

Copyright Alert: I Bought It; I Own It—Or Do I?

Vernor v. Autodesk: Ninth Circuit Rules on Software Transfers

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On September 10, 2010, the Ninth Circuit issued a much-awaited ruling on appeal in *Vernor v. Autodesk*, addressing whether software purchasers are *owners* or *licensees* of the copies of the software in their possession. (9th Cir. No. 09-35969.) The court held that “a software user is a *licensee* rather than an *owner* of a copy of the software where the copyright owner (1) specifies that the user is granted a license; (2) significantly restricts the user’s ability to transfer the software; and (3) imposes notable use restrictions.”

The distinction between owner and licensee can be critical to software publishers because owners have rights under the first sale doctrine (17 U.S.C. § 109(a)) and the “essential step defense” (§ 117(a)), whereas licensees and their transferees can be precluded from re-selling software or engaging in other conduct a publisher may want to control.

The first two requirements of *Vernor*’s three-prong test – calling the agreement a license and imposing transfer limitations – will be satisfied whenever the issue is posed, so the critical question under the Ninth Circuit’s ruling will always be whether the agreement imposes “notable use restrictions.” *Vernor* holds that it is sufficient, for a software agreement to be deemed a license, that the agreement bars use outside the Western Hemisphere and prohibits a transferee from modifying, translating or reverse-engineering the software, from removing any proprietary marks, and from defeating any copy protection device.

The ruling is important not only for its resolution of the distinction between owners and licensees but also for the circumstances surrounding the decision. This summer, the same panel of the Ninth Circuit, Judges Canby, Callahan and Ikuta, had not one, but three, lower court cases before it, all on the first sale issue and pending determination of whether contractual terms can deem a transfer that looks like a sale a license. The others are *UMG Recordings, Inc. v. Augusto*, 558 F. Supp.2d 1055 (C.D. Cal. 2008), in which a reseller of promotional CDs was sued by Universal Music Group and the lower court concluded that promotional CDs were not licensed but “sold” for the purposes of the first sale doctrine; and *MDY Industries v. Blizzard Entertainment, Inc.*, 89

U.S.P.Q.2d 1015 (D. Ariz. July 14, 2008), in which the lower court held that the transfer of computer software represented a license. At the time of this writing, *Augusto* and *Blizzard* had not been decided. Stay tuned!

Background and Lower Court Ruling

To recap the facts of the *Vernor* case, which we wrote about in the Summer 2008 edition of *Fenwick & West’s IP Bulletin*, Timothy Vernor is an individual who sells goods on eBay. When he offered lawfully-made packages of Autodesk’s AutoCAD software for sale, Autodesk sent eBay a DMCA take-down notice, claiming Vernor’s sale would infringe its copyright, and eBay ended the auction. Vernor lodged a DMCA counter-notice, to which Autodesk did not respond. eBay reinstated the auction, and Vernor sold the Autodesk software. After this happened four more times in 2007, eBay suspended Vernor’s eBay account for repeat infringement, and Autodesk threatened to “take further action” should Vernor attempt to continue to sell copies of AutoCAD. Vernor possessed two further copies of AutoCAD which he wished to sell. He sued for declaratory relief of non-infringement and for unfair competition.

The copies at issue were originally produced by Autodesk and transferred to an architectural firm, Cardwell/Thomas Associates (“CTA”), as part of the settlement of an unrelated dispute. The Settlement Agreement provided that CTA would adhere to an Autodesk software license agreement, which included restrictions on the transfer of the Autodesk software. Since the copies at issue were lawfully made, if CTA (then Vernor) were deemed “owners” of the copies, they would plainly be allowed — pursuant to the first sale doctrine — to sell their copies to others without violating Autodesk’s distribution right. 17 U.S.C. § 109(a). But if Autodesk had merely *licensed* the software, as licensees they would not have the right to re-sell the software. The lower court held that the initial transfer of the software from Autodesk to CTA was a sale, *not* a license.

Three-Prong Test – Software: a License or a Sale

The United States Court of Appeals for the Ninth Circuit overturned the lower court's decision, siding with Autodesk and concluding that the first sale doctrine did not apply because Vernor was not an owner of the copies of the software he possessed – he had not bought it from a legitimate owner because CTA had merely licensed the software from Autodesk.

Purporting to reconcile a group of earlier Ninth Circuit decisions which suggested varying tests, the *Vernor* court adopted a three-pronged test to determine whether software is licensed or sold:

“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.”

The Autodesk software license agreement described itself as a *license* and the agreement specifically included limitations on the transfer of the software and the software use restrictions described above. The court therefore concluded that “Autodesk's direct customers are licensees of their copies of the software rather than owners,” which, the court said, had two ramifications: “Because Vernor did not purchase the AutoCAD copies from an owner, he may not invoke the first sale doctrine, and he also may not assert an essential step defense on behalf of his customers.”

The court affirmed that Congress had enacted the essential step defense “to codify that a software user who is the “owner of a copy” of a copyrighted software program does not infringe by making a copy of the computer program, if the new copy is “created as an essential step in the utilization of the computer program in conjunction with a machine and . . . is used in no other manner.” 17 U.S.C. § 117(a)(1).” However, the court held, this defense was not applicable to Vernor because he was not the owner of the copy of the Autodesk software.

Policy Arguments

The court acknowledged the policy considerations raised by the parties and their amici, the Software & Information Industry Association and the Motion Picture Association of America supporting Autodesk, and eBay and the American Library Association supporting Vernor. But the Ninth Circuit declined even to comment on these arguments. There were “serious

contentions on both sides,” the court observed, “but they do not alter our conclusion that our precedent... requires the result we reach. Congress is free, of course, to modify the first sale doctrine and the essential step defense if it deems these or other policy considerations to require a different approach.”

Implications of Vernor

Vernor provides a template for software licensors who wish to make sure that their software is licensed with certain restrictions (and not deemed to have been “sold”) – assuming the Ninth Circuit ruling stands and governs the transaction, or that other circuits agree with its reconciliation of the cases on this issue. But *Vernor* does not make entirely clear what use restrictions are necessary to satisfy its third prong, other than that those restrictions set forth in Autodesk's Software License Agreement are sufficient. Possibly, the forthcoming decisions in *Augusto* and *Blizzard*, which arise in different contexts, will help clarify this issue.

Importantly, the *Vernor* three-prong test is not necessarily limited to software licensing. Under *Vernor*, owners of any kind of content or material may be in a position to try prohibition of certain actions in their agreements. Certainly, the terms held sufficient in *Vernor* for license status – bars on reverse engineering, removal of trademarks, and trying to thwart copy protection – are common in the software industry, and we would expect those whose agreements do not contain all of these elements to consider whether their own use restrictions (present or to be adopted) may qualify as “notable.” It will be interesting to see how other industries outside of the software industry react to this decision and if any of their practices will change as a result.

Vernor's counsel has indicated that he intends to ask a full panel of eleven judges in the Ninth Circuit to review the September 10 decision en banc before considering a possible appeal to the US Supreme Court.

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