, 64 F.3d at 1333. In the presence of this ongoing relationship, along with other strict rules about who was permitted to use the software, the court found that there was no transfer of ownership.⁹

In *MAI*, the court stated in a footnote, without any accompanying analysis or citations, that the defendant was not an “owner” of a particular piece of plaintiff MAI’s software for purposes of § 117 “[s]ince MAI licensed its software.” *MAI*,

⁹ Similarly, the district court in *Novell v. Unicom Sales, Inc.*, 2004 WL 1839117 at *9, concluded that the defendant did not own the software in question based on the limited term of the license, a recurring annual license fee, and the requirement that software be returned at the conclusion of the license term.

991 F.2d 511, 519 n.5. But that statement is out of place: MAI did not assert a § 117 defense, and the point is relevant only to explain one of the authorities cited by the court in support of its holding that the copying of software into RAM can be copyright infringement. *See MAI* at 519 (citing *Apple Computer Inc. v. Formula Intern., Inc.*, 725 F.2d 521, 523 (9th Cir. 1984)). Far from a pronouncement of a new legal doctrine, the *MAI* footnote is an offhand comment that helps explain the applicability of the *Apple Computer* case on an unrelated issue.

These cases are in harmony with the cases and commentary cited above that examine actual character, rather than the merely the label, of a transaction in order to determine whether a first sale has occurred.

b. The district court cases cited by UMG base their holdings on the unique nature of distributing software.

Another case relied upon heavily by UMG, *Adobe Systems, Inc. v. One Stop Micro, Inc.*, 84 F. Supp. 2d 1086, 1092 (N.D. Cal. 2000), explicitly bases its holding on “the unique nature of distributing software,” relying on a declaration stating that ordinary copyright principles are insufficient in the software context because “[t]he rate of change of technology is orders of magnitude greater than the ability of intellectual property laws to keep up.” 84 F. Supp. 2d. at 1092. And the court in *Microsoft Corp. v. Harmony Computers & Electronics, Inc.*, 846 F. Supp. 208 (E.D.N.Y. 1994) had before it “samples of seized ‘counterfeit’ Microsoft Products from defendants’ premises,” 846 F. Supp. at 212—showing that, whether or not defendants were “the owner[s] of a particular copy or phonorecord,” 17 U.S.C. § 109(a), those copies were not, as the first sale doctrine requires, “lawfully

made.” *Id.*; see also *Microsoft Corp. v. Software Wholesale Club, Inc.*, 129 F. Supp. 2d 995, 1006 (S.D. Tex. 2000) (defendant was distributing counterfeit software that was not lawfully made).

The remaining software cases cited by UMG are similarly inapposite. In *ISC-Bunker Ramo Corp. v. Altech, Inc.*, 765 F. Supp. 1310 (N.D. Ill. 1990), the defendant infringed the reproduction right, which does not fall within the scope of the first sale doctrine. See *id.* at 1314, 1326, 1331. And the decision in *Storm Impact, Inc. v. Software of the Month Club*, 13 F. Supp. 2d 782 (N.D. Ill. 1998), turned on the fair use doctrine, not first sale. *Id.* at 787.

To the extent these decisions have been read to support the view that software licenses necessarily trump § 109, they have been roundly criticized by other courts and leading copyright commentators. For example, Professor Nimmer declares that “if the court [in *Microsoft v. Harmony*] inferred simply from the fact that the copyright to the software was licensed to end-users that Section 109(a) was therefore somehow inapplicable, then it entirely misunderstood the first sale doctrine.” 2 NIMMER § 8.12[B][1][d][i]. Nimmer further concludes that “the *Adobe v. One Stop* gloss on *Microsoft v. Harmony* is untenable.” *Id.*; see also John A. Rothchild, *The Incredible Shrinking First Sale Rule: Are Software Resale Limits Lawful?*, 57 RUTGERS L. REV. 1, 37-43 (2004) (criticizing *Microsoft v. Harmony*); Nimmer, Brown & Frischling, *The Metamorphosis of Contract Into Expand*, 87 CAL. L. REV. 17, 34-40 (1999) (same). No court has ever extended the rationale of these cases to cover music CDs, nor has UMG suggested any reason why this Court should be the first to do so.

The critical difference between software and music CDs is that often one *needs* a license to make ordinary uses of computer software: computers cannot do anything without copying data into RAM, and it is common that computer programs must be copied onto a hard drive even before they can be copied yet again into RAM. *See MAI*, 991 F.2d at 518-519. While some of these copies are privileged under 17 U.S.C. § 117, some are not. Thus, because many ordinary computer uses might infringe copyright but for some license or applicable exception, a license is generally needed where software is concerned. No comparable license is needed to play a music CD.

This is why, even if UMG's purported "license" had any legal weight at all, a breach would have to be remedied in *contract* law, not as a copyright infringement. UMG is attempting to transform what is, at best, a contract or a conversion claim against the original recipient into a claim for copyright infringement against any and all downstream purchasers. Its reasons for doing so are easy to discern: UMG dare not risk offending the "taste-makers" to whom it sends the CDs, despite the fact that many of those recipients regularly sell promo CDs to used record stores.¹⁰ Moreover, UMG contends that the CDs are of no continuing value to it, and thus the damages from a contract or conversion claim would be nonexistent. But in copyright, a plaintiff is entitled to pursue downstream purchasers, rather than the taste-makers, and seek statutory damages

¹⁰ *See Roberts, supra* ("I have a box under my desk, and it's filled up every two weeks," says one editor of a prominent national music magazine. "I really do try to listen to most of what comes in. And then I'll keep the things that I really like." The discs then go to a communal table for the staff. "The things that don't get taken

of up to \$150,000 per work even without showing any damage. 17 U.S.C. § 504(c)(2). This Court should not countenance UMG's attempt to leverage what would be a valueless contract or conversion claim into a copyright remedy.

5. Augusto has sufficiently demonstrated a chain of title derived from a first sale.

Because Augusto has shown that he bought the CDs at issue, and that UMG gave away all of the CDs of that type, he has shown that he is an owner of the CDs, as set forth below. He has thus satisfied his burden of demonstrating ownership under Section 109.

a. It is undisputed that Augusto was a good faith purchaser of the CDs.

UMG argues that the burden is on Augusto to demonstrate a chain of title that leads back to an initial transfer of ownership sufficient to trigger § 109. Augusto's undisputed evidence establishes two propositions that, taken together, show that he is the "owner of a particular phonorecord" within the meaning of § 109(a).

First, Augusto has established that UMG's delivery of "promo CDs" to their initial recipients constitutes a "first authorized disposition by which title passes," thus triggering § 109. *See* 2 NIMMER § 8.12[B][1][a]. Once such a disposition is shown, a copyright owner's authority to control further "downstream" resales is exhausted. *Quality King Distribs.*, 523 U.S. at 152 ("The whole point of the first sale doctrine is that once the copyright owner places a copyrighted item in the stream of commerce by selling it, he has exhausted his exclusive statutory right to off the free table, I sell."").

control its distribution.”).

Second, Augusto has produced evidence that he purchased the “promo CDs” in question on eBay or from secondhand stores in the Los Angeles area, thus establishing that he became the lawful owner of the CDs in question. ER 203. Augusto testified regarding his regular business practice of purchasing “promo CDs” from these stores, and that he has no reason to believe that the 26 CDs at issue were obtained in any other manner. *Id.* Documentary evidence, in the form of purchase receipts, corroborates his testimony regarding his regular business practice. ER 207-65. This undisputed evidence shows that Augusto purchased the particular “promo CDs” at issue here in accordance with his usual practice. In view of Augusto’s showing of a good chain of title to the CDs, the burden is on UMG to come forward with evidence that Augusto came by the CDs in some other manner. But UMG has come forward with no such evidence.

Augusto has thus shown that that *all* UMG “promo CDs” are subject to a prior first disposition by which title passed, and thus Augusto’s subsequent downstream purchase and resale of such CDs comes within the scope of § 109. In the words of the Supreme Court, “[a]fter the first sale of a copyrighted item ‘lawfully made under this title,’ any subsequent purchaser . . . is obviously an ‘owner’ of that item.” *See Quality King v. L’Anza*, 523 U.S. at 136. Where the evidence shows that a copyright owner routinely authorized first sales of an entire category of works, that alone is enough to “shift the burden back to the plaintiffs.” *Am. Int’l Pictures*, 576 F.2d at 665; *accord Softman Prods. Co. v. Adobe Sys., Inc.*, 171 F. Supp. 2d at 1084-89 (holding that defendant was the “owner” of software

on the basis of evidence regarding Adobe's general distribution practices); 2 NIMMER § 8.12[B][1][d] at n.37.57 (“[T]he lesson must be that to the extent the defendant can trace the copy in his possession back to a previous source, and that source . . . was not required to return the subject copy to the copyright owner upon demand (or other incidents of ‘sale’ are present), then the defense is fully applicable.”).

b. Requiring a showing of a full chain of title would lead to absurd results.

UMG's view of the “chain of title” burden faced by a defendant that invokes the first sale doctrine is untenable. Where a work is routinely subject to upstream “first sales,” requiring evidence of a perfect chain of title would lead to absurd results, potentially exposing millions of consumers to unexpected copyright liability.¹¹ For example, if § 109 required a showing of a particularized chain of title for each individual copy, then an individual would be vulnerable to an infringement action if she lent a book to a friend unless she could marshal receipts and records tracing title all the way back to the publisher. Similar documentation would be required before anyone could sell a CD to a used record store. In fact, UMG contends that *throwing away* copyrighted material constitutes an “unauthorized distribution,” thus creating the specter of “chain of title” audits for consumers on trash day. ER 920.

¹¹ The cases insisting on a complete chain of title involved copies of works that were not widely distributed, such as films prior to the advent of videocassettes. *See, e.g., Amer. Int'l Pictures v. Foreman*, 576 F.2d at 664; 2 NIMMER § 8.12[B][1][c] (discussing first sale treatment of stray copies of largely undistributed works).

Imposing an onerous chain-of-title record-keeping burden on every citizen is not what Congress had in mind when enacting § 109. Under the scheme enacted by Congress, it is enough for a downstream reseller to show that the copyright owner's distribution practices result in a "first authorized disposition by which title passes." 2 NIMMER § 8.12[B][1][a]. This is precisely what Augusto has shown here.

No doubt UMG will continue to argue in its response that books, DVDs, and non-promotional CDs are not at issue in this case.¹² See Blue Br. at 38. But UMG has never answered the most critical question it faces: if UMG's view of the law is correct, what legal theory would prevent Toni Morrison from eliminating the aftermarket for *Beloved* by placing a "Licensed for personal use only, not for resale" label on the cover? 2 NIMMER § 8.12[B][1][d][ii]. And what legal theory would prevent UMG from placing that language on its non-promotional CDs, or Universal Studios from placing similar language on DVDs banning rentals?¹³

¹² Indeed, UMG's trade group has already deployed this argument. See RIAA Br. at 3 n.2 ("Commercial copies sold to the public are not subject to license restrictions."). Of course, on UMG's theory, that would change if they simply put a "Licensed, not sold" label on the commercial CDs.

¹³ This is not merely a hypothetical concern. Universal Studios has recently taken to threatening wholesalers who sell DVDs to Redbox, a company which rents DVDs from automated kiosks. See Ryan Paul, *Studio Makes Redbox an Offer It Can't Refuse, Redbox Sues*, ARS TECHNICA, Oct. 28, 2008, at <http://arstechnica.com/tech-policy/news/2008/10/universal-studios-attacks-dvd-rental-kiosks.ars>. But for the first sale doctrine, these DVD rentals would infringe Universal Studios' distribution right.

C. Even if the label creates a licensing contract that would otherwise affect ownership of the CD, the CD may be treated as a gift under § 3009 notwithstanding the contract.

Augusto urges this Court to follow the *Wise* rule and hold that, because they were given away for an unlimited time with no provision for return, ownership passed to the industry insiders who received the “promo CDs.” But, as the district court found, Augusto is also entitled to summary judgment on another, entirely independent ground.

Under federal postal and competition law, UMG, by shipping unordered “promo CDs,” made a gift of the CDs to those who received them. As the district court found below, the recipients thus had good title to the CDs, and were entitled to give or sell the CDs to the thrift stores, secondhand music shops, and eBay sellers from whom Augusto purchased them.

Under 39 U.S.C. § 3009, any “unordered merchandise” “may be treated as a gift by the recipient, who shall have the right to retain, use, discard, or dispose of it in any manner he sees fit without any obligation whatsoever to the sender.” 39 U.S.C. § 3009(a) & (b). “Unordered merchandise” means any “merchandise mailed without the prior expressed request or consent of the recipient.” 39 U.S.C. § 3009(d). As the Third Circuit recently held, “§ 3009(b)’s language is ‘rights-creating.’” *Wisniewski v. Rodale, Inc.*, 510 F.3d 294, 302 (3d Cir. 2008). That is, it “create[s] a personal right for recipients to treat unsolicited merchandise as a gift.” *Id.*

Accordingly, any recipient of a UMG promotional CD is free to “retain, use, discard, or dispose of it in any manner he sees fit without any obligation

whatsoever” to UMG. 39 U.S.C. § 3009(b). Thus, good title passed to the charity thrift shops and secondhand record stores to which the original recipients gave or sold their promotional CDs, and Augusto took good title when he purchased the CDs from those outlets.

The RIAA argues in its brief that the statute is inapplicable because the original recipients of the “promo CDs” are not “consumers.” RIAA Br. at 18. But the word “consumer” appears nowhere in § 3009, and the relevant inquiry is not whether the CDs were sent to consumers, but rather whether the CDs were “merchandise mailed without the prior expressed request or consent of the recipient.”¹⁴ 39 U.S.C. § 3009(d). Here, the undisputed facts show that the CDs were such “unordered merchandise.”

1. The CDs were “merchandise.”

UMG argues in passing that the promotional CDs do not qualify as “merchandise” as that term is used in § 3009. Blue Br. at 42-43; *contra Great Am. Music Mach., Inc. v. Mid-South Record Pressing Co.*, 393 F. Supp. 877, 884 (M.D. Tenn. 1975) (holding that promotional vinyl records were “unordered merchandise” under § 3009). UMG argues that sale is the hallmark of “unordered merchandise.” Blue Br. at 43. But this argument is defeated by the plain language of § 3009, which includes as “unordered merchandise” even “free samples” when

¹⁴ Even if the identity of the recipient were relevant, this argument is still unavailing. CDs are consumed by listening to them, and the “promo CDs” are sent out so that the recipients will listen to them. *See UMG Recordings*, 558 F. Supp. 2d at 1063; *cf. Blakemore v. Superior Court*, 129 Cal. App. 4th 36 (2005) (hair care products were not “merchandise” when they were sent for the purpose of resale rather than for the purpose of being put in the recipient’s hair).

they are not “clearly and conspicuously labeled as such.” 39 U.S.C. § 3009(a).

The “intangible product” cases UMG cites are not to the contrary. From time to time, parties have argued that even intangible products, such as insurance or club memberships, may be treated as gifts when documents describing those products are sent unsolicited. *See, e.g., Kipperman v. Acad. Life Ins. Co.*, 554 F.2d 377 (9th Cir. 1977) (the plaintiff received an unsolicited offer to buy insurance, and maintained that he was therefore entitled to treat the intangible insurance as a gift); *Sanford v. Memberworks, Inc.*, No. 02CV0601, 2008 WL 4482159 (S.D. Cal. Sept. 30, 2008) (the plaintiff received unsolicited membership documents, and maintained that he was therefore entitled to treat the intangible membership as a gift); *Kashelkar v. Rubin & Rothman*, 97 F. Supp. 2d 383 (S.D.N.Y. 2000) (the plaintiff received an unsolicited offer to open a line of credit, and maintained that he was therefore entitled to treat the loaned money as a gift). These arguments, of course, have failed; just because a person receives an unsolicited advertisement offering to sell them a house doesn’t mean that they may treat the house as a gift. But no sender has ever argued, and no court has ever held, that the *physical items* actually received by the recipients were still the property of the sender, as UMG argues here.

UMG attempts to undermine the plain, clear, and unambiguous terms of § 3009 with selective references to legislative history. But where, as here, the statute’s language is plain and unambiguous, the Court’s inquiry begins and ends with the words of the statute and it ought not seek to divine further meaning from the speeches of legislators. *BedRoc Ltd., LLC v. United States*, 541 U.S. 176, 183

(2004) (“[O]ur inquiry begins with the statutory text, and ends there as well if the text is unambiguous.”); *In re Ferrell*, 539 F.3d 1186, 1190 n.10 (9th Cir. 2008) (if the statute is unambiguous, the court’s inquiry must cease).

UMG does not even argue that the text of § 3009 is ambiguous. And indeed, it is not. The text of § 3009 provides that certain “merchandise” may be treated as a gift by the recipient. The Oxford English Dictionary, for example, defines merchandise to include “[b]randed products used to promote a particular film, pop group, etc.”¹⁵ Where a word is not statutorily defined, “the legislative will is expressed by the ordinary meaning of the words used in the statute.” *Columbia Pictures Indus., Inc. v. Prof’l Real Estate Investors, Inc.*, 866 F.2d 278, 280 n.4 (9th Cir. 1989). Here, UMG’s CDs are branded products used to promote particular music groups. The word “merchandise” cannot be construed in a way that would not include music CDs. CDs are UMG’s stock-in-trade, and UMG mailed out unordered CD’s. The idea that CDs are not “merchandise” contradicts common sense and common English usage.

Neither may UMG rely on legislative history and extrinsic evidence to create ambiguity. Such extrinsic evidence can only be used to resolve ambiguity, never to create it. *See In re Ferrell*, 539 F.3d at 1190 n.10. Because the text is unambiguous, this Court need not divine contrary meaning from legislative history. Under the term’s clear and unambiguous everyday meaning, CDs are “merchandise.”

¹⁵ “Merchandise,” OXFORD ENGLISH DICTIONARY (2008), *available at* <http://dictionary.oed.com/cgi/entry/00306116> (last visited January 28, 2009).

2. The CDs were “mailed without the prior express consent or request of the recipient.”

In its brief, UMG argues for the first time that the recipients of the promotional CDs requested them and that therefore the CDs were not unordered merchandise under § 3009. Blue Br. at 51-55. This argument is waived. UMG failed even to mention it below, either in its opposition to summary judgment or in its own cross-motion for summary judgment. *See Travelers Prop. Cas. Co. of Am. v. ConocoPhillips Co.*, 546 F.3d 1142, 1146 (9th Cir. 2008) (argument raised for first time on appeal is waived); *Walsh v. Nev. Dep’t of Human Res.*, 471 F.3d 1033, 1037 (9th Cir. 2006) (“Issues not presented to a district court generally cannot be heard on appeal.”). Accordingly, this Court should not consider this new argument.

At any rate, UMG’s argument fails based on UMG’s own interrogatory responses. The statute provides the following definition: “‘unordered merchandise’ means merchandise mailed without the prior expressed request or consent of the recipient.” 39 U.S.C. 3009(d). During discovery, Augusto served UMG with an interrogatory asking it to explain, for each CD at issue, the “expressed request or consent” to send the CD that UMG had received. UMG responded as follows:

Subject to UMG’s previously served objections, the consent to receive the AUCTIONED CDs was based on the understanding of the parties and the license contained on the AUCTIONED CD and sticker (including but not limited to the statement, “acceptance of this CD shall constitute an agreement to comply with the terms of this license.”)

ER 1115 (UMG’s response to Augusto’s Interrogatory No. 1).

Of course, *implied* consent based on “the understanding of the parties” does not constitute “expressed . . . consent,” and *after-the-fact* consent based on retention of the CD cannot be “prior . . . consent.” Although UMG now asserts that it is “probable” that the original recipients of the CDs in fact consented to receive the CDs, Blue Br. at 52, neither UMG nor Augusto can substantiate or refute this claim, because UMG does not keep permanent records of the identities of the recipients of the “promo CDs” it gives out. ER 1025.

III. Conclusion

The first sale doctrine forms an important part of the copyright scheme. This court should not allow it to be vitiated by the simple expedient of a “Not for Sale” label. The judgment of the district court should be affirmed.

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