Hearing on

"First-Sale Under Title 17"

United States House of Representatives Committee on the Judiciary
Subcommittee on Courts, Intellectual Property, and the Internet

June 2, 2014

New York, N.Y.

Testimony of Emery Simon
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Good morning Chairman Coble, Ranking Member Nadler, and members of the Committee. My name is Emery Simon, and I appreciate the opportunity to testify today on behalf of BSA | The Software Alliance ("BSA"). BSA is the leading advocate for the global software industry in the United States and around the world. Our members are among the world's most entrepreneurial and innovative companies, creating software solutions that spark economic growth and improve modern life.[1]

Since the software industry's inception, developers have relied on copyright law—and copyright licenses in particular—to provide their products and services to users. This licensing-based business model has been instrumental to the industry's success and has generated tremendous benefits for consumers, for example, as developers have tailored their offerings to a wide range of customer needs.

BSA members therefore have a keen interest in today's hearing on whether to extend the first-sale doctrine beyond physical copies of works to include works acquired through digital transmissions. We urge this Committee to reject any proposal to extend the first-sale doctrine to copies of software acquired under a licensing agreement or otherwise to convert the first-sale doctrine into a "first-license" doctrine. We believe such an extension would undermine the licensing models that our business and individual customers depend on today, upsetting long-standing business practices and leading to substantial confusion among consumers about the rights and quality associated with "secondhand" software, resulting in unintended and harmful consequences.

Software and the Economy

The commercial software industry is one of the world's most powerful engines of economic growth. In just the past decade, the global software industry has nearly doubled in size, generating annual revenues of nearly $360 billion in 2012, up from $180 billion on 2000.[2] This represents a compounded annual growth rate of greater than 6 percent—more than double the global GDP growth average of 2.5 percent.

The software industry also generates millions of high-quality, high-paying jobs. The U.S. software services industry today employs nearly two million workers whose median income far exceeds the national average. The U.S. Bureau of Labor Statistics projects that software jobs will grow at an annual rate of 3.1 percent through 2020, and that the software industry as a whole will grow by almost 9 percent annually, making it the second-fastest growing U.S. industry sector over the next few years.[3]

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[1] BSA's members include: Adobe, Altium, Apple, ANSYS, Autodesk, AVG, Bentley Systems, CA Technologies, CNC/Mastercam, Dell, IBM, Intel, Intuit, Microsoft, Minitab, Oracle, PTC, Rockwell Automation, Rosetta Stone, Siemens PLM, Symantec, Tekla, The MathWorks, and Trend Micro. *See* www.bsa.org.

[2] *See* BSA, *Powering the Digital Economy: A Trade Agenda to Drive Growth* (2014), at http://digitaltrade.bsa.org/pdfs/DTA_study_en.pdf.

[3] *Id.* at 4.

Software generates even greater economic returns through its use by customers because it enables businesses and individuals across the economy to become more efficient, productive, and competitive, and because it provides them with the tools for further innovation.

The pace of these gains will only accelerate as users transition to cloud computing and other online services. As BSA noted in a recent report:

> "[W]ith infinitely scalable processing power and unimaginably vast data storage at their disposal, banks can now analyze patterns in their transaction records to detect fraud; doctors can assess from historical outcomes the most effective courses of treatment for diseases; and manufacturers can spot the causes of production delays in global supply chains. [Cloud] technologies also collapse distance as never before, allowing companies to operate seamlessly in international markets—interacting with suppliers and serving customers wherever they may be."[4]

Licensing Models Allow Flexibility for Evolving Software Delivery Models

Licensing-based business models have been core to the software industry's success since its beginning. In 1969, when IBM first began to offer software separate from hardware, it used copyright licenses to do so. This enabled IBM to protect its economic interests in its software while also providing customers with rights that exceeded what they would have acquired from an outright "sale" of the software. Licensing has tremendous benefits for users, including by providing them with more choices, lower prices, and various post-transaction benefits that users would not receive through outright sales of software.

Although the software industry has grown exponentially since 1969 and the terms of software licenses have adapted to changes in technology and the marketplace, licenses remain the industry standard for distributing software to users. Licensing will remain the predominant business model as users transition to software-as-a-service subscription models and businesses devise other innovative ways to meet customers' changing demands for software. It makes little sense to apply first-sale concepts in this context. Just as we would never think that first-sale applies to streaming services such as Netflix, or a subscription to the online version of the Wall Street Journal, it similarly makes no sense to apply these rules to subscriptions to use cloud-computing services.

Such evolving software services business models provide tremendous benefits to users: they are flexible, extremely scalable, and allow customers to access massive computing power quickly and at a small fraction of what they would pay to run these services themselves. Whether offered for a one-time fee, as a subscription service, or under other terms, these services all rely on licensing to provide software functionality to users, rather than a transfer of ownership.

Licensing Models Offer Substantial Benefits to Consumers

Extending the first-sale doctrine, for example, to copies of software acquired by digital transmission would undermine the substantial consumer benefits that flow from the licensing models that apply to such transmissions today. Licenses provide consumers with an explicit bundle of rights, including in many cases rights that are more extensive than would be conveyed by a sale of software. Licenses also establish a relationship between the software developer and the customer that often continues long after the initial transaction takes place. For example:

[4] *Id.* at 1.

- Many software licenses entitle the customer licensee to patches and other updates for improved functionality and to fix security vulnerabilities, and in some cases even provide discounted or free access to new versions of the software. These updates can help protect consumers from malware and other security threats that can have disastrous consequences, including theft of their personal information and corruption of their computers.[5] Critically, licenses also often provide authorization for the developer to install such updates on the consumer's computer—conduct that in some cases could trigger civil or criminal liability in the absence of such authorization—and provide reasonable limitations on liability to ensure that developers are not deterred from making these benefits available to their customers.
- Software licenses also often provide consumers with rights that might not be available with regard to a sale under the Copyright Act. For instance, licenses often permit the customer licensee to install the software on more than one computer (*e.g.*, on up to four devices within a single household).
- Software licenses also enable software developers to tailor their offerings to accommodate a range of customer requirements, allowing them to offer different features and charge fees that reflect the customer's situation (*e.g.*, students, home users, businesses) and that accommodate different customer needs (*e.g.*, per-use, per-user, per-device). A business customer, for instance, might be willing to pay a higher price for a copy of software that has relatively broader use rights, additional features, or network licensing options (*e.g.*, allowing software to be installed on multiple devices for non-concurrent use). A student, by contrast, might prefer a lower-priced version of the software with fewer features and usage options. By enabling software developers to tailor usage rights to very discrete scenarios and customer needs, licensing facilitates a far greater range of choices for consumers than would be possible if digital transmissions of software were treated as sales.

Courts Have Sternly Rejected Arguments That a Software License Is Really a Sale

Courts have repeatedly upheld the enforceability of software licenses, including against claims that the first-sale doctrine applies to them. For instance, in the recent case of *Vernor v. Autodesk*, the Ninth Circuit confirmed that the first-sale doctrine applies only to "*owners* of copies of copyrighted works" and is "unavailable to those who are only *licensed* to use their copies of copyrighted works."[6] The court articulated a simple test, based in precedent and state-law contract principles, for evaluating whether a user is a "licensee" or an "owner" of a particular copy of software and thus whether the first-sale doctrine applies.[7]

[5] The threats posed by malware and other cyber threats—both to a customer's computer or system and to the country's information technology infrastructure more broadly—are well recognized. A 2014 study by the International Data Corporation ("IDC") found "that consumers and enterprises have a 33% chance of encountering malware when they obtain a unlicensed software package or buy a PC with unlicensed software on it." *See, The Link between Pirated Software and Cybersecurity Breaches: How Malware in Pirated Software is Costing the World Billions*, IDC White Paper, Mar. 2014.

[6] *Vernor v. Autodesk, Inc.*, 621 F.3d 1102, 1107 (9th Cir. 2010) (emphasis added), *cert. denied*, 132 S. Ct. 105 (2011).

[7] *Id.* at 1111 ("We hold today that a software user is a licensee rather than an owner of a copy 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 *Vernor* test, and similar tests adopted by other courts, look to the license agreement to determine whether the parties *intended* the transaction to be a license, or instead a sale.[8] These precedents provide a clear legal framework for licensing-based business models and certainty for both software developers and their customers. Extending the first-sale doctrine to licensed copies acquired by digital transmissions, by contrast, would *override* the parties' intent by formulaically treating licensing transactions as sales regardless of what the license said or the parties intended.

Applying First-Sale to Licensed Copies Would Create Substantial Consumer Risk

Expanding the first-sale doctrine to apply to software acquired under a license would have substantial detrimental consequences. First, buyers of secondhand software often will be unable to tell whether the copy at issue is genuine or counterfeit, yet will incur liability if the copy turns out to be infringing. Secondhand purchasers also will typically have to rely on representations from the seller about what rights from the original license convey with the software—*e.g.*, to patches, upgrades, after-sales support, etc.—and may have no recourse if these representations turn out to be false.

Secondhand purchasers also have no way of knowing whether the used software they acquire includes security patches, or even might be infected with viruses or other malware. This risk is substantial. A recent IDC study found that 78 percent of counterfeit software downloaded from the Internet was secretly infected with spyware or other malicious code. Installing software infected with malware not only places the user at risk, it also increases the security risks for all other Internet users because the vast "botnet" networks created by infected computers are often used to mount denial-of-service or other attacks on users of non-infected computers.

Creating a right for licensees to transfer copies of software to new users also would raise difficult issues of privity between the software developer and the subsequent transferee. The resulting uncertainty over the parties' respective rights and obligations would complicate efforts to enforce the original license, including provisions specifying the terms of the transaction and the remedies and other rights of the parties. Beyond just casting doubt on whether the subsequent transferee was entitled to services, updates, or other benefits granted to the original licensee, it would also raise the question whether the developer might incur liability in providing such benefits (*e.g.*, providing software updates often requires the licensor to access the user's computing device, which could raise liability concerns absent the user's authorization).

These and related uncertainties would deter developers from offering consumers multiple purchasing options of their works and leave them less able to offer a range of prices for different users and usage scenarios. Developers would be particularly averse to offering these options if they faced the risk of having less-sophisticated versions of their software (*e.g.*, for student use) displace more complex versions intended for commercial settings (*e.g.*, for enterprise use).

The On-Going Threat of Unlicensed Use

Copyright licenses are also a critical tool in combatting software infringement. Nearly one in five copies of software used in the United States has been installed without proper licensing, at a commercial value of

[8] *Cf. Kirtsaeng v. John Wiley & Sons, Inc*., 133 S. Ct. 1351, 1373 (2013) (Kagan, J., *concurring*) (endorsing interpretation of the first-sale doctrine and the importation provision set forth in 17 U.S.C. 602(a)(1) that "turns on the *intended market* for copies . . . instead of on their *place of manufacture*") (emphasis in original).

nearly $10 billion.[9] To effectively prevent this unauthorized use, software developers will continue to rely heavily on the enforceability of copyright licenses (including for online services).

Extending the first-sale doctrine to software distributed under a license would undermine these benefits by creating substantial consumer confusion and threatening the viability of licensing as a business model. By its terms, the first-sale doctrine applies only to the owner of a particular copy of a work—*i.e.*, one to whom the copy has been sold rather than licensed.[10] Indeed, the House Report on this provision stated that it applied only to those who acquire a copy by "outright sale."[11] Converting the first-sale doctrine into a first-license doctrine, by for example extending it to digital transmission, would brush aside this existing law and ignore the important differences between physical copies that are sold and intangible copies that are licensed.

Such a change would materially increase risks of infringement, particularly for digital works such as software. As the Copyright Office noted in opposing such an extension to the first-sale doctrine in 2001,

> "In applying a digital first sale doctrine as a defense to infringement it would be difficult to prove or disprove whether that act had taken place, thereby complicating enforcement. This carries with it a greatly increased risk of infringement in a medium where such risks are already orders of magnitude greater than in the physical world. Removing, even in limited circumstances, the legal limitations on retransmission of works, coupled with the lack of inherent technological limitations on rapid duplication and dissemination, will make it too easy for unauthorized copies to be made and distributed, seriously harming the market for those works."[12]

These concerns are even more acute today given the rapid growth in online distribution of works. When the owner of a physical copy of a work, sells that copy, the owner losses possession of that copy, and physical copies almost always degrade over time. Thus, application of the first-sale doctrine to sales of physical copies of works poses limited risks against infringing use since the original owner of the copy will necessarily lose possession of his copy when it is sold to a second purchaser.

Threats of infringing use of software would be substantially exacerbated were a digital first-sale rule applied to copies of software acquired online. It is nearly impossible to police in cost-effective ways whether a person who purports to transfer a copy of a computer program actually deletes that program from their system once the copy is sold. In fact, because of this policing problem, it is easy to see how a single copy of a program may end up being resold multiple times and each purchaser believing they have acquired a legitimate copy of the software when in fact they have not.

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[9] BSA, *Shadow Market: 2011 BSA Global Software Piracy Study* 4 (9th ed., May 2012), at http://globalstudy.bsa.org/2011/downloads/study_pdf/2011_BSA_Piracy_Study-Standard.pdf.

[10] 17 U.S.C. §109(a).

[11] H.R. Rep. No. 1476, 94th Cong., 2d Sess. 79 (1976).

[12] U.S. Copyright Office, *A Report of the Register of Copyrights Pursuant to § 104 of the Digital Millennium Copyright Act* 83-84 (2001), at http://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf.

In sum, extension of the first-sale doctrine to copies acquired under licenses by digital transmissions or other means would reduce consumer choice by undermining the legal foundations that software developers rely on to offer multiple licensing options and sharply increase infringement risks in ways that do not arise with respect to sales of physical copies of works and. For these reasons, BSA and its members urge this Committee to oppose any extension of the first-sale doctrine to copies of software distributed under licensing agreements.

Thank you again for providing this opportunity to share BSA's views on this important matter. I welcome your questions and look forward to continuing to work with members of the Committee.