

RESALE OF DIGITAL MUSIC: CAPITOL RECORDS V. REDIGI

What I love about this case is that it pushes and pulls our intuitions about copyright in so many different directions. It brings up fundamental questions not just about unsettled corners of doctrine, but also about what copyright is for. It offers grist for every mill, food for every kind of thought.

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¹ James Grimmelmann, *ReDigi and the Purpose of First Sale*, PRAWFSBLAWG, Feb. 8, 2012, <http://prawfsblawg.blogs.com/prawfsblawg/2012/02/redigi-and-the-purpose-of-first-sale.html>.

I. INTRODUCTION

In virtually all industries involving durable goods, marketplaces for used products have existed ever since and are widely accepted as part of our economy. The used cars industry, for instance, sells about twice as many used cars than new cars are sold, and it represents about half of the U.S. auto retail market in terms of revenue.² Institutions like secondhand clothing stores, secondhand bookstores or flea markets are an integral part of our culture. Likewise, used record stores have long been an essential feature of the music industry. Now that brick-and-mortar used record stores have almost completely vanished, should there be a counterpart in the digital world, a secondhand marketplace for digital music files? This is what the legal dispute between Capitol Records and ReDigi is about.

When ReDigi was launched in October 2011, it established a secondhand marketplace for digital song files. The music industry was, however, not happy about this "eBay for digital music" and in November 2011, a month after ReDigi's launch, the Recording Industry Association of America sent the start-up a cease-and-desist-letter demanding that it terminates its allegedly infringing activities, i.e. shuts down its service.³ ReDigi did not comply with the music industry's demands and, in January 2012, Capitol Records (a label of EMI Music) sued ReDigi for copyright infringement. The lawsuit is now awaiting trial.

This paper discusses the legal framework of the resale of digital music files and analyzes the legal arguments made by the parties in the lawsuit. It also explores the economic function of secondhand marketplaces and asks whether current copyright law adequately reflects the changed technological environment and whether the resale of digital music should be permissible as a matter of policy. This paper does not discuss Capitol Record's allegations of copyright infringement in connection

² *Used Car Industry in the US*, WIKIPEDIA, http://en.wikipedia.org/wiki/Used_car#Used_car_industry_in_the_US (last visited Apr. 26, 2012).

³ Letter from Jennifer L. Pariser, Recording Industry Association of America, to John Ossenmacher, ReDigi, Inc. (Nov. 10, 2011), available at <http://origin.static.arstechnica.com/2011/11/14/ReDigiRIAA.pdf>. Ars Technica called it a "cease-and-desist-then-roll-over-and-die letter"; Matthew Lasar, *Selling used iTunes tracks? ReDigi insists it's legal*, ARS TECHNICA (Jan. 22, 2012), <http://arstechnica.com/tech-policy/news/2012/01/used-digital-music-file-seller-no-copying-here-almost.ars>.

with the performance of 30-second sound clips and the display of cover artwork on ReDigi's website.⁴

Also, this paper does not discuss the matters of state common law copyright raised in Capitol Record's lawsuit.

II. ECONOMIC ANALYSIS OF SECONDARY MARKETS

1. Secondary Markets Have Multiple Effects

Secondary markets for used products have a variety of effects on a market for durable goods. Most obvious, secondary markets compete with the primary market: When used products are available for a cheaper price, consumers are less likely to spend more for a new product.⁵ For this reason, secondary markets place a price pressure on new products offered on the primary market. Needless to say that producers, who are in the business of selling new products and usually do not share in the profits made by reselling used products, do not like this.

Another effect of secondary markets is that they enhance the value of the original purchase: Because the original purchaser can resell the product and thus recoup at least part of his investment, secondary markets reduce the effective price of a new product.⁶ The original purchaser takes the possibility of reselling the product into account when making his purchase decision and, therefore, he or she

⁴ ReDigi claims that it has licensing agreements with Rdio in place for these services; Def.'s Mem. of Law in Opp'n to Pl.'s Mot. for a Prelim. Inj., Jan. 27, 2012, 6-7, *available at* http://beckermanlegal.com/Lawyer_Copyright_Internet_Law/capitol_redigi_120127MemorandumOfLawOpposingPreliminaryInjunction.pdf. On February 10, 2012, Rdio terminated ReDigi's access to sound clips and cover artwork and published a statement that ReDigi was in violation of Rdio's API Terms of Use. In response, ReDigi claimed that Capitol Records exerted pressure on Rdio to disable its access and requested a pre-motion conference regarding reinstatement of the Rdio licenses, which was denied by the court. *See* Letter from Ray Beckerman, Ray Beckerman, P.C., Attorneys at Law, to Hon. Richard J. Sullivan, District Judge, S.D.N.Y. (Feb. 11, 2012), *available at* http://beckermanlegal.com/Lawyer_Copyright_Internet_Law/120211RBToCourtInjunctionRdio.pdf.

⁵ Andrew Harmeyer, *Can Digital Music Files Really Be Considered "Used"?*, COLUM. BUS. L. REV. ONLINE (Feb. 2, 2012, 10:29 PM), <http://cblr.columbia.edu/archives/11955>; Pedro Echeverria Faz, *Digital Information and the Secondary Market*, TECH POLICY SEMINAR (Jan. 5, 2012), http://picker.typepad.com/picker_seminar/2012/01/digital-information-and-the-secondary-market.html; Rick Sanders, *ReDigi: A Digital Secondary Market*, AARON SANDERS LAW BLOG (Oct. 19, 2011), <http://www.aaronsanderslaw.com/blog/redigi-a-digital-secondary-market-part-15-of-our-online-music-services-series>.

⁶ *Id.*

is more willing to make the purchase in the first place. The existence of a secondary market thus serves as an incentive to make purchases in the primary market and can stimulate the market for new products.

Secondary markets also increase the affordability of the product and provide consumer access to the market at a lower cost.⁷ In other words, the availability of secondhand products allows consumers with a lower willingness to pay to participate in the market. Further, a secondary market can provide access to a product where the producer has discontinued production or otherwise taken the product off the market.⁸ And finally, secondary markets can increase circulation and knowledge of a product, which can in turn increase demand for the product on the primary market.⁹

2. Producers Strive To Weaken Secondary Markets

As we have seen, secondary markets have multiple effects on primary markets. Some of these effects are to the advantage of producers, e.g. that secondary markets lower the effective price of new products and can thus stimulate the primary market. Other effects are to the disadvantage of producers, most notably that used products offered on the secondary markets compete with new products offered on the primary market and thus place a downward pressure on prices for new products.

In practice, producers place much more weight on the adverse effects of secondary markets and the general perception is that secondary markets increase the consumer surplus and decrease the producer surplus. Experience shows that producers generally oppose secondhand marketplaces. In addition to a general rejection of secondary markets by producers, the content industry has long been complaining that—contrary to other industries—there is no opportunity whatsoever to earn anything from

⁷ Ruth Anthony Reese, *The First Sale Doctrine in the Era of Digital Networks*, 44 B.C.L. REV. 577 (2003), 585-592, available at <http://lawdigitalcommons.bc.edu/bclr/vol44/iss2/9>; Echeverria Faz, *supra* note 5.

⁸ Reese, *supra* note 7, at 592-610; Echeverria Faz, *supra* note 5.

⁹ Echeverria Faz, *supra* note 5.

used music records or books.¹⁰ Content producers argued that while carmakers can still make some money through service and maintenance or the sale of spare parts, there was simply no revenue to be made with resold music records or books.¹¹

Producers have developed various strategies to weaken secondary markets and to decrease the appeal of used products offered on the secondary market. A good example is Apple's offer to personalize new iPods and iPads by having short messages engraved on the device at no additional cost to customers.¹² By offering free engraving, Apple makes new devices more valuable to its consumers. At the same time, they are less valuable to other consumers and thus the resale value of these previously engraved products is decreased. Other strategies pursued by producers to weaken the secondary market include renting or leasing the product instead of selling it, or making the product less durable—although these strategies are only feasible for a monopolist.¹³ In the digital world, digital rights management (DRM) seems to be an obvious choice to prevent a secondhand market for digital files.

3. Digital Is Different

It has been shown that secondary markets can stimulate the primary market by creating a resale value and giving liquidity to the product.¹⁴ In the context of digital music files, where illegal copies are widely available and piracy is rampant, this stimulating effect may even be heightened. A secondhand marketplace provides an affordable alternative to illegal file sharing platforms such as BitTorrent or LimeWire.

¹⁰ Nate Anderson, "Can I Resell My MP3s?": *The Post-Sale Life of Digital Goods*, ARS TECHNICA (Dec. 17, 2008), <http://arstechnica.com/tech-policy/news/2008/12/post-sale-life.ars>.

¹¹ This does not seem entirely true: A secondary market can increase circulation and knowledge of an artist and his music, which can in turn boost ticket sales and other merchandise, or sales of future records of that artist.

¹² Eli Dourado, *Why Does Apple Offer Free Engraving?*, ELI DOURADO BLOG (Nov. 27, 2010), <http://elidourado.com/blog/free-engraving>; Eli Dourado, *Free Engraving for Non-Economists*, ELI DOURADO BLOG (Nov. 29, 2010), <http://elidourado.com/blog/free-engraving-non-economists>.

¹³ Jeremy I. Bulow, *Durable-Goods Monopolists*, 90 J. POL. ECON. 2 (April 1982), 314-332; Michael Waldman, *Eliminating the Market for Secondhand Goods: An Alternative Explanation for Leasing*, 40 J. LAW & ECON. 1 (April 1997), 61-92.

¹⁴ *Supra* II.1.

When analyzing secondhand markets for digital files, three significant differences between digital files and tangible products must, however, be considered that affect the balance between primary and secondary markets. The first characteristic is that there is, actually, no such thing as a used digital file: Pre-owned digital files are always pristine and have the exact same quality as a new and unused file.¹⁵ In contrast to tangible products, there is no need to discount for wear and tear in the case of digital music—digital song files do not scratch like compact disc, warp like vinyl records, or tear like cassette tapes. Because digital files do not degrade over time, the downward pressure placed by the secondary market on prices in the primary market is significantly higher in markets for digital files than in market for tangible goods. Rather than in a secondary market in the typical sense, used digital files do in fact compete in the primary market with new files.¹⁶ Users have no real reason to buy from licensed sellers on the primary market, such as iTunes or Amazon, instead of secondhand marketplaces such as ReDigi.¹⁷

The second characteristic distinguishing digital files from tangible goods is that while the transport of physical copies takes time and costs money, digital files can be transmitted almost instantly at negligible costs.¹⁸ In the digital environment, transaction costs no longer serve as a natural brake on the effect of secondary markets. This lack of transaction costs further increases the impact secondary markets have on primary markets in the digital realm.

The third characteristic of digital content is that digital files are indefinitely reproducible: While a tangible product is impartible, a digital file can be copied an indefinite amount of times without

¹⁵ U.S. COPYRIGHT OFFICE, DMCA SECTION 104 REPORT 82 (August 2001), *available at* <http://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf>; Sanders, *supra* note 5; Harmeyer, *supra* note 5; Nakimuli Davis, *Reselling Digital Music: Is There a Digital First Sale Doctrine?*, 29 LOY. L.A. ENT. L. REV. 363 (2009), 371, *available at* <http://digital-commons.lmu.edu/elr/vol29/iss3/2>.

¹⁶ Harmeyer, *supra* note 5.

¹⁷ Anderson, *supra* note 11. One reason for costumers to still choose to buy from services such as iTunes or Amazon might be that these services always offer the full back-catalog, while at ReDigi's marketplace a song is only available if there is a willing seller; Harmeyer, *supra* note 5.

¹⁸ U.S. COPYRIGHT OFFICE, *supra* note 15, at 82-83; Grimmelmann, *supra* note 1.

loss of quality.¹⁹ A seller can easily keep a perfect copy of a song file on his hard drive (or on another device) and continue enjoying it even after he sold the song. For this reason, it is critical in secondhand markets for digital files to ensure that the seller has no longer access to the file after it is sold. Without making sure that all of the seller's copies of the file are deleted, a secondhand market for digital music can easily degenerate to yet another playground for illegal file sharing. In contrast to earlier attempts to establish a secondary market for digital music files—such as the short-lived Bopaboo²⁰—ReDigi seems to make an effort to address this issue by verifying that the files uploaded were legitimately purchased and that any copies stored on the seller's devices are deleted.²¹

III. FIRST SALE DOCTRINE

1. Rationale of the First Sale Doctrine

The first sale doctrine is a limitation on the copyright owner's exclusive right of distribution and forms the legal basis for secondary markets beyond the exclusive control of the copyright owner. Used record stores have long relied on the first sale doctrine for the sale of used compact discs, vinyl records and other physical embodiments of music.

The first sale doctrine says that a copyright owner's exclusive distribution right is exhausted after the owner's first sale of a particular copy of the copyrighted work, i.e. that a copyright owner does not retain control over the resale or other transfer of a particular copy of a work after that copy has been lawfully sold. The first sale doctrine thus allows the legitimate owner of a particular copy of a copyrighted work to dispose of that copy without the need to obtain the permission of the copyright owner.

¹⁹ U.S. COPYRIGHT OFFICE, *supra* note 15, at 82; Davis, *supra* note 15, at 371.

²⁰ *Infra* IV.1.

²¹ *Infra* IV.2.

The underlying rationale of the first sale doctrine is that by releasing a particular copy into the public channels, the copyright owner consents to the disposition of that copy and has no legitimate interest in controlling further distribution of that copy.²² The first sale doctrine accounts for the fact that the distribution right is a mere supplement to the reproduction right, which is at the very core of copyright, and that no reproduction is involved in the distribution of a tangible copy that has already been released into the distribution channels.²³ The first sale doctrine balances the copyright owner's exclusive right to control the distribution of his work and the right of owners of personal property to dispose of their property as they wish.²⁴ At the point where a copy of a copyrighted work has been put on the market, the first sale doctrine says that the copyright owner's monopoly must give way to freedom of trade.²⁵

2. The First Sale Doctrine and the Copyright Act

The roots of the first sale doctrine go back to the 1908 decision *Bobbs-Merrill Co. v. Straus* in which the Supreme Court held that the exclusive right to "vend" was applicable only to the initial sale and that, absent a contractual agreement as to the future sale price, it did not permit a copyright owner to impose a price limitation on the retail sale.²⁶ The court held that "[t]he purchaser of a book, once sold by authority of the owner of the copyright, may sell it again, although he could not publish a new edition of it".²⁷ The first sale doctrine was subsequently codified in Section 109(a) of the Copyright Act, the first sentence of which provides:²⁸

²² 2 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 8.12(A).

²³ *Id.*

²⁴ Grimmelmann, *supra* note 1.

²⁵ NIMMER, *supra* note 22, § 8.12(A).

²⁶ *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339 (1908). In *Bobbs-Merrill*, the publisher had inserted a notice in the book entitled "The Castaway" that any retail sale at a price under \$1 would constitute a copyright infringement. The defendants disregarded the notice and sold the books in their department store at a lower price without the publisher's consent.

²⁷ *Id.*, at 350.

²⁸ 17 U.S.C. § 109.

Notwithstanding the provisions of section 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.

The four-prong test to assert a first sale defense under the Copyright Act therefore is: (i) The copy was lawfully produced with the permission of the copyright owner; (ii) that particular copy was transferred under the copyright owner's authority; (iii) the defendant is the lawful owner of that copy; and (iv) the defendant simply distributed that particular copy.²⁹

3. The First Sale Doctrine and Digital Content

The first sale doctrine was drafted with physical objects in mind and in a time where digital goods were still a long way off. It goes without saying that the world has changed: The use of digital content has become ubiquitous and, after some reluctance, the content industry has largely moved to digital distribution models. Sales of MP3 files have long surpassed the sales of compact discs. Consequently, the question arises whether and to what extent the transmission of digital content falls within the scope of the first sale doctrine as stipulated in Section 109 of the Copyright Act. Reiterating the four-prong test of the first sale doctrine, it is namely the third prong (lawful owner) and the fourth prong (mere distribution of a particular copy) that need closer attention with regard to digital transmission.

As we have seen, only the lawful owner of a particular copy of a copyrighted work may assert the first sale defense.³⁰ The first sale doctrine does not apply to a person who possesses a copy of the copyrighted work without owning it, such as a licensee. This general rule is codified in Section 109(d) of the Copyright Act.³¹

The privileges prescribed by subsections (a) and (c) do not, unless authorized by the copyright owner, extend to any person who has acquired possession of the

²⁹ NIMMER, *supra* note 22, § 8.12(B)(1)(a).

³⁰ *Supra* III.2.

³¹ 17 U.S.C. § 109(d). See *Quality King Distribs., Inc. v. L'anza Research Int'l Inc.*, 523 U.S. 135, 146-47, 118 S.Ct. 1125, 140 L.Ed.2d 254 (1998).

copy or phonorecord from the copyright owner, by rental, lease, loan, or otherwise, without acquiring ownership of it.

Now, digital content, including MP3 files, is usually not sold but merely licensed to the user, which suggests that the first sale doctrine does not apply to the transmission of digital content. However, not always is a user characterized as a licensee in the applicable agreement a licensee for the purposes of the first sale doctrine: In *Vernor v. Autodesk, Inc.*, the Ninth Circuit created a three-prong test to determine whether a user of digital content is a licensee rather than an owner of a copy.³² In that case, the defendant had purchased several sealed copies of Autodesk's software AutoCAD at a garage sale and put the CD-ROMs up for auction on eBay. AutoCAD was sold under the terms of a shrink-wrap license that contained a number of use restrictions, among them a restriction to transfer the software. The Ninth Circuit held:³³

First, we consider whether the copyright owner specifies that a user is granted a license. Second, we consider whether the copyright owner significantly restricts the user's ability to transfer the software. Finally, we consider whether the copyright owner imposes notable use restrictions.

Thus, according to the Ninth Circuit's decision in *Vernor*, a software user is a licensee rather than an owner of a copy for purposes of the first sale doctrine only if the copyright owner (i) specifies that the user is granted a license; (ii) significantly restricts the user's ability to transfer the software; and (iii) imposes notable use restrictions.³⁴

In the context of musical recordings, the same Ninth Circuit held in *UMG v. Augusto*³⁵ that the recipients of promotional CDs distributed by Universal Music qualified as owners rather than licen-

³² *Vernor v. Autodesk Inc.*, 621 F.3d 1102 (9th Cir. 2010), cert. denied, 132 S. Ct. 105 (U.S. 2011).

³³ *Id.*, at 1110-1111. In an earlier case, *United States v. Wise*, the same court held that the crucial factor was whether the transaction gave rise to a right of perpetual possession in the transferee: If the transferee is not required to return the copy to the copyright holder, it is a sale; *United States v. Wise*, 550 F.2d 1180 (9th Cir.1977).

³⁴ Cf. the criticism of *Autodesk* in NIMMER, *supra* note 22, § 8.12(B)(1)(d)(i): "[I]n short, it is respectfully submitted that the Ninth Circuit's ruling facially contradicts binding Supreme Court precedent [*Bobbs-Merrill Co. v. Straus*], which Congress in turn codified onto the face of the statute." See also Vivian F. Wang, *Sale or License? UMG v. Augusto, Vernor v. Autodesk, and the First Sale Doctrine*, 19 TEX. INTELL. PROP. L.J. 1 (Summer 2010), 2-28.

³⁵ *UMG Recordings, Inc. v. Augusto*, 628 F.3d 1175 (9th Cir. 2011).

sees, even though a notice affixed to the discs proclaimed that "[t]his CD is the property of the record company and is licensed to the intended recipient for personal use only" and that "[r]esale or transfer of possession is not allowed and may be punishable under federal and state laws".³⁶ The court concluded that UMG's distribution of the promotional CDs constituted a transfer of title of the CDs to the recipients and, therefore, that a resale was permissible without UMG's authorization under the first sale doctrine.³⁷

As we will see, the ownership/license dichotomy is not a major issue in the *Capitol v. ReDigi* case.³⁸ More important is the fourth prong of the first sale test, according to which only a mere distribution of a particular copy is protected by the first sale doctrine, but not a reproduction of the work. The first sale doctrine is a limitation only to the copyright owner's right of distribution, but it does not limit the other exclusive rights of the copyright owner, such as the right of reproduction.³⁹ The problem now is that—apart from transferring a physical manifestation of a digital file such as a hard drive or an iPod—a digital file cannot be transferred without copying. The copy in possession of the transferee after an online transmission is different from the source copy with which the sender began.⁴⁰ Copying is the way by which digital files are transferred. This, however, invokes the copyright owner's reproduction right and the new copy in possession of the transferee is unlawful if it was created without the copyright owner's permission.⁴¹

This premise that a transmission of a digital file is not possible without making a copy led the Copyright Office to conclude in its 2001 report following the passage of the Digital Millennium Copyright Act that the first sale defense is not available in the context of online transmissions.⁴² The Copyright

³⁶ *Id.*, at 1178.

³⁷ *Id.*, at 1183.

³⁸ *Infra* V.2.a.

³⁹ NIMMER, *supra* note 22, § 8.12(B)(1)(a); U.S. COPYRIGHT OFFICE, *supra* note 15, at 79.

⁴⁰ U.S. COPYRIGHT OFFICE, *supra* note 15, at 79.

⁴¹ Davis, *supra* note 15, at 371.

⁴² U.S. COPYRIGHT OFFICE, *supra* note 15, at 79-80: "The ultimate product of one of these digital transmissions is a new copy in the possession of a new person. Unlike the traditional circumstances of a first sale transfer, the recipient obtains a new copy,

Office also recommended against amending Section 109 of the Copyright Act to facilitate a digital first sale right.⁴³ As we will see, ReDigi offers a surprising legal strategy to the problem that a digital music file cannot be transferred without making at least one intermediate copy of the file.⁴⁴

IV. BUSINESS MODEL AND LAWSUIT

1. The Predecessor

ReDigi is not the first attempt to establish a secondary market for digital music. In 2008, a service named "Bopaboo" started a secondhand marketplace for digital music files where registered users were able to upload song files they wished to sell. By uploading a file for sale, the user assured that the file was legally obtained and agreed to delete all copies of the file from his hard drive and any backup media after the sale.⁴⁵ Bopaboo had some song-identification technology in place to avoid the sale of multiple copies of the same file, but the service did not capture the origin of the files or verify that all of the seller's copies are deleted after the sale.⁴⁶

It seems that Bopaboo was trying to obtain licenses for its secondhand marketplace and offered the record labels some kind of revenue sharing deal.⁴⁷ But the service's endeavors to get the labels on board proved unsuccessful, and Bopaboo disappeared even before it was properly launched amidst legal pressure from copyright owners.⁴⁸

not the same one with which the sender began. Indeed, absent human or technological intervention, the sender retains the source copy."

⁴³ U.S. COPYRIGHT OFFICE, *supra* note 15, at 97-101.

⁴⁴ *Infra* V.1.b.

⁴⁵ Greg Sandoval, *Reselling MP3s: The Music Industry's New Battleground?*, CNET NEWS (Dec. 11, 2008), http://news.cnet.com/8301-1023_3-10120951-93.html.

⁴⁶ Sandoval, *supra* note 45; Harmeyer, *supra* note 5.

⁴⁷ Anderson, *supra* note 11; Sandoval, *supra* note 45.

⁴⁸ Harmeyer, *supra* note 5.

2. The Business Model

For a legal analysis of DeDigi's business model, it is important to understand how ReDigi works:⁴⁹ After signing up for an account and installing ReDigi's proprietary software, a user can upload music files from his computer to a personal storage space on ReDigi's servers (cloud locker). Only music files purchased from Apple's iTunes or subsequently from ReDigi's own marketplace are eligible for upload, thereby excluding files ripped from CDs, downloaded from other music stores (such as Amazon) or obtained from other sources. ReDigi's software client verifies that the uploaded music file is eligible and deletes all copies of the file on the seller's computer and attached devices. If a copy of the uploaded file is detected on a subsequently attached device, the user is prompted to authorize its deletion or else his or her account is suspended.

A distinct copy for each user is stored in the cloud if multiple users upload the same file and only the user associated with a particular cloud locker has access to its contents, i.e. the only person who can use a particular song file is the owner of that file. Once a file is uploaded to his or her cloud locker, the user can (i) stream the file to an internet-connected device; (ii) download the file to his or her computer, in which case the file is deleted from his or her cloud locker; and (iii) select the file for resale on ReDigi's used digital music marketplace. If the file is selected for resale, other ReDigi users can search for and find the file through ReDigi's software client. When the file is sold, the file pointer associating it with the seller's cloud locker is modified so to associate the file with the purchaser's cloud locker, and the seller can no longer access the file. ReDigi earns a fee on each sale transaction.

⁴⁹ The following description of ReDigi's business structure draws upon *How ReDigi Works*, REDIGI.COM, <https://www.reddigi.com/#!/learn> (last visited Apr. 20, 2012); Decl. John Ossenmacher, CEO and founder of ReDigi, Jan. 25, 2012, ¶¶ 2-7, available at http://beckermanlegal.com/Lawyer_Copyright_Internet_Law/capitol_reddigi_120127_Declaration-JohnOssenmacher.pdf; Decl. Larry Rudolph, CTO and founder of ReDigi, Jan. 27, 2012, ¶¶ 2-30, available at http://beckermanlegal.com/Lawyer_Copyright_Internet_Law/capitol_reddigi_120127_DeclarationLarryRudolph.pdf; and Letter from Morlan Ty Rogers, Of Counsel, Ray Beckerman, P.C., Attorneys at Law, to Hon. Richard J. Sullivan, District Judge, S.D.N.Y. (Jan. 19, 2012), available at http://beckermanlegal.com/Lawyer_Copyright_Internet_Law/capitol_reddigi_110119MTRToCourtSummJudgePreConfLetter.pdf.

3. The Lawsuit

On January 5, 2012, Capitol Records filed a lawsuit against ReDigi with the United States District Court for the Southern District of New York for direct copyright infringement, contributory copyright infringement, vicarious copyright infringement and inducement of copyright infringement under the Copyright Act as well as common law copyright infringement under the law of the State of New York for recordings fixed prior to February 15, 1972.⁵⁰ In its complaint, the record label is seeking injunctive relief, profits garnered by the service, and actual damages or statutory damages of \$150,000 per copyrighted work infringed.⁵¹

On February 6, 2012, District Judge Richard Sullivan denied the issuance of a preliminary injunction on the grounds that irreparable harm was not established and that monetary damages should be adequate to compensate for the alleged injury.⁵² While Judge Richard Sullivan denied a preliminary injunction, he also noted that the plaintiff has demonstrated likelihood of success on the merits and that its arguments on their face seem compelling.⁵³ The trial is scheduled for August. A request of Google to file an amicus brief (in support of neither party) was denied.⁵⁴

⁵⁰ Pl.'s Compl., Jan. 5, 2012, *available at* http://beckermanlegal.com/Lawyer_Copyright_Internet_Law/capitol_redigi_120106Complaint.pdf.

⁵¹ *Id.*, at 17-18.

⁵² Order Den. Prelim. Inj. Mot., Hon. Richard J. Sullivan, District Judge, S.D.N.Y., Feb. 6, 2012, *available at* http://beckermanlegal.com/Lawyer_Copyright_Internet_Law/capitol_redigi_120206Order.pdf.

⁵³ Tr. of Decis. Den. Prelim. Inj. Mot., Hon. Richard J. Sullivan, District Judge, S.D.N.Y., Feb. 6, 2012, *available at* http://beckermanlegal.com/Lawyer_Copyright_Internet_Law/capitol_redigi_120206Transcript.pdf

⁵⁴ Order Den. Mot. of Google Inc. for Leave to File Amicus Curiae Br., Hon. Richard J. Sullivan, District Judge, S.D.N.Y., Feb. 1, 2012, *available at* http://beckermanlegal.com/Lawyer_Copyright_Internet_Law/capitol_redigi_120201OrderDeny_Google-MotionLeaveFileAmicus.pdf.

V. LEGAL ANALYSIS

1. Reproduction Right

a. *No Transfer of Digital Files without Copying*

As we have seen, a digital music file cannot be transferred without making at least one copy of the file.⁵⁵ In ReDigi's structure, copying occurs in two instances: The first time when the seller uploads the file from his computer to his cloud locker, and the second time when (and if) the buyer chooses to download the purchased file from his cloud locker to his computer after the sale.⁵⁶ By their very nature, up- and downloading can only be accomplished by making copies of the file, i.e. the file stored in ReDigi's cloud locker is necessarily a copy of the seller's original file. Obviously, such copying invokes the copyright owner's reproduction right. As we have also seen, the first sale doctrine does not provide a defense to the making of copies, as it is a limitation only to the copyright owner's right of distribution, but not to the other exclusive rights of the copyright owner.⁵⁷

The fact that unauthorized copying takes place is one of the main assertions made in Capitol's memorandum of law.⁵⁸

Whether the original file was simultaneously or subsequently deleted does not matter, as the Copyright Act does not excuse unauthorized reproduction simply because the infringer chooses to destroy the source copy. It is the act of reproduction itself that is reserved for the copyright owner by 17 U.S.C. §106(1). [...] The system simply cannot work without making copies in direct violation of the copyright rights of Capitol and other owners of sound recordings.

⁵⁵ *Supra* III.3.

⁵⁶ *Supra* IV.2.

⁵⁷ *Supra* III.3.

⁵⁸ Pl.'s Mem. of Law in Supp. of Mot. for Prelim. Inj., Jan. 19, 2012, 7, *available at* http://beckermanlegal.com/Lawyer_Copy-right_Internet_Law/capitol_redigi_120120plttffsprelinjmotmemolaw.pdf.

b. *Copying as Fair Use*

ReDigi does not deny that copying takes place in its business model, but the service argues that no copy is made in direct connection with the resale of a file: When a file is sold on ReDigi's marketplace, only the file pointer associating the file with the seller's cloud locker is modified so as to associate the file with the purchaser's cloud locker, but no copy of the file is made and the file remains in the same location ReDigi's cloud.⁵⁹ One could say that not the audio file per se is sold in such a transaction, but rather the title to the audio file.⁶⁰

ReDigi argues that copying takes only place for the storage of a file in the cloud and that such copying is protected by fair use.⁶¹ The fair use doctrine is a limitation and exception to the exclusive rights of the copyright owner that permits the use of a copyrighted work in a reasonable manner without the consent of the copyright owner.⁶² For its fair use argument, ReDigi invokes the same "space shifting" theory on which Google, Amazon and Apple⁶³ are relying for their respective cloud music services.⁶⁴ The rationale of the space shifting theory is that a user who owns a copyrighted work should be allowed to place a copy of that work in a space and in a format that is more convenient to him or her.

The "space shifting" theory goes back to the so-called *Sony Betamax* case, in which the Supreme Court held that the recording of television broadcasts for later viewing ("time shifting") consti-

⁵⁹ Def.'s Mem. of Law, *supra* note 4, at 3; Decl. Rudolph, *supra* note 49, ¶ 10.

⁶⁰ Rick Sanders, *Music Industry v. ReDigi: Cute or Clever?*, AARON SANDERS LAW BLOG (Jan. 25, 2012), available at <http://www.aaronsanderslaw.com/blog/music-industry-v-redigi-cute-or-clever>.

⁶¹ Def.'s Mem. of Law, *supra* note 4, at 9-13.

⁶² Section 107 of the Copyright Act reads as follows: "Notwithstanding the provisions of sections 106 and 106A, the fair use of a copyrighted work, including such use by reproduction in copies or phonorecords or by any other means specified by that section, for purposes such as criticism, comment, news reporting, teaching (including multiple copies for classroom use), scholarship, or research, is not an infringement of copyright. In determining whether the use made of a work in any particular case is a fair use the factors to be considered shall include: (1) the purpose and character of the use, including whether such use is of a commercial nature or is for nonprofit educational purposes; (2) the nature of the copyrighted work; (3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and (4) the effect of the use upon the potential market for or value of the copyrighted work." 17 U.S.C. § 107.

⁶³ To the extent its iCloud service is not licensed.

⁶⁴ Def.'s Mem. of Law, *supra* note 4, at 10-13.

tutes a personal noncommercial use protected by the fair use doctrine.⁶⁵ The Supreme Court also held that "time shifting" necessarily requires the making of a full copy of a protected work.⁶⁶ Building on this precedent, the Ninth Circuit held in *Diamond* that copying of files from a computer to a portable external storage drive is likewise protected by fair use under the Copyright Act.⁶⁷ The court held that by copying song files to an MP3 player, a user is merely "space shifting" files that already reside on his or her hard drive.⁶⁸

The Rio [defendant's MP3 player] merely makes copies in order to render portable, or "space-shift", those files that already reside on a user's hard drive. [...] Such copying is paradigmatic noncommercial personal use entirely consistent with the purposes of the Act.

The time and space shifting doctrines established in the *Sony Betamax* and *Diamond* cases have formed the legal basis of the online cloud storage services of prominent industry participants such as Google, Amazon and Apple.⁶⁹ Cloud locker storage is a rapidly growing business and the cloud computing industry constituted an estimated \$41 billion global market in 2010.⁷⁰ ReDigi claims that it is fundamentally nothing else than a music cloud locker storage service that offers its subscribers the additional functionality of selling their files to other subscribers. According to ReDigi, the only features distinguish-

⁶⁵ *Sony Corp. of America v. Universal City Studios, Inc.*, 464 U.S. 417 (1984), at 449-450.

⁶⁶ *Id.*

⁶⁷ *Recording Industry Association of America v. Diamond Multimedia Systems, Inc.*, 180 F.3d 1072 (9th Cir. 1999), at 1079.

⁶⁸ *Id.*

⁶⁹ Two other cases should be mentioned in connection with space shifting: In *MP3.com*, the U.S. District Court for the Southern District of New York held that a virtual space shifting model which granted access to song files stored on a server after the user had proven that he or she already owned the CD (by inserting the CD into the computers) was not protected by fair use. The court held that rather than the users themselves, it was MP3.com doing the copying from the CDs onto its servers, and the same file was streamed to multiple users; *UMG Recordings, Inc. v. MP3.com, Inc.*, 92 F. Supp. 2d 349 (S.D.N.Y. 2000). In *Cablevision*, the Second Circuit held that the defendant's remote video recorder service was protected by fair use since copying only took place at the direction of the users and a distinct copy was stored for each user who recorded a program; *Cartoon Network, LP v. CSC Holdings, Inc.*, 536 F.3d 121 (2d Cir. 2008).

⁷⁰ Letter from Kathryn J. Fritz, Renwick & West LLP, to Hon. Richard J. Sullivan, District Judge, S.D.N.Y., re Req. to File an Amicus Brief on behalf of Google Inc. (Feb. 1, 2012), available at http://beckermanlegal.com/Lawyer_Copyright_Internet_Law/capitol_redigi_120201GoogleLetterReAmicusBrief.pdf.

ing its service from other cloud locker storage services are its verification technology, which prevents the existence of more than one copy at any given time, and its used digital music marketplace:⁷¹

[U]ploading and downloading [of music files to a user's personal cloud locker in ReDigi's cloud] is no different than that which occurs when consumers use other cloud storage providers, such as Apple iCloud, Google Music, Amazon Cloud Drive and Player, Microsoft LiveMesh & SkyDrive, Apple MobileMe, Amazon AWS, Google Docs / GMail Drive, and a dozen others. The only difference between ReDigi's cloud storage, and any other cloud storage system of which we are aware, is that ReDigi's proprietary technology takes the additional step of searching for and removing, or causing to be removed, any other instances of the file which may be found on the drive from which the file is removed. [...]

ReDigi thus counters the intermediate copying argument by structuring itself as an online cloud storage service that also provides its subscribers with access to a pre-owned digital music marketplace.

c. Copying as Essential Step

In the alternative, ReDigi is invoking the essential step doctrine to justify the copying that occurs when files are uploaded to or downloaded from a user's cloud locker.⁷² The essential step defense permits owners of a "computer program" to make a copy if such copying is an essential step in the "mechanical utilization" of that computer program. Section 117(a) of the Copyright Act provides in relevant parts:⁷³

Notwithstanding the provisions of section 106, it is not an infringement for the owner of a copy of a computer program to make or authorize the making of another copy or adaptation of that computer program provided: (1) that such a new copy or adaptation is created as an essential step in the utilization of the computer program in conjunction with a machine and that it is used in no other manner, or [...].

⁷¹ Def.'s Mem. of Law, *supra* note 4, at 12. See also Decl. Ossenmacher, *supra* note 49, ¶¶ 4-5.

⁷² Def.'s Mem. of Law, *supra* note 4, at 13-14.

⁷³ 17 U.S.C. § 117(a).

Thus, the essential step doctrine only applies to the instant case, if (i) digital music files are computer programs within the meaning of the provision, and (ii) the copying is necessary to use the file in the intended manner, i.e. to play the music file.

The Copyright Act defines computer programs as "a set of statements or instructions to be used directly or indirectly in a computer in order to bring about a certain result".⁷⁴ Digital content such as an MP3 file seems to be less than executable code, as it requires an application to translate its content for a computer, but it is certainly more complex than pure data and it can well be argued that an MP3 file is a computer program for purposes of the essential step doctrine.⁷⁵

While a digital music file may qualify as a computer program, it is hard to see how the uploading to and downloading from ReDigi's server is an indispensable link in the "utilization" of these music files "in conjunction with a machine". The essential step doctrine is designed to exempt incidental copying necessary for a functional use of a computer program from the copyright owner's right of reproduction, such as installing a program on the computer's hard drive or loading software into RAM storage when the program is executed.⁷⁶ Section 117 provides a defense only to copying without which it is not possible to execute or enjoy the computer program, but the essential step doctrine does not extend to conduct that is not a necessity, but a mere matter of convenience.⁷⁷ Even if one follows ReDigi's argument that copying does not take place in direct connection with the sale of the music file, but only for non-commercial personal use of the file by its owner (space-shifting), such copying is not absolutely nec-

⁷⁴ 17 U.S.C. § 101.

⁷⁵ Rick Sanders, *ReDigi Redux: Essentials of the Essential Step Defense*, AARON SANDERS LAW BLOG (Nov. 21, 2011), <http://www.aaronsanderslaw.com/blog/redigi-redux-essentials-of-the-essential-step-defense-part-16-of-our-online-music-services-series>.

⁷⁶ NIMMER, *supra* note 22, § 8.08(B)(1).

⁷⁷ *Wall Data Inc. v. Los Angeles County Sheriff's Dept.*, 447 F.3d 769 (9th Cir. 2006), at 785-786; *Madison River Mgmt. Co. v. Business Mgmt. Software Corp.*, 387 F. Supp. 2d 521, 538 (M.D.N.C. 2005). For a more liberal construction of the essential step requirement, see *Krause v. Titleserv, Inc.*, 402 F.3d 119 (2nd Cir. 2005).

essary to play the song, but only a means to preserve flexibility in its utilization. ReDigi's essential step argument is without merit.

2. Distribution Right

a. Ownership of Digital Music Files

As we have seen, the first sale doctrine, which allows the sale of a particular copy without the permission of the copyright owner, applies only to the *owner* of that particular copy.⁷⁸ Under *Vernor v. Autodesk, Inc.*, the possessor of a copy of a copyrighted work is a mere licensee, and not an owner, for purposes of the first sale doctrine if (i) the copyright owner (i) specifies that the purchaser is granted a license, (ii) significantly restricts the purchaser's ability to transfer the copy, and (iii) imposes notable use restrictions.⁷⁹

In ReDigi's case the ownership/license dichotomy turns out not to be a major issue. Only files purchased from Apple's iTunes music store are eligible for upload to ReDigi's cloud and resale through ReDigi's used digital music marketplace, and the iTunes Terms and Conditions prove to be very liberal with regard to music.⁸⁰ In particular, the Terms and Conditions do not contain language characterizing the transaction as a license.⁸¹ Rather, the Terms and Conditions repeatedly refer to the transactions as sales and purchases and provide that the title to the downloaded music files passes to the consumers: "[T]itle for all electronically delivered transactions pass to the purchaser [...] upon electronic transmission to the recipient."⁸² Further, the Terms and Conditions do not prohibit a resale or transfer of the

⁷⁸ *Supra* III.2.

⁷⁹ *Vernor v. Autodesk Inc.*, 621 F.3d 1102 (9th Cir. 2010), at 1110-1111.

⁸⁰ The iTunes Terms and Conditions are far more restrictive when it comes to software, movies, TV shows, music videos, etc.; see iTunes Store Terms and Conditions, available at <http://www.apple.com/legal/itunes/us/terms.html>.

⁸¹ iTunes Store Terms and Conditions, available at <http://www.apple.com/legal/itunes/us/terms.html>.

⁸² *Id.*

purchased files and only impose moderate use restrictions.⁸³ Applying the *Vernor* test, it is safe to assume that the iTunes Terms and Conditions confer ownership on the digital music files purchased from Apple's iTunes music store for purposes of the first sale doctrine.⁸⁴

In contrast to iTunes' liberal Terms and Conditions, the Terms of Use for Amazon's MP3 Music Service are much more restrictive and explicitly prohibit any transfer of the purchased file. Section 2.2 of Amazon's MP3 Music Service Terms of Use provides in relevant parts:⁸⁵

[Y]ou agree that you will not redistribute, transmit, assign, sell, broadcast, rent, share, lend, modify, adapt, edit, license or otherwise transfer or use the Digital Content. You are not granted any synchronization, public performance, promotional use, commercial sale, resale, reproduction or distribution rights for the Digital Content.

There can be little doubt that under the *Vernor* test, purchases from Amazon music store qualify as mere licenses to which the first sale doctrine does not apply.⁸⁶ ReDigi is, therefore, well advised to exclude from its service song files downloaded from Amazon's music store and other digital music stores.

Regarding the question why Apple's terms and conditions are more liberal than those of its competitors, some observers speculate that Apple obtained the right to transfer title on the audio files to its customers as a part of the deal it reached with rights holders in 2009 to raise prices in return for removal of digital rights management.⁸⁷ The reasons for Apple's interest in giving its customers more rights in the purchased audio files, however, remain unclear. One theory is that Apple might think that

⁸³ *Id.*

⁸⁴ Sanders, *supra* note 5.

⁸⁵ Section 2.2 of Amazon's MP3 Music Service Terms of Use, available at <http://www.amazon.com/gp/help/customer/display.html?nodeId=200154280>.

⁸⁶ Rick Sanders, *ReDigi Finale: Comparing Apples to Amazons*, AARON SANDERS LAW BLOG (Dec. 2, 2011), <http://www.aaronsanderslaw.com/blog/redigi-finale-comparing-apples-to-amazons-part-20-in-our-online-music-services-series>.

⁸⁷ *Id.*

liberal terms and conditions are honored by the market and give its music store a competitive advantage over competitors, thus increasing sales of its music files and players.⁸⁸

b. Limitation to Material Objects

In its memorandum of law, Capitol makes the argument that the first sale doctrine is limited to the distribution of physical embodiments of copyrighted works and, because no material objects are transferred when digital music files are sold, the first sale doctrine does not apply to ReDigi's used music marketplace.⁸⁹ In order to understand Capitol's argument, we have to recall the text of Section 109(a) of the Copyright Act, which refers to "the owner of a particular copy or phonorecord".⁹⁰ The terms "copy" and "phonorecord" are in turn defined as material objects in Section 101 of the Copyright Act:⁹¹

"Copies" are *material objects*, other than phonorecords, in which a work is fixed by any method now known or later developed, and from which the work can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device. The term "copies" includes the *material object*, other than a phonorecord, in which the work is first fixed.

"Phonorecords" are *material objects* in which sounds, other than those accompanying a motion picture or other audiovisual work, are fixed by any method now known or later developed, and from which the sounds can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device. The term "phonorecords" includes the *material object* in which the sounds are first fixed.

Because both terms "copies" and "phonorecords" encompass only material objects in which a copyrighted work is fixed, so Capitol's argument, the first sale doctrine does not apply to purely digital transmissions such as in ReDigi's case. According to Capitol's argument, a consumer could sell the physical medium on which the song file was embodied (e.g. a CD or a computer hard drive), but not the song file itself without the physical medium.

⁸⁸ *Id.*

⁸⁹ Pl.'s Mem. of Law, *supra* note 58, at 13.

⁹⁰ *Supra* III.2.

⁹¹ 17 U.S.C. § 101 (emphasis supplied).

ReDigi seems to have a persuasive counter-argument to Capitol's physical fixation assertion by highlighting that not only the first sale doctrine is based on the terms "copies" and "phonorecords", but also the distribution right itself. Section 106(3) of the Copyright Act, which codifies the distribution right, reads as follows:

[T]he owner of copyright under this title has the exclusive rights to do and to authorize any of the following: [...] (3) to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending; [...].

ReDigi's argument is that the physical fixation limitation either applies to both provisions, in which case the distribution right is not infringed in the first place, or it applies to neither provision, in which case ReDigi's service is protected by the first sale doctrine.⁹² In other words, ReDigi asserts that if digital music files were to be considered copies or phonorecords within the meaning of Section 106(3) of the Copyright Act such that their sale or transfer implicates the distribution right, they would also have to be considered copies or phonorecords for purposes of the first sale doctrine pursuant to Section 109(a) of the Copyright Act.⁹³

On balance, ReDigi seems to have the stronger physical fixation argument, as there is simply no apparent reason why the same terms should be construed differently in two closely related provisions.⁹⁴ Further, it seems more likely that the court will construe both provisions broadly so to include purely digital transmissions (as opposed to construe both provisions narrowly so to be limited to physical objects) since the Supreme Court presumed that the sale of digital copies of articles through an electron-

⁹² Def.'s Mem. of Law, *supra* note 4, at 15-22.

⁹³ *Id.*, at 16.

⁹⁴ *Cf.* Letter from Kathryn J. Fritz, *supra* note 70: "Either both provisions apply, and ReDigi's service may be protected by the first sale doctrine, or neither applies, and ReDigi's service does not infringe the distribution right." See also Rick Sanders, *Music Industry v. ReDigi: The Problem with Phonorecords*, AARON SANDERS LAW BLOG (Jan. 27, 2012), <http://www.aaronsanderslaw.com/blog/music-industry-v-redigi-the-problem-with-phonorecords-copyright>. Capitol's reply memorandum does not provide a reason for such a distinction, but instead focuses on the alleged violation of the reproduction right; Pl. 's Reply Mem. of Law in further Supp. of Pl's Mot. for Prelim. Inj., Feb. 1, 2012, at 5-6, *available at* http://beckermanlegal.com/Lawyer_Copyright_Internet_Law/capitol_redigi_120201PlaintiffsReplyMemo-randum.pdf

ic database constitutes a distribution (although only in dicta and without analysis),⁹⁵ and because a literal reading of the distribution right would create problems throughout the entire copyright system.⁹⁶

VI. DISCUSSION

1. ReDigi Should Prevail in Court

ReDigi seems to have a viable legal strategy for most of Capitol's copyright infringement allegations. With regard to the distribution right, ReDigi seems to be on fairly solid legal ground by only admitting files purchased from the iTunes store and ReDigi's own secondhand marketplace to its service. The iTunes Terms and Conditions are liberal and do not conflict with ReDigi's business model: For purposes of the first sale doctrine, files purchased from the iTunes store are owned by the user and not merely licensed.⁹⁷ Moreover, Capitol's argument that the first sale doctrine is limited to the physical manifestation of a copyrighted work is not convincing.⁹⁸ Capitol does not offer a compelling reason why identical terms ought to be construed differently in two interrelated provisions.

It seems that the outcome of the case will depend on whether the court will follow ReDigi's argument that the copying taking place in its business model is protected by fair use under the space shifting doctrine.⁹⁹ It seems unlikely that the court will dismiss the space shifting doctrine in its entirety. A dismissal of this doctrine would put the legality of all cloud storage services in jeopardy with potential-

⁹⁵ *New York Times v. Tasini*, 533 U.S. 483 (2001). In *Perfect 10 v. Amazon*, 508 F.3d 1146 (9th Cir. 2007), the Ninth Circuit court followed Tasini's dicta, although without analysis and with no one having argued otherwise. The opposite view has been argued by the Electronic Frontier Foundation in its amicus brief in *Elektra Entertainment Group, Inc. v. Barker*; Electronic Frontier Foundation, Br. of Amicus Curiae Computer & Communications Industry Association and US Internet Industry Association in Connection with Defendant's Motion to Dismiss the Complaint, *Elektra Entm't Group, Inc. v. Barker*, 551 F. Supp. 2d 234 (S.D.N.Y. 2008) (No. 05-CV-7340), Feb. 24, 2006, at 12, available at https://www.eff.org/sites/default/files/filenode/elektra_v_barker/CCIA%20amicus.pdf. Cf. Ken Nicholds, *The Free Jammie Movement: Is Making a File Available to Other Users Over a Peer-to-Peer Computer Network Sufficient to Infringe the Copyright Owner's 17 U.S.C. § 106(3) Distribution Right?*, 78 *FORDHAM L. REV.* 983 (2009), at 1004-1005, available at <http://ir.lawnet.fordham.edu/flr/vol78/iss2/14> (citing further cases).

⁹⁶ Sanders, *supra* note 94.

⁹⁷ *Supra* V.2.a.

⁹⁸ *Supra* V.2.b.

⁹⁹ *Supra* V.1.b.

ly serious consequences for the entire cloud computing industry. Such an outcome would be economically and technologically disruptive, stifle innovation and throw the rapidly growing Internet industry back several years. Many consider the remote storage and processing of data the future of the music industry and of computing in general.

While the space shifting doctrine is likely to be upheld in principle, the court might dismiss ReDigi's portrayal of its service as a mere music cloud locker with the additional functionality of a secondhand marketplace. The court might hold that ReDigi may be structured as an online music locker, but that it is in fact only a secondary market for digital music and that the uploading of the files to ReDigi's cloud locker is a mere prelude to the sale. Indeed, ReDigi advertises itself mainly as an online digital marketplace for used audio files; without its secondhand marketplace, ReDigi would offer an inferior cloud storage product by only admitting song files purchased on iTunes and requiring the deletion of all copies of the files uploaded to the cloud. If used only as a music locker, other music cloud locker services offer a better product without such restrictions.

While it might well be true that the secondhand marketplace is the dominant feature of ReDigi's business model, it is submitted that the dispute should nevertheless be decided in ReDigi's favor. Copyright law is a technical law, not a moral code.¹⁰⁰ The fact that ReDigi is technically structured as an online music locker should be enough to uphold ReDigi's fair use defense, the more so as the allegation of unauthorized copying is itself a technical one. It is based on the fact that uploading song files to the cloud locker is technically copying although functionally such copying is only a transfer of the file to ReDigi's servers. Copying is how digital content is transferred, but such copying is fundamentally different from the reproduction that copyright law intends to reserve exclusively for the copyright holder, i.e. the

¹⁰⁰ Rick Sanders, *Copyright and Digital Content: A 40,000-Foot View*, AARON SANDERS LAW BLOG (Aug. 10, 2011), <http://www.aaronsanderslaw.com/blog/copyright-and-digital-content-a-40000-feet-view>.

creation of an independent copy that can be enjoyed by another person and increases the number of parallel users of a work.

It would be illogical to accept a purely technical argument for infringement of the reproduction right, but to deny the same reliance on technicalities for purposes of the fair use defense.¹⁰¹ It should also be noted that ReDigi appears to be a well-meaning innovator that is carefully limiting its product's functionality (e.g. by only admitting files purchased on iTunes) to comply with applicable law and is doing everything it can to prevent its users from infringing copyright (e.g. by requiring the deletion of all copies of an uploaded file).¹⁰² ReDigi is using its best efforts to avoid copyright infringement in an uncertain legal environment (apart from obtaining licenses), thereby distinctly distinguishing itself from copyright infringement systems such as Napster, LimeWire, BitTorrent, etc.

2. Digital Secondary Markets are the Result of a Free Market Process

This paper argues that ReDigi should prevail in court, as no copying takes place in direct connection with the sale transactions and, because ReDigi is structured as an online music locker, the copying necessary for uploading to and downloading from ReDigi's cloud is protected by fair use under the space shifting doctrine. Another question is whether secondary markets for digital content should be permitted from a policy standpoint.

¹⁰¹ This should not mean that copyright law's reliance on technicalities is a good thing. Indeed, legal qualification and economic reality seem to be drifting apart in the digital environment: Legally, a sound recording is licensed when economically it is sold, and a song file is copied when functionally it is merely transferred. Copyright law was not made for the digital world and not always does it adequately reflect economic realities and emerging business models. Therefore, I would welcome a shift of copyright law towards a more functional approach in which functionally equivalent transactions are treated equally regardless of technical differences.

¹⁰² It should be noted, however, that users will find ways to circumvent ReDigi's automatic deletion, e.g. by burning song files on a CDs or transferring them to another computer in the household before uploading them to ReDigi's cloud. In an interview with Wired, ReDigi attorney Rey Beckerman acknowledged that "ReDigi's technology cannot stop customers from file sharing or copying iTunes music purchases before they had uploaded them to the service"; David Kravets, *Online Market for Pre-Owned Digital Music Hangs in the Balance*, WIRED, Feb. 2, 2012, <http://www.wired.com/threat-level/2012/02/pre-owned-music-lawsuit/>.

We have seen that digital files do not wear out and can be copied an indefinite amount of times without loss in quality and, consequently, secondary markets for digital content have a much greater impact on primary markets than in the physical world: "[D]igital transmissions can adversely affect the market for the original to a much greater degree than transfers of physical copies".¹⁰³

In my view, this greater impact of secondary markets on primary markets in the digital world does, however, not suffice to disenfranchise consumers of a fundamental right such as the first sale right.¹⁰⁴ It should be kept in mind that, theoretically, right holders could easily prevent a secondary market for digital music through digital rights management or restrictive licensing regimes (prohibiting the resale and containing other use restrictions). However, the market (or Apple) evidently demands otherwise as the DRM-free files sold on iTunes and the liberal terms of use show. This result of a free market process should be respected.

It is important to note that copyright owners could still prevent a secondary market for digital music by making their content primarily available as streams instead of traditional downloads. It is generally expected that the way music is consumed will shift from downloads (i.e. selling music files) to streams (i.e. selling access to music) in the medium term.¹⁰⁵ The existence of secondary markets for digital music files would likely accelerate this transition from downloads to streams. The debate on secondhand markets for digital music files might soon become obsolete.

¹⁰³ U.S. COPYRIGHT OFFICE, *supra* note 15, at xix.

¹⁰⁴ It could, however, give cause to participate right holders in the revenue made on the secondary market. If ReDigi's information can be trusted, it does indeed on a voluntary basis pay artists directly through its Artist Syndication Program. See *About ReDigi*, REDIGI.COM, <http://newsroom.redigi.com/about/> (last visited Apr. 20, 2012): "Just by using ReDigi, you are supporting your favorite artists directly because they get paid every time you buy or sell one of their songs. This is the first time artists have profited from the re-sale of their work in the secondary market, unlike the sale of a used CD, where artists never see a dime." This would leave the record labels as the only industry participants cut out of the secondary market, a guild already struggling to justify its very existence.

¹⁰⁵ See, e.g., Brandon Griggs, *Spotify Founder: Future of Music is Access, Not Ownership*, CNN TECH, Jul. 21, 2011, http://articles.cnn.com/2011-07-21/tech/spotify.fortune.brainstorm_1_spotify-daniel-ek-share-songs-and-playlists?_s=PM:TECH; Steven Levy, *Facebook, Spotify and the Future of Music*, WIRED MAGAZINE, Oct. 21, 2011, http://www.wired.com/magazine/2011/10/ff_music/all/1; Alex Knapp, *Spotify: The Future of Music?*, FORBES.COM, Jul. 20, 2011, <http://www.forbes.com/sites/alexknapp/2011/07/20/spotify-the-future-of-music/>; Randall Roberts, *With Spotify, the Future of Music is Here*, THE L.A. TIMES MUSIC BLOG, Jul. 22, 2011, http://latimesblogs.latimes.com/music_blog/2011/07/critics-notebook-with-spotify-the-future-of-music-is-here.html.