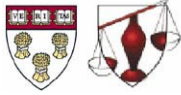




iTunes: How Copyright, Contract, and Technology Shape the Business of Digital Media

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iTunes

How Copyright, Contract, and Technology Shape the Business of Digital Media – A Case Study

This paper provides an analysis of Apple's iTunes Online Music Store. The exploratory case study presented in this document is research in progress. Comments and questions are encouraged. The paper analyzes relevant law to achieve deeper understanding of current shifts in the digital media landscape, but does not provide legal advice.

Research Team

This paper is a case study developed by the Digital Media Project team at the Berkman Center for Internet and Society at Harvard Law School. Gartner|G2 served as our research partner in this venture. Particular thanks to Mike McGuire of Gartner|G2.

Digital Media Project Principal Investigator

William W. Fisher, III

Hale and Dorr Professor of Intellectual Property Law, Harvard Law School

Researchers & Authors

Urs Gasser, John Palfrey, Derek Slater, Derek Bambauer, Andrew Bragin, Jacqueline Harlow, Charles Hoffmann, Renny Hwang, Joseph Jackson, Georg Krog, Edward Locke, Stephen Mohr, Ivan Reidel, and C. Lee Wilson

Communications Director

Mary Bridges

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Introduction

Abstract

In this paper, the Berkman Center's Digital Media Project has conducted an exploratory case study of Apple's iTunes Online Music Store (iTMS) from a legal and business perspective. The objective of this analysis is twofold: First, it seeks to gain advanced knowledge of the relationships among copyright law, contract law, digital rights management schemes, and business modeling processes in the Post-Napster world. Understanding such interactions is crucial when attempting to balance the divergent interests of consumers, artists, the entertainment industry, and technology manufacturers through regulatory mechanisms such as law, code, market mechanisms, and adjustment of social norms. Second, the paper is intended as a further step toward expanding the knowledge base of the Digital Media Project beyond U.S. law to include a more detailed coverage of the legal and regulatory frameworks of other countries. The focus of the comparative law analysis conducted in this initial study is on European jurisdictions and selected nations in the Asia-Pacific.

A. Background

The Berkman Center for Internet & Society and GartnerG2 White Paper, "Copyright and Digital Media in a Post-Napster World,"¹ analyzed the shift from analog and physical media to digital and online media and examined how the shift is altering the media industry and changing the way people use and enjoy consumer electronic products, media, and entertainment. More specifically, the foundation paper identified today's critical technological issues in the digital media debate, explored key legal and regulatory developments regarding copyright and related intellectual property issues, and discussed business models upset by digital media distribution and new models made possible.

The second paper² by the Digital Media Project at the Berkman Center set forth five scenarios for digital media in a Post-Napster world that could emerge over the next few years. This second study also included an initial analysis of the legal, business and economic impacts of these five scenarios. Since the release of the second paper, these scenarios have been extensively discussed, reviewed, and further developed. Today, the five scenarios include:³

- The [No-Change Scenario](#) assumes that confusion remains about doctrines like "fair use" and "first sale" as the DMCA and copyright law continue to guide digital media distribution.

¹ See <http://cyber.law.harvard.edu/home/2003-05>.

² See <http://cyber.law.harvard.edu/home/2003-07>.

³ See <http://cyber.law.harvard.edu/media/scenarios>.

- The [Speedbumps Scenario for Digital Media](#) forecasts that technological restrictions like encryption will create small barriers to users' access and control of digital content.
- The [Technology Lockdown Scenario](#) projects that restrictive digital rights management (DRM) schemes will unilaterally determine users' experience of the content they purchase.
- The [Alternative Compensation System Scenario](#) imagines that users access digital content through a state-run system that would tax consumers according to use and reward creators according to the popularity of their work.
- The [Entertainment Co-op Scenario](#) envisions that voluntary associations emerge within the existing copyright structure to allow distribution of digital content between subscribers and creators.

B. Objectives and Scope

The present case study of Apple's iTunes⁴ has been conducted against the backdrop of these prior reports by the Digital Media Project at the Berkman Center. These reports have made clear that any potential solution to the current media crisis must balance the potentially divergent interests of consumers, artists, the entertainment industry, and technology manufacturers in order to create a viable foundation for future growth. Regardless of which solution is envisioned, balancing of these interests through the law, technology, market mechanisms, and adjustments of social norms requires an understanding of the complex interplay between these basic regulatory modalities and their effects on business models, industry structure, technology, and the normative and social environments.

This paper, by analyzing iTunes, focuses on one particular aspect within this complex network of interrelations and interdependencies—the interaction between doctrines of copyright and contract law, digital rights management regimes, and business modeling processes. Such interactions and interrelationships are assumed under all five scenarios, but have not yet been explored in detail. Moreover, the research paper aims to expand the knowledge base of the Digital Media Project beyond the U.S. law by including an analysis of the critical legal issues in the digital media debate in Europe, Japan, and China.

The following key legal issues and their interactions with the business model are discussed from both a U.S. and international perspective:

- Copyright and Contract Law Interplay: Online media services such as Apple's iTMS regularly use two legal strategies to govern consumer's actions with respect to purchased e-content such as songs, movies or e-books: agreements through contracts and limitations through copyright

⁴ We examine Apple's iTunes Online Music Store because it is the pacesetter in the digital media marketplace. However, it is important to note that iTunes provides only one example of an online media distribution system. Please note that when the term "iTunes" appears in this case study, it is used as a generic term encompassing the entire business model and its software. When specifically referring to the software, iTunes version 4.6 will be used. Otherwise the abbreviation iTMS, meaning the iTunes Online Music Store, will be used.

protections. Part I explores the interaction between these two doctrines and illustrates how Apple's ability to control the iTunes depends on this interplay.

- Digital Rights Management (DRM): One key element of the iTunes (and digital media services in general) is the DRM system, which constrains by technological means ("Code") what users are able and allowed to do with digital content. Part II describes Apple's DRM system (called FairPlay) and discusses how the business model may depend on the Digital Millennium Copyright Act (DMCA) and its counterparts in other jurisdictions to provide a cause of action against users who bypass these restrictions.
- Digital First Sale Doctrine: Copyright law provides a set of exclusive control rights such as the right of reproduction and the right of distribution. However, such exclusive rights are only granted within certain limits. Part III discusses the limitation on the right of distribution through the first sale doctrine (the principle of exhaustion), explores whether the doctrine—originally created for tangible goods—applies to digital content distributed over the Internet, and illustrates why these questions matter from the business perspective of digital media service providers such as the iTunes.
- Fair Use Doctrine: Part IV discusses another set of limitations on copyright law—the privilege of users to use copyrighted materials such as songs downloaded from the iTunes in a reasonable manner without the permission of the copyright owner. It analyzes the potential effects of this doctrine on the business models of digital media services like the iTunes.

C. Overview of the iTunes Music Store

Apple's iTunes Music Store lets customers search a catalog of over 700,000 tracks, including music from all five major labels.⁵ With one click, users can purchase the songs and download them into their iTunes music library for \$0.99 cents per song and \$9.99 per album, without any subscription fees. Songs are downloaded in digital quality and can be burned onto CDs for personal use, played on up to three computers, and listened to on an unlimited number of portable players such as Apple's iPod. Access to the iTunes Music Store and its song catalog is embedded in Apple's iTunes software,⁶ which includes a music player, CD ripping and burning tools, an interface to the iPod, free Internet radio stations, and a limited streaming audio feature called Rendezvous. In October 2003, Apple released similar software for Windows, and announced product tie-ins with America Online and Pepsi Cola.⁷ The service is currently only available in the United States. However, Apple is scheduled to launch iTunes in Europe on June 15, 2004.⁸ Recently, a deal to distribute iTunes version

⁵ See <http://www.apple.com/pr/library/2004/may/05itunes.html>; the major labels are AOL/Time-Warner, EMI, Sony, Vivendi-Universal, and BMG.

⁶ Available at <http://www.itunes.com/>.

⁷ See <http://www.pnnewswire.com/cgi-bin/stories.pl?ACCT=SVBIZINK8.story&STORY=/www/story/10-16-2003/0002037635&EDATE=THU+Oct+16+2003,+02:06+PM>.

⁸ See <http://news.bbc.co.uk/1/hi/entertainment/music/3784799.stm>.

4.6 in China was reported, but no announcement about the expansion of the iTunes has been made.⁹ Additionally, after opening Apple's first retail store in Japan on November 27, 2003, Apple representatives informally stated that the iTunes service would be offered sometime in 2004.¹⁰

Sixteen days and two million downloads after opening,¹¹ Apple's iTunes¹² had become the pacesetter in the digital music marketplace. Finally, there was a simple, inexpensive music service that could satisfy consumers. With over 70 million downloads since its launch,¹³ the Store has elicited renewed interest in the online music market. What makes the iTunes Music Store special? The following paragraphs sketch the Store's main characteristics and explain how it differs from previous services.

1. Pricing

Apple's iTunes was the first service with content from all five major labels to sell songs *à la carte* with no subscription fees. The Store's pricing seems both revolutionary and obvious—the former because the prices are significantly lower than previous services' (including brick-and-mortar CD stores), and the latter because they come closer to projected price points. Market research firm Jupiter Research projected last year that \$0.99 per song would attract a significant number of consumers. In May 2004, rumors abounded that the five major record labels were forcing Apple to raise prices to as much as \$1.25 for more popular singles. Such price discrimination has long been a common practice in the offline world, where it allows the labels to make more money on newer songs while increasing demand for older tunes through lower prices. Apple denied any price increase for singles, asserting that it had multiyear agreements with the labels.¹⁴ Nevertheless, online prices for albums did not hold steady at the \$9.99 that was advertised during the iTunes launch, as some iTunes album prices even exceeded those of their on-the-shelf counterparts.¹⁵

The flexibility and convenience offered by the iTunes's *à la carte* pricing make the music store feel like P2P in certain ways. In a P2P service, downloaders get what they want on a whim. Apple's combination of *à la carte* purchases with fast searching, one-click purchasing, and integrated software tools keep the consumer's focus on short-term costs and his or her immediate desire for a song. Thus, the low up-front price can lead to "impulse buys." However, one arguable vulnerability of the iTunes model is the tremendous expense of amassing a large collection. At \$0.99 per song, it would cost \$5,000 to fill Apple's medium capacity iPod and \$10,000 to fill a large capacity iPod.¹⁶ Microsoft has yet to launch its own online music service. But with the

⁹ See Apple's press release available at <http://www.apple.com/pr/library/2004/may/18founder.html>.

¹⁰ See http://www.theregister.co.uk/2004/05/06/music_biz_apple_fears/. For Japan, See <http://maccentral.macworld.com/news/2004/01/05/japanmusic/>.

¹¹ See <http://news.com.com/2009-1027-1009538.html>.

¹² See <http://www.apple.com/itunes/store/>.

¹³ See <http://www.apple.com/pr/library/2004/apr/28itunes.html>.

¹⁴ "Apple Denies Report of Price Increase," *Reuters*, May 10, 2004, at <http://www.macminute.com/2004/05/07/itunes>.

¹⁵ Significantly, in April 2004, the iTunes offered rock-rap group N.E.R.D.'s album "Fly or Die" for \$16.99. A physical copy of the album sold on Amazon.com for \$13.49. Roxio's Napster 2.0 also sold the digital version at higher price than its real world counterpart, offering "Fly or Die" for \$13.99. See <http://digitalmusic.weblogsinc.com/entry/8673568589278779/>.

¹⁶ Although no formal study has cataloged the source of content people save on their iPods, previous CD purchases can be "ripped" using iTunes version 4.6 software and transferred to iPods. Additionally, even pirated mp3s can be transferred to an iPod.

release of Windows Media Player 10, it is poised to break Apple's monopoly on the hardware aspect of digital music delivery. A new DRM scheme embedded in Media Player 10 utilizes synchronization between portable devices and a home computer. This new technology will increase portability of music in subscription services. With a subscription service that supports portable devices, consumers will be able to fill their devices by paying a monthly fee that is much more affordable than a comparable pay-per-download model.¹⁷ Though subscription services might often be cheaper for high-volume downloaders, the initial fees they charge may lead consumers to focus on high up-front costs. Even forcing consumers to buy "packs" of downloads rather than individual songs, as former music service Pressplay did, may seem too costly to many consumers. In the meantime, some services are trying to cash in on both markets; Roxio's Napster 2.0 music service, developed from its purchase of Pressplay, includes both subscription and *à la carte* options, while RealNetworks operates its *à la carte* Music Store separately from its subscription service, Rhapsody.

Apple's iTunes uses the same price for singles across the board. In contrast, rival *à la carte* service BuyMusic.com has adopted a strategy which includes varying prices for downloads depending on the perceived consumer willingness to pay. Napster 2.0 offers its users unlimited full listening rights of its entire library for a \$10.00 monthly fee; users of the subscription service then pay a discounted rate of as little as (\$0.80) for the rights to burn, download, and use on portable devices.¹⁸

2. Song Catalog

Apple's iTunes originally featured a 200,000 song catalog that did not represent a wide variety of labels, particularly independent labels. With its expansion to Windows, followed by its one year anniversary on April 28, 2004, Apple announced that it had a 700,000 song catalog including offerings from 450 independent music labels.¹⁹ Apple is expected to continue expanding its catalog to keep up with newer offerings; BuyMusic.com offers 400,000 songs, and Napster 2.0 offers more than 500,000 songs including many independent labels.²⁰

3. Ease of Use

The Store has become well-known for its ease of use:²¹ After browsing the catalog for free, purchases can be made immediately with "one-click technology" or can be progressively added to a shopping cart for later purchase. Parents can also create special accounts for their children with individual spending limits.²²

¹⁷ See <http://audioworld.com/cgi-bin/Framelt.cgi?Url=http://www.newsfactor.com/perl/story/23730.html&ConfigFile=Framelt.cfg>.

¹⁸ Napster light offers a 99 cents per download option with no subscription fee, users lose full listening rights. For a full comparison see http://www.napster.com/what_is_napster.html. Napster UK offers downloads for £1.09 (converts to \$1.98) a track using Napster UK light and £0.88 per track using the full subscription service which costs £9.95 a month (given current exchange rates this works out to be \$18.04/month). Currency conversions according to exchange rate on June 14, 2004.

¹⁹ See <http://www.apple.com/pr/library/2004/apr/28itunes.html>.

²⁰ See Chris Marlowe, "Roxio Reloads Legal Napster," *Hollywood Reporter* (Oct. 13, 2003). As many as many as 200,000 from independent labels, see http://msl1.mit.edu/furdlog/docs/nytimes/2003-07-28_nytimes_ap_napster.pdf.

²¹ See, e.g., <http://www.earthv.com/Art.s.asp?Art.ID=2037>.

²² See <http://www.apple.com/itunes/store/>.

4. Digital Rights Management System

All tracks are encoded using the open standard, Advanced Audio Coding (AAC)²³ at 128 kbps rather than the ubiquitous, though marginally lower quality, standard, MP3 (MPEG Audio Layer-3). In addition, Apple employs its own proprietary Digital Rights Management (DRM) system called FairPlay. This DRM system restrains usage in two ways:

- First, users can only download a purchased song once and can use the song on five²⁴ computers. However, they can move songs to a portable iPod an unlimited number of times. Users also can make unlimited CD burns of any given song, but can only burn the same exact playlist seven²⁵ times in order to help prevent mass-production of copies for illicit sale.²⁶ Unlike Napster 2.0's subscription model, Rhapsody, and Pressplay, Apple's purchases are treated like sales, not rentals.²⁷ As a consequence, and in contrast to subscription models, playing a song is not contingent on remaining a customer of the Store. Perhaps because of Apple's success, the newer *à la carte* services have negotiated similar usage restrictions.²⁸
- Apple's DRM, as mentioned, is proprietary in nature. No portable player aside from the iPod supports FairPlay, and the iPod only supports the AAC and MP3 standard rather than the dominant standard used by the other digital music services, Microsoft's Windows Media DRM for Windows Media Audio (WMA). This lack of interoperability, however, might be a key part of Apple's business model. After the iTunes became available on Windows, Apple Senior Vice President Phil Schiller stated in an interview: "The iPod makes money. The iTunes Music Store doesn't."²⁹ Using software to drive hardware sales is a typical strategy for Apple, so it might accept moderate losses from the Store to recover a net profit with device sales. Apple has continued to strengthen its hold on the digital music market. On June 7, 2004, it released the AirPort Express, a tiny (6.7 ounce) mobile wireless networking base station. When linked with a user's home stereo, the device can function as a remote speaker system.³⁰ iTunes version 4.6,

²³ See http://www.iis.fraunhofer.de/amm/download/mpeg_aac.pdf (describing audio format).

²⁴ Before April 28, 2004 users could only share with three other computers. See April 28 announcement at <http://www.apple.com/pr/library/2004/apr/28itunes.html>.

²⁵ By way of contrast, Napster allows users to burn the same playlist only five times, and Sony's Connect tosses out the whole notion of playlists and allows burns on a per track basis, allowing five burns to ATAC CD's and five burns to Redbook CDs. See <http://www.napster.com/terms.html> and <http://www.connect.com/tos.html> for more information.

²⁶ Before April 28, 2004, users could burn up to ten copies of a given playlist. Apple wanted to honor its commitment to preventing piracy through sales of illicit copies. See April 28, 2004 announcement at <http://www.apple.com/pr/library/2004/apr/28itunes.html>.

²⁷ See Part II on Copyright and Contract Law and Part III on Digital First Sale Doctrine. Apple has at least been open to the possibility that songs are owned inasmuch as they could be legally resold, although that would be technically difficult. <http://news.com.com/2100-1027-3-5072842.html>. Though Apple reserves the right to modify the usage restrictions at any time, even if doing so means "you may no longer be able to use Products to the same extent as prior to such change or discontinuation," it is highly unlikely that such changes will affect songs. However, one customer has reported that, when re-initializing his domestically purchased songs outside of the country, the songs became inoperable, see <http://www.interesting-people.org/archives/interesting-people/200307/msg00150.html>.

²⁸ Slight differences are common, however. For instance, Musicmatch's service only allows 5 burns of a given playlist, but the difference is negligible. See <http://news.com.com/2100-1027-5083282.html> and <http://www.musicmatch.com/info/company/press/releases/?year=2003&release=13>.

²⁹ See <http://news.com.com/2100-1041-5092559.html?tag=nl>.

³⁰ See <http://maccentral.macworld.com/news/2004/06/07/jobsd/>.

released on June 9, 2004, introduced a new technology called AirTunes to support the Airport Express.³¹ In addition, inasmuch as Apple can require use of the iTunes and Apple's QuickTime to play FairPlay files, Apple can increase the value of its brand by associating Apple with all uses of digital music.³²

5. Extra Features

Forrester Research suggests that, even if other programs could easily operate FairPlay files, iTunes' integrated tools would still be valuable because they increase ease of use and consumers' willingness to treat the iTunes as the home for all music listening and buying.³³ In contrast, Buymusic.com and Wal-Mart have chosen to offer standalone, Web-based music stores.

The Store also offers free music videos, album art, thirty-second song previews, and CD descriptions. Exclusive special features include playlists created by celebrities, exclusive tracks, and audiobooks. These features are just the tip of the iceberg of potential features iTunes could provide. For instance, it could provide tour information, including ways to purchase tickets, community building tools similar to Amazon's "so you'd like to..." and "listmania" features, and music magazines like Napster 2.0's "Fuzz."

³¹ See <http://maccentral.macworld.com/news/2004/06/09/itunes/>.

³² RealNetworks' RealPlayer can play iTunes' songs, but the user must also have iTunes software installed. See <http://news.com.com/2100-1027-5136275.html>.

³³ See <http://news.com.com/2030-1027-5093879.html>.

Part I: Contract-Copyright Interplay

A. Summary: Where Copyright Permits, Contracts May Prohibit

Apple uses two legal strategies to govern what actions consumers may take with songs purchased from the iTunes Music Store: agreements through contract and limitations from copyright protections. The extent of Apple's ability to control the iTunes Music Store depends on how contract and copyright doctrine interact. Copyright law typically provides exceptions to its protections that effectively create greater freedom of action for consumers who purchase copies of protected works such as songs. However, if contracts can re-allocate copyright's entitlements, Apple can use license agreements with iTunes Music Store users to support its business model by limiting what the users can do with their songs—even overriding rights consumers would otherwise enjoy under copyright. Hence, where contract law can override copyright, and governments do not impose mandatory contract terms, Apple's license agreements can plug holes copyright creates. If copyright overrides contract law, Apple loses some control over iTunes Music Store songs once users download them, but users enjoy greater freedom of action. This might weaken the iTunes Music Store business model, especially if greater user freedom creates a secondary market in downloaded songs, permits users to reverse-engineer Apple's FairPlay digital rights management technology, or decreases artist and licensor willingness to provide music. To understand the interaction of contract and copyright, we must explore briefly the two doctrines, understand their interplay, and look to their effects on the iTunes Music Store service.

1. Copyright

Copyright law protects certain works and rewards their creators by providing exclusive control over specific uses of the work through a government-granted monopoly for a limited time period. In theory, copyright's protections and proscriptions operate universally; everyone but the copyright holder must obtain permission to perform lawfully a protected action. Copyright statutes determine the works that qualify for protection, the uses that are exclusive to the copyright holder, the duration of the protections, and the penalties for violating these rights. Once a copyright expires, the protected work enters the public domain—anyone may use it.

However, copyright law creates exceptions to and limitations upon its exclusive rights in order to safeguard socially desirable uses of protected works. These exceptions often include the “first sale” doctrine,³⁴ the “idea/expression” distinction,³⁵ and “fair use.”³⁶ These exceptions may operate as defenses, preventing

³⁴ See Part II on Digital First Sale Doctrine.

³⁵ This concept forbids protection to the central idea or theme of a work while guarding its particular expression. See, e.g., 17 U.S.C. § 102(b) (United States); see also *Baker v. Selden*, 101 U.S. 99 (1879) for the classic statement of U.S. doctrine on the idea versus expression dichotomy.

copyright holders from successfully suing users who perform actions within these categories, or as affirmative grants of a right to users or consumers generally.

2. Contract

By contrast, contract law enforces private agreements between parties who agree to perform or forgo certain actions.³⁷ The conceptual model is a mutually beneficial exchange whose terms are negotiated by the parties (subject to governmental restrictions based on public policy or normative concerns such as starkly unequal bargaining power).³⁸ The duration of a contract depends on its terms but is theoretically unlimited.

Computer software and Internet-based commerce introduced a new form of contract known as “clickwrap.”³⁹ In a clickwrap contract, the software or Internet site presents the user or potential purchaser with contractual terms governing the use of the software or site. The user must agree to those terms and click a button or link demonstrating her assent to use the software or site.⁴⁰ Apple uses clickwrap contracts with iTunes version 4.6 and the iTunes.⁴¹

The key question for the iTunes and similar services is whether contracts can alter the allocation of rights and exceptions under copyright law. Contract clearly can change the distribution of rights in some circumstances. For example, the iTunes permits users to copy a downloaded song file to five computers.⁴² The contract

³⁶ See Part IV on Fair Use.

³⁷ Contract law varies by jurisdiction—rules differ between countries (such as between Japan and China) and even within countries (such as between California and New York in the United States). International efforts have sought to harmonize these rules, particularly in the scope of online commerce, but have enjoyed mixed success at best. See, e.g., United Nations Commission on International Trade Law (UNCITRAL) Model Law on Electronic Commerce, available at <http://www.uncitral.org/english/texts/electcom/ml-ecomm.htm>; see also UNCITRAL Status of Conventions and Model Laws, available at <http://www.uncitral.org/english/status/status-e.htm> (listing 19 countries adopting the Model Law on Electronic Commerce).

³⁸ See, e.g., Consumer Contract Act of May 12, 2000 (Japan) (expressly forbidding contract terms seen as unfair to consumers, such as liquidated damages and complete damage waivers by businesses, in some circumstances); *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445 (D.C. Cir. 1965) (United States) (finding that a court could refuse to enforce a “boilerplate” provision in a furniture rental agreement that repossessed all rented furniture if the renter missed a payment on any of it); *Brower v. Gateway 2000, Inc.*, 676 N.Y.S.2d 569, 574-76 (N.Y. App. Div. 1998) (United States) (finding an arbitration clause in an agreement for purchase of a personal computer invalid because the prohibitive cost of the arbitration process made the term substantively unconscionable).

³⁹ Clickwrap contracts are a technical extension of the idea of shrinkwrap contracts in which a person is said to consent to a the terms of a product by opening the shrinkwrap – In clickwrap contracts clicking “I agree” means that the user consents to the the terms of use. See, e.g., *i.Lan Sys. V. NetScout Serv. Level Corp.*, 183 F. Supp. 2d 328, 329 (D. Mass. 2002) (United States) (defining a “clickwrap license” and finding it enforceable).

⁴⁰ See, e.g., *Specht v. Netscape Communications Corp.*, 306 F.3d 17, 20 (2d Cir. 2002) (United States) (affirming that Netscape could not enforce an arbitration provision in a software license agreement since users did not have to click to agree to terms in the agreement before using the downloaded software).

⁴¹ Installing iTunes version 4.6 requires that the user agrees to *all* of the terms in the license. It contains the statement “if you do not agree to the terms of this licence do not use this software.” In addition to the usual statements limiting its liability and limiting its warranty, the license does have a specific clause related to iTunes file which reads as follows: “This software may be used to reproduce materials. It is licensed to you only for reproduction of non-copyrighted materials, materials in which you own the copyright, or materials you are authorized or legally permitted to reproduce. This software may also be used for remote access to music files for listening between computers.” An unofficial copy of the full license agreement can be found posted at <http://blogs.23.nu/contracts/stories/3219/>.

Additionally before using the iTunes a user must consent to another clickwrap agreement. The agreement requires that the user, who must be at least 13 years of age, agree that all iTunes content (including iTunes songs) is proprietary content and can only be used according to the terms of the agreement. These terms allow for personal use only, and include all of the usage restrictions protected by Apple’s FairPlay DRM (see section 4 on DRM of the Introduction). The agreement is available on the web at <http://www.apple.com/support/itunes/legal/terms.html>

⁴² § 9(b), iTunes Music Store Terms of Service (“iTunes Terms of Service”), available at <http://www.info.apple.com/usen/itunes/terms.html>.

between Apple and the consumer (the iTunes Music Store Terms of Service) waives Apple's (and the copyright holder's) right to sue based on this copying—copying that technically violates the exclusive right to reproduce the protected song under copyright law. Apple, like any other copyright holder, can grant exclusive or non-exclusive rights to its copyright entitlements through contract.⁴³

In other circumstances, however, the relationship between contract and copyright is less certain. A crucial issue is whether Apple can require consumers to forgo certain rights and defenses under copyright law in exchange for access to its protected works (the iTunes music). For example, could Apple require consumers to give up their ability to make “fair use”⁴⁴ or private copies⁴⁵ of the songs in exchange for the right to download and use an iTunes file? Apple can generally expect to enforce such agreements with users, but this answer varies with the copyright and contract law in effect where Apple deploys the iTunes.

B. Effects of Contract versus Copyright Tension on iTunes

Apple can use agreements with consumers to reinforce its business model where contract law most freely permits re-allocating copyright entitlements and where it most fully allows private parties to define terms. If contract law can effectively override copyright, and as far as enforcement of contractual provisions is practicable, Apple can “lock down” its song files by specifying precisely what uses of and actions with those files are permitted and prohibited.⁴⁶

The iTunes business model relies in part upon the contract between Apple and the consumer effectively re-allocating copyright entitlements. For example, § 8(b) of the iTunes Terms of Service states that the user agrees “not to attempt to, or to assist another person to, circumvent, reverse-engineer, decompile, disassemble, or otherwise tamper with any of the security components [in Apple's DRM]... for any reason whatsoever.”⁴⁷ This provision waives any right to reverse-engineer the software consumers might have under copyright⁴⁸ or other applicable law⁴⁹. Apple also requires iTunes users to “agree not to modify, rent, lease, loan, sell, distribute, or create derivative works” from downloaded songs—a condition that could waive resale rights under a “digital first sale” doctrine.⁵⁰ Apple further retains the “right to change, suspend, remove, or disable access... at any time without notice.” Finally, iTunes' Terms of Service include language in § 13(a) that might preclude

⁴³ Apple enters into a licensing contract with the copyright owners of its music (generally, major record labels such as Sony) permitting the company to distribute copies of the songs in exchange for fees. See, e.g., Jeff Leeds, *Sour Apples Between Beatles, iTunes; Computer maker's online music store triggers lawsuit by the band's licensing firm*, Los Angeles Times, Sept. 13, 2003, at 1 (describing a licensing disagreement over music by the Beatles).

⁴⁴ See, e.g., 17 U.S.C. § 107 (United States).

⁴⁵ See, e.g., art. 30, Copyright Law of Japan (see *supra* note 128).

⁴⁶ Apple's Digital Rights Management system and usage agreements are mutually reinforcing—DRM prevents users from performing actions that the contract with Apple forbids. See Part II on Digital Rights Management.

⁴⁷ § 8(b), iTunes Terms of Service; see also § 9(b) (defining usage rules).

⁴⁸ See *Sega Enterprises*, 977 F.2d at 1527-28.

⁴⁹ See, e.g., 17 U.S.C. § 1201(f) (United States).

⁵⁰ § 13(b), iTunes Terms of Service. This provision makes the transfer of iTunes songs to a consumer appear more like a license (such as with a copy of a software program) than the transfer of title to the embodiment of a copyrighted work (such as with a copy of a book). Clearly, whether a “first sale” doctrine applies to iTunes songs would affect this distinction. . . . See Part III on Digital First Sale Doctrine.

fair use of downloaded songs: “You agree that the Service [the iTunes Music Store], including but not limited to graphics, audio clips, and editorial content, contains proprietary information and material that is owned by Apple and/or its licensors... and that you will not use such proprietary information or materials *in any way whatsoever* except for use of the Service in compliance with the terms of this Agreement [the Terms of Service].”⁵¹ If copyright law overrides these terms, consumers could sell access to their songs, reverse-engineer FairPlay (though the DMCA would still apply), or use songs for fair use purposes (assuming that the FairPlay DRM doesn’t prevent them from so doing). These actions might weaken the iTunes business model.

If Apple can effectively limit and predict what consumers can do with the songs they purchase from the iTunes, the company can maximize revenue from sales.⁵² Geographic restrictions in Apple’s agreements let the company fine-tune pricing to demand in each national market.⁵³ Price discrimination based on consumer location depends both on technological measures to detect location and enforce nation-specific access and on legal measures to prohibit circumventing the technology and validate market differentiation.⁵⁴ In contrast, if copyright exceptions limit Apple’s contractual control over iTunes music, users may have greater freedom of action but fewer songs to choose from—copyright owners may be less confident in entrusting songs to Apple’s store. For example, if a digital “first sale” doctrine exists, and Apple cannot preclude re-sale via contract, copyright owners may seek alternative distribution methods rather than lose sales to a secondary market in “used” iTunes songs.⁵⁵ In the following sections, the interplay between copyright and contract law will be discussed in greater detail.

C. Copyright versus Contract in the United States

Copyright and contract are in tension in the United States.⁵⁶ We examine two key issues: whether federal copyright law prevents contracts from altering its entitlements, and how different remedies for contract and copyright affect digital media business models.

Determining whether contract can alter copyright entitlements is complicated by the duality of legal authority in the U.S. federal legal system. The U.S. Constitution gives the Congress power to reward authors with exclusive rights over their creations.⁵⁷ The Constitution’s Supremacy clause allows Congress to displace or

⁵¹ § 13(a), iTunes Terms of Service (emphasis added).

⁵² See *ProCD*, 86 F.3d at 1449-50 (explaining price discrimination in sales of a telephone listing database on CD-ROM).

⁵³ See § 10, iTunes Terms of Service. [Details] See generally William W. Fisher III, *Property and Contract on the Internet*, 73 Chi.-Kent. L. Rev. 1203, 1234-40 (1998) (arguing that technology and contract enhance the ability to engage in price discrimination, charge customers based on more individualized demand, and maximize revenue).

⁵⁴ Legal measures prohibiting resale, and technical measures enforcing this restriction, would allow Apple to prevent consumers from engaging in arbitrage that undercuts price discrimination and national restrictions through a secondary market in downloaded songs.

⁵⁵ Japanese courts have considered this issue regarding importation of movie videocassettes from the United States. See Darren E. Donnelly, *Parallel Trade and International Harmonization of the Exhaustion of Rights Doctrine*, 13 Santa Clara Computer & High Tech. L.J. 445, 485 (1997).

⁵⁶ See Jacques de Werra, *Moving Beyond the Conflict Between Freedom of Contract and Copyright Policies: In Search of a New Global Policy for On-Line Information Licensing Transactions: A Comparative Analysis Between U.S. Law and European Law*, 25 Colum. J.L. & Arts 239, 268 (2003).

⁵⁷ See Art. I, § 8, cl. 8, U.S. Constitution; see also *Eldred v. Ashcroft*, 537 U.S. 186, 192-93 (2003).

supersede state laws that conflict with its legislation.⁵⁸ Congress created copyright legislation to protect certain works⁵⁹ and, in its 1976 revisions to the Copyright Act, pre-empted state laws covering works eligible for copyright protection and providing rights equivalent to those in the federal copyright statutes.⁶⁰

Contracts are governed by the laws of individual American states.⁶¹ As such, a contract allocating or altering entitlements to a work may be pre-empted by federal copyright law.⁶² The issue of pre-emption arises when there may be a conflict between contract rights and copyright—for example, it would apply if a state were to forbid copying a protected work⁶³ or to outlaw all fair use of copyrighted works.⁶⁴ To determine whether copyright pre-empted state law, courts ask two questions. First, is the work at issue eligible for copyright protection based on its subject matter?⁶⁵ Second, is the protection that state law creates equivalent to the rights offered by copyright?⁶⁶ If the answer to both questions is “yes,” copyright overrides the state law.⁶⁷ This analysis is complicated—the court must consider which state’s law applies, what that state law constitutes, and how to apply federal copyright pre-emption doctrine. As such, pre-emption varies by interpreting court.⁶⁸ This diversity of decisions reduces certainty about what law will apply to a contract, though parties can increase certainty by specifying which state’s laws should apply and where disputes should be resolved.⁶⁹

Despite this conceptual uncertainty, US courts increasingly agree that copyright law does not override contract law, and permit contracts to assign or waive copyright protections and defenses. For example, two influential

⁵⁸ See Art. VI, § 2, U.S. Constitution.

⁵⁹ 17 U.S.C. § 102.

⁶⁰ See 17 U.S.C. § 301.

⁶¹ See *Sun Microsystems, Inc. v. Microsoft Corp.*, 188 F.3d 1115, 1122 (9th Cir. 1999) (stating that courts “rely on state law to provide the canons of contractual construction provided that such rules do not interfere with federal copyright law or policy” (internal quotation marks and citation omitted)).

⁶² 17 U.S.C. § 301; see *Lipscher v. LRP Publ’ns*, 266 F.3d 1305, 1311 (11th Cir. 2001) (explaining the general two-part test for pre-emption). Note that the *Lipscher* court held that a tort claim (“acquisition misconduct”) was pre-empted, but found that a contract claim was not. 266 F.3d at 1312, 1318.

⁶³ *Vault Corp. v. Quaid Software*, 847 F.2d 255 (5th Cir. 1988).

⁶⁴ A law forbidding all fair use would override 17 U.S.C. § 107 and therefore be pre-empted. The Supreme Court views fair use as constitutionally required. *Eldred*, 537 U.S. at 221.

⁶⁵ *Lipscher*, 266 F.3d at 1311.

⁶⁶ *Lipscher*, 266 F.3d at 1311-12. Courts often express this as the “extra element” test—whether the state law claim (such as breach of contract) requires proof of a different or additional element compared to the elements of a copyright infringement claim.

⁶⁷ *Lipscher*, 266 F.3d at 1311.

⁶⁸ Different federal Circuit Courts of Appeals view these issues differently. The Seventh Circuit views pre-emption relatively narrowly relative to contracts (see *ProCD*, 86 F.3d 1447 (relying primarily on statutory pre-emption)). The Fifth Circuit voided a Louisiana statute that prevented all software copying in *Vault*, 847 F.2d 255, but relied primarily on case precedent in doing so (see *Vault*, 847 F.2d at 269-70). These jurisdictional differences matter because Apple would likely have to litigate in different courts for different defendants, and these courts could interpret both contract law and pre-emption doctrine differently.

⁶⁹ § 22 of the iTunes Terms of Service provides that California law governs disputes, and that any disputes must be litigated in California state courts. While such a “choice of law” and “choice of venue” provision is helpful, it is not always controlling. See *U.S. ex rel B & D Mech. Contractors v. St. Paul Mercury Ins. Co.*, 70 F.3d 1115 (10th Cir. 1995), *cert. denied*, 517 U.S. 1167 (1996) (holding a venue selection clause specifying Texas state courts as the exclusive jurisdiction for litigation void because it attempted to deprive federal courts of statutory exclusive jurisdiction).

federal courts of appeals held that contract law is not pre-empted for two reasons: first, the agreement between contracting parties provides the “extra element” distinguishing contract rights from copyright protections; and second, copyright’s protections are universal, while contractual rights only apply to the agreeing parties.⁷⁰ Some scholars criticize this result as incompatible with the public policies underlying copyright.⁷¹ Though some courts have not hesitated to strike down state laws expressly allowing contracts to duplicate copyright protections,⁷² it is not clear that these decisions apply to contracts generally rather than to the specific state statutes at issue.

Even if contract law can displace copyright, a contract may not be enforceable because users did not have an adequate opportunity to review its terms, or because those terms are considered oppressive by courts.⁷³ For example, a New York court refused to enforce a contractual provision requiring consumers who purchased computers from Gateway to resolve disputes with the company through arbitration because the arbitration process imposed excessive costs on customers.⁷⁴ In the United States, courts generally enforce clickwrap contracts like those used by the iTunes if users can review terms and clearly demonstrate consent.⁷⁵ Apple’s contract appears strong because users must review and assent to its terms before using the iTunes, and because there are other ways for consumers to access the music at issue.

However, contract law provides less potent remedies than copyright to protect iTunes songs. Copyright law affords strong remedies, including easy access to injunctive relief,⁷⁶ possible criminal sanctions,⁷⁷ and the choice of statutory damages or the defendant’s profits plus actual damages.⁷⁸ Contract law, though, presumes that monetary damages generally compensate injured parties.⁷⁹ Unless a breaching user engages in large-scale copying or distribution, monetary damages would likely be minimal.⁸⁰ This weakens contract’s effectiveness in controlling iTunes users. Indeed, some U.S. courts suggest that users might breach contracts to make fair use of protected works since they face only nominal damages.⁸¹

⁷⁰ See *ProCD*, 86 F.3d at 1454-55, and *Bowers*, 320 F.3d at 1323-24; see also Kwong, 18 Berkeley Tech. L.J. at 359-60.

⁷¹ See, e.g., de Werra, 25 Colum. J.L. & Arts at 272-73.

⁷² See, e.g., *Vault*, 847 F.2d at 269-70.

⁷³ See, e.g., *Gateway 2000, Inc.*, 676 N.Y.S.2d at 574-76 (finding unconscionability); see also *Specht*, 150 F. Supp. 2d at 593-96 (finding insufficient notice to consumers of contractual terms).

⁷⁴ *Gateway 2000, Inc.*, 676 N.Y.S.2d at 574-76.

⁷⁵ See *Specht*, 306 F.3d at 23-25; see also *ProCD v. Zeidenberg*, 86 F.3d 1447, 1452 (7th Cir. 1996); cf. *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147, 1149-50 (7th Cir. 1997), cert. denied, 522 U.S. 808 (1997) (enforcing terms contained in an agreement contained in a personal computer carton in part because the buyer could return the computer for a refund if she did not want to accept the terms).

⁷⁶ 17 U.S.C. § 502(a); see also *Johnson Controls v. Phoenix Control Sys.*, 886 F.2d 1173, 1174 (9th Cir. 1989).

⁷⁷ 17 U.S.C. § 506.

⁷⁸ 17 U.S.C. § 504(a).

⁷⁹ See generally Restatement (Second) of Contracts § 347.

⁸⁰ Apple might be able to specify damages in case of breach in its contracts with users (known as “liquidated damages” clauses), but courts are generally suspicious of such clauses. See generally *Lake River Corp. v. Carborundum Co.*, 769 F.2d 1284, 1288-1290 (7th Cir. 1985) (exploring courts’ hostility to liquidated damages clauses and providing economic arguments for and against such provisions).

⁸¹ See, e.g., *Bowers*, 320 F.3d at 1326.

In the United States, online music providers such as Apple can use contractual agreements with consumers quite effectively to alter the balance of rights and defenses available under contract. While the uncertainty of copyright pre-emption and the limited damages available for contract rather than copyright increase Apple's risk somewhat, the overall trend of U.S. law mitigates these risks and bolsters the iTunes business model.

D. Copyright versus Contract in Europe

Law governing the interplay between contract and copyright in Europe is turbulent, making it difficult to predict how US-centered business models like the iTunes work in Europe. European Union ("EU") directives partially harmonize contract and copyright and provide flexibility in how member states interpret and implement them. Contract's ability to override copyright has only recently become a pressing issue, and few statutes directly address this situation.⁸² Recent changes to EU copyright law couple ambiguous statutory language with opaque legislative intent.⁸³ As a result, the legal framework governing online music services varies from country to country in Europe.

1. European Union

European countries possess distinct and variable historical traditions that shape their copyright laws. While the American copyright system primarily pursues utilitarian objectives, the European *droit d'auteur* system is based on the author's personality rights.⁸⁴ However, there is no single, homogeneous EU copyright regime; rather, member states display a multitude of partly harmonized national copyright laws varying both in approach and in details. Contract law differs even more significantly among EU states. The following sections sketch the relevant regulatory framework at the EU-level and then outline briefly the copyright and contract interplay in Germany as an illustrative example.

a. Copyright Regulation by the European Union

The European Parliament has been working to harmonize the varied legal regimes of member states to achieve greater consistency. In 2001, the European Parliament finalized Directive 2001/29/EC, commonly known as the EU Copyright Directive ("EUCD").⁸⁵ The EUCD implements the World Intellectual Property Organization ("WIPO") treaties and tries to harmonize member states' myriad schemes of copyright limitation in the hope of generating consistent statutes and application.⁸⁶ Although the original 1997 EUCD draft contained only seven admissible limitations, extensive lobbying expanded the final number to twenty-

⁸² See Council Directive of 14 May 1991 on the legal protection of computer programs (91/250/EEC); see also Directive 96/9/EC of the European Parliament and of the Council of 11 March 1996 on the legal protection of databases, available at <http://europa.eu.int/ISPO/infosoc/legreg/docs/969ec.html>.

⁸³ Directive 2001/29/EC of the European Parliament and of the Council of 22 May 2001 on the harmonisation of certain aspects of copyright and related rights in the information society available at http://europa.eu.int/eur-lex/pri/en/oj/dat/2001/l_167/l_16720010622en00100019.pdf. ("EUCD").

⁸⁴ Lucie M.C.R. Guibault, *Copyright Limitations and Contracts: An Analysis of the Contractual Overridability of Limitations on Copyright 7* (2002).

⁸⁵ *Supra* note 83.

⁸⁶ European Commission, *Explanatory Memorandum to the Proposal for a European Parliament and Council Directive on the harmonization of certain aspects of copyright and related rights in the Information Society*, Dec. 10, 1997, COM(97) 628 final, at 35.

three.⁸⁷ This list is exhaustive, though, so that after EUCD adoption, member states cannot allow other exceptions. However, only one exception is mandatory; member countries may adopt any or all of the others.⁸⁸ Optional limitations include photocopying if fair compensation is paid⁸⁹; non-commercial private use with fair compensation;⁹⁰ non-commercial acts by libraries and educational institutions⁹¹; ephemeral recordings made by and for broadcasting organizations;⁹² and non-commercial reproduction of broadcasts by social institutions with fair compensation.⁹³

Since, with one exception, each state can choose which copyright limitations to adopt, most EU member states will probably keep intact their national laws as much as possible.⁹⁴ The EUCD approach to copyright exceptions works against harmonization and makes it more difficult for a single iTMS approach (based on the U.S. model) to succeed in all European markets.

b. Contract Regulation by the European Union

In addition to attempting to harmonize copyright law, the European Parliament has sought to standardize laws governing online contracts. Two directives address the validity of online contracts: the Distance Contract Directive (Directive 97/7/EC)⁹⁵ and the Electronic Commerce Directive (Directive 2000/31/EC).⁹⁶ The Distance Contract Directive covers all contracts

concerning goods or services concluded between a supplier and a consumer under an organized distance sales or service-provision scheme run by the supplier, who, for the purpose of the contract, makes exclusive use of one or more means of distance communication up to and including the moment at which the contract is concluded.⁹⁷

For example, art. 4(1) of the Distance Contract Directive requires that “in good time prior to the conclusion of any distance contract” consumers receive information on the supplier’s identity, the main characteristics of

⁸⁷ Lucie M.C.R. Guibault, *The nature and scope of limitations and exceptions to copyright and neighbouring rights with regard to general interest missions for the transmission of knowledge: prospects for their adaptation to the digital environment*, June 2003, at http://portal.unesco.org/culture/en/ev.php@URL_ID=17316&URL_DO=DO_TOPIC&URL_SECTION=201.html.

⁸⁸ Art. 5(1), EUCD is mandatory and protects “acts of reproduction . . . which are transient or incidental [and] an integral and essential part of a technological process and whose sole purpose is to enable” network transmissions or a lawful use of a work with “no independent economic significance.”

⁸⁹ Art. 5(2a), EUCD (excluding sheet music from this exception).

⁹⁰ Art. 5(2b), EUCD.

⁹¹ Art. 5(2c), EUCD.

⁹² Art. 5(2d), EUCD

⁹³ Art. 5(2e), EUCD.

⁹⁴ See Bernt Hugenholtz, *Why the Copyright Directive is Unimportant*, EIPR 11, 501, 501 (2000).

⁹⁵ Directive 97/7/EC of the European Parliament and of the Council of 20 May 1997 on the Protection of Consumers in Respect of Distance Contracts, Official Journal, L 144, June 4, 1997, at 19-27 (“*Distance Contract Directive*”).

⁹⁶ Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on Certain Legal Aspects of Information Society Services, in Particular Electronic Commerce, in the Internal Market, Official Journal, L 178, 17 July 2000, at 1-16 (“*E-Commerce Directive*”).

⁹⁷ Art. 2, Distance Contract Directive. “Consumer” means “any natural or legal person who, in contracts covered by [the] Directive, is acting for purposes which are outside his trade, business or profession.” *Id.*, at art. 2(2).

the goods or services, and the total price (including all taxes, delivery costs, etc.). Most importantly, the Directive grants consumers a right of withdrawal from any distance contract—a right that cannot be waived by contract. Article 6(1) states that consumers have at least seven business days to withdraw from the contract without penalty and without giving any reason.⁹⁸ Although the Directive does not explicitly address copyright licenses, scholars argue that goods and services offered through clickwrap licenses over the Internet are covered under it.⁹⁹ Accordingly, European music stores such as Tiscali Music Club grant customers a right to “return” downloaded digital music within seven days.¹⁰⁰ However, the legal situation with regard to the right of withdrawal varies among EU member states. The German *Fernabsatzgesetz*, for example, excludes the right of withdrawal for music- and video-downloads.¹⁰¹ Exceptions are also granted under UK law: Napster UK, for instance, grants its users only the right to cancel certain purchases made online with Napster, namely purchases of goods such as shirts. Any “electronic products,” however, are not cancelable or refundable once delivered.¹⁰²

The E-Commerce Directive instructs each member state to “ensure that their legal system allows contracts to be concluded by electronic means” and to “ensure that the legal requirements applicable to the contractual process neither create obstacles for the use of electronic contracts nor result in such contracts being deprived of legal effectiveness and validity on account of their having been made by electronic means.”¹⁰³ It requires that users be able to store and reproduce contract terms and conditions.¹⁰⁴ Since the iTunes version 4.6 clickwrap contract is persistent and reproducible, it is almost certainly valid under the E-Commerce Directive.

European law requires that a contract’s existence and content be known before sale,¹⁰⁵ and clickwrap licenses almost always meet this condition. Apple requires the consumer to review and accept the iTunes Terms and License Agreement before using the iTunes Music Store or purchasing songs.

Still, whether these Directives govern the iTMS is not certain. Since the E-Commerce Directive and the Directive on Distance Contracts apply to both products and services, they theoretically affect the iTMS regardless of whether the business is considered a product or a service. However, depending on where Apple locates its European iTMS business center, these directives might have different effects.¹⁰⁶ The E-Commerce

⁹⁸ Art. 6, Distance Contract Directive.

⁹⁹ Guibault, *Copyright Limitations and Contracts* at 303.

¹⁰⁰ See, e.g., Tiscali Music Club, Frequently Asked Questions, available at <http://sib1.od2.com/common/frameset/frames.asp?shid=012B002E> (stating that if customers want “to return a digital download for any reason within 7 days of purchase” they can do so by sending an e-mail message that requests a refund, contains the music file, and provides purchaser information).

¹⁰¹ § 3(2) no. 2 Fernabsatzgesetz.

¹⁰² Napster Terms and Conditions, available at <http://www.napster.co.uk/terms.html>. This interpretation seems to be based on an exception to the right of withdrawal as set out in Regulation 13 of the U.K. Consumer Protection (Distance Selling) Regulations 2000, which implement the Distance Contract Directive. According to Regulation 13, the consumer is not entitled to cancel the contract, among other exceptions, in the case of supply of services the parties have agreed that the consumer cannot cancel the contract once performance has begun.

¹⁰³ § 3 art. 9(1), E-Commerce Directive.

¹⁰⁴ § 3 art 10(3), E-Commerce Directive.

¹⁰⁵ See, e.g., Guibault, *Copyright Limitations and Contracts* at 297.

¹⁰⁶ See Appendix on Jurisdiction.

Directive requires that each “Member State shall ensure that the information society services *provided by a service provider established on its territory*” comply with the (harmonized) national provisions applicable in that state.¹⁰⁷ This article establishes the principle of control by the country of origin that is based on the concept of establishment.¹⁰⁸ Article 2(c) of the E-Commerce Directive defines an “established service provider” as a provider “who effectively pursues an economic activity using a fixed establishment for an indefinite period.” Thus, the Directive applies to e-commerce service providers established within the EU. A service provider with an EU subsidiary or branch—such as Napster UK Limited, for instance—will therefore be covered by the Directive. But if the business conducting sales is established outside a member state, only international law regulates it. The E-Commerce Directive “should not apply to services supplied by service providers established in a third country.”¹⁰⁹ If “it is difficult to determine from which of several places of establishment a given service is provided, this is the place where the provider has the centre of his activities relating to this particular service.”¹¹⁰

For the operation of the iTunes in Europe, Apple could be established in the U.S. or alternatively in an EU member state depending on “where it pursues its economic activity.”¹¹¹ If Apple “has several places of establishment it is important to determine from which place of establishment the service concerned is provided.”¹¹² Though the U.S. contains Apple’s corporate headquarters, this fact is not decisive; the key question is where the center for distribution of European iTunes is established. The Directive states that the mere “presence and use of the technical means and technologies required to provide the service do not, in themselves, constitute an establishment of the provider.”¹¹³ Accordingly, locating a Web server within the European Union, hosting a Web site on such a server, and providing access to the site from a member state do not automatically establish a digital media service provider in the EU from the perspective of the E-Commerce Directive.

The Distance Contract Directive, by contrast, applies to any contract for goods or services involving an EU consumer, regardless of whether the supplier has a physical or virtual presence in the European Union. Thus, even U.S. companies without a foreign subsidiary or branch must comply with the Directive and member state laws implementing it if they employ distance contracts with consumers.¹¹⁴

¹⁰⁷ Art. 3(1), E-Commerce Directive. (emphasis added).

¹⁰⁸ See also *Id.* at recital 22 (stating that “information society services should in principle be subject of the law of the Member State in which the service provider is established”).

¹⁰⁹ *Id.* at recital 58.

¹¹⁰ *Id.* at recital 19.

¹¹¹ *Id.*

¹¹² *Id.*

¹¹³ Art. 2(c), E-Commerce Directive.

¹¹⁴ Art. 2, Distance Contract Directive.

c. Contractual Modification of Copyright Entitlements in the European Union

In two specific instances, European Union statutes explicitly resolve the tension between contract and copyright. Article 15 of the European Database Directive states that “any contractual provision contrary to Articles 6 (1) and 8 shall be null and void.”¹¹⁵ Similarly, the Computer Programs Directive states that “any contractual provisions contrary to Article 6 or to the exceptions provided for in Article 5 (2) and (3) should be null and void.” More generally, however, the EUCD does not specify clearly which copyright exemptions are absolute and which are only default rules that can be waived via contract. Art. 6(4) subparagraph 1 states (in the context of technical protection measures) that

[n]otwithstanding the legal protection provided for in paragraph 1, in the absence of voluntary measures taken by rightholders, including agreements between rightholders and other parties concerned, Member States shall take appropriate measure to ensure that rightholders make available to the beneficiary of an exception or limitation provided for in national law in accordance with [a short list of limitations].¹¹⁶

However, art. 6(4) subparagraph 4 states that subparagraph 1 does not apply to works made available through interactive on-demand services “where such services are governed by contractual agreements”. Thus, the Directive allows technical protection measures to override copyright limitations. As a consequence, contractual provisions may preempt copyright limitations as well.

d. Example: Copyright-Contract Interaction in Germany

The German copyright system lies conceptually between the American and French *droit d'auteur* systems; it is founded on the same natural right principles as the French one, but provides significantly more consideration of the public interest.¹¹⁷ Germany regulates copyright principally under the Law on Copyright and Related Rights (*Gesetz über Urheberrecht und verwandte Schutzrechte*) commonly referred to as *Urheberrechtsgesetz* (“UrhG”).¹¹⁸ In implementing the EUCD primarily through the Law on the Regulation of Copyright in the Information Society (*Gesetz zur Regelung des Urheberrechts in der Informationsgesellschaft*),¹¹⁹ Germany is making the most extensive changes to the UrhG since its inception in 1965.¹²⁰ Changes include new private copying provisions, legal provisions on the circumvention of technological copy protection measures, and a new

¹¹⁵ Directive 96/9/EC of the European Parliament and of the Council of 11 March 1996 on the legal protection of databases, available at <http://europa.eu.int/ISPO/infosoc/legreg/docs/969ec.html>. Art. 6(1) provides an exception to the database author’s control rights if the usage method “is necessary for the purposes of access to the contents of the database and normal use of the contents.” *Id.* Art. 8 states that “Whereas the unauthorized extraction and/or re-utilization of the contents of a database constitute acts which can have serious economic and technical consequences.” *Id.*

¹¹⁶ Art. 6(4), EUCD. Paragraph 1 refers to the protection against reverse-engineering. *Id.*

¹¹⁷ *Id.* at 15.

¹¹⁸ Available at <http://bundesrecht.juris.de/bundesrecht/urhg/inhalt.html>.

¹¹⁹ Gesetz zur Regelung des Urheberrechts in der Informationsgesellschaft, available at http://www.urheberrecht.org/topic/Info-RiLi/ent/Bundesrat_Drucksache_271_03.pdf.

¹²⁰ Found. for Info. Policy Research at 72.

definition of copying that includes temporary file storage on a computer but excludes technical copies such as caching.¹²¹

Germany protects an author's rights under art. 5 (guaranteeing freedom of expression), art. 1(2) (guaranteeing right to personality), and art. 14(1) (protecting property rights) of the *Grundgesetz* (German Constitution).¹²² In addition, the Universal Declaration of Human Rights guards authors through human rights with "protection of the moral and material interests resulting from any scientific, literary, or artistic production of which [one] is the author."¹²³ While authors' rights are preeminent, German copyright balances public interests. For example, art. 14(2) of the German Constitution requires that copyright, as a form of constitutionally protected property, must serve the public.¹²⁴ This requirement, known as *Sozialbindung*, is found only in Germany.¹²⁵ The copyright regime in Germany shifted recently towards protecting copyright holders with a new amendment that took effect on September 13, 2003. Sec. 53(1) of the UrhG allows users—under certain conditions—to make copies for private purposes, including copies from digital works. However, § 95a UrhG supports technical protection measures and undercuts the § 53(1) exception. DRM technology, buttressed by § 95a UrhG, creates a legally-protected bar to copying for private purposes, making the § 53 UrhG privilege powerless. Sec. 95b UrhG delineates specific copyright limitations, such as privileges for handicapped people in § 45a, that are immune to technical protection measures and contractual pre-emption. These specific protections, though, do not apply to works distributed over the Internet. In addition, sec. 108b(1) Nr. 2 UrhG exempts individuals who circumvent technical protection measures for private purposes from punishment. Therefore, circumventing technical protection measures to copy a digital song for private purposes is illegal, but not punishable. Since German law prohibits this circumvention, though, private contracts could likely duplicate this restriction. Even without criminal sanctions, German iTunes users could thus face liability for breach of contract.

2. Summary of Business Impact

In deploying online music services such as the iTunes to Europe, service providers like Apple must grapple with the region's limited harmonization of contract law and (to a lesser extent) copyright laws. Moreover, the concept of harmonization under EU Directives provides a degree of flexibility regarding implementation by member states. Internet-based digital media services such as the iTunes may find researching national statutes and implementing a service tailored to each state's requirements to be quite costly—it may be more effective for these businesses to create a single platform with standardized terms of use that comply with EU Directives and with the majority of national laws. In short, the business value of precise compliance with particularized member state laws may be outweighed by its cost; services must estimate their expected liability from potential enforcement.

¹²¹ *Id.*

¹²² See, e.g., Guibault, *Copyright Limitations and Contracts* at 9.

¹²³ Universal Declaration of Human Rights, Art. 27(2) at <http://www.un.org/Overview/rights.html>.

¹²⁴ Guibault, *Copyright Limitations and Contracts* at 12.

¹²⁵ *Id.*

E. Copyright versus Contract in Asian Countries

The interplay between copyright's rights and defenses, and the ability of parties to re-allocate these entitlements through private contractual agreements, varies in Asian legal regimes. We examine the legal systems of Japan and China and their likely effects on the iTunes since its business model acts as the current trendsetter in the new online music space.

1. Japan

Contract can re-allocate rights and entitlements under Japanese copyright law. Where it might fail to do so, copyright limitations pose little risk to online digital media services. Apple's ability to designate which legal regime governs its agreements with users and to engage in price discrimination based on national location bolster the certainty of its business model. However, barriers to enforcing copyright or contractual rights through litigation effectively increase users' freedom of action.

a. Copyright in Japan

Japan has a well-established copyright system¹²⁶ and has updated its laws to address technological changes¹²⁷. Its copyright laws rest on promoting Japanese creativity and cultural beliefs; the goal is to protect the rights of copyright holders, "having regard to a just and fair exploitation of [their] cultural products, and thereby to contribute to the development of culture."¹²⁸ Authors of creative works automatically¹²⁹ enjoy moral rights¹³⁰ and rights comprised in copyright¹³¹. Economic rights include the rights to reproduce the work¹³²; to perform¹³³ or publicly transmit¹³⁴ the work; to distribute the work (if it is cinematic)¹³⁵ and to transfer its ownership¹³⁶; to lend it¹³⁷; and to create derivative works based on it.¹³⁸ Copyright entitlements are protected by civil¹³⁹ and criminal¹⁴⁰ penalties for infringement. While copyright law does not address reverse-

¹²⁶ See Law No. 10 of June 21, 1898.

¹²⁷ See, e.g., Law No. 72 of June 19, 2002. Japan amended its copyright statutes in 1997 to address specifically Internet transmissions. See Daniel J. Gervais, *Transmissions of Music on the Internet: An Analysis of the Copyright Laws of Canada, France, Germany, Japan, the United Kingdom, and the United States*, 34 Vand. J. Transnat'l L. 1363, 1382 (2001). These amendments effectively broadened the exclusive rights of copyright holders to include authorizing public transmission over the Internet. *Id.* at 1384.

¹²⁸ Art. 1, Copyright Law of Japan, translation available at http://www.cric.or.jp/cric_e/cj/cj.html.

¹²⁹ In Japan, creators receive copyright protection automatically, without application to or grant from the government, upon creation of works of authorship in the literary, scientific, artistic, or musical domain. Art. 2, Copyright Law of Japan.

¹³⁰ Art.s 18-20, Copyright Law of Japan.

¹³¹ Art.s 21-28, Copyright Law of Japan.

¹³² Art. 21, Copyright Law of Japan.

¹³³ Art. 22, Copyright Law of Japan.

¹³⁴ Art. 23, Copyright Law of Japan.

¹³⁵ Art. 26, Copyright Law of Japan. Note that Art. 26 is limited to authors of cinematographic works and authors of works reproduced in cinematographic works.

¹³⁶ Art. 26*bis*, Copyright Law of Japan. Note that Art. 26*bis* does not include cinematographic works.

¹³⁷ Art. 26*ter*, Copyright Law of Japan. Note that Art. 26*ter* does not include cinematographic works.

¹³⁸ Art. 28, Copyright Law of Japan.

engineering, the only case to examine the issue concluded that printing a reverse-engineered listing of a computer programming language compiler violated copyright.¹⁴¹

Japan balances these economic copyright protections with limitations. Japan has no generalized “fair use” concept—restraints on copyright entitlements are specifically enumerated in the Copyright Law.¹⁴² A user may reproduce a copyrighted work for private use unless doing so circumvents technological protection measures.¹⁴³ Public works can be performed, transmitted, and loaned for non-profit purposes.¹⁴⁴ Scholastic use is broadly protected,¹⁴⁵ as is journalistic use.¹⁴⁶ Consumers who own a copy of protected software may make copies or adaptations to use the software on their computers.¹⁴⁷ In addition, compulsory licenses for public works are available for a royalty fee in limited circumstances.¹⁴⁸ While Japan recognizes “first sale” exhaustion of copyright for tangible goods,¹⁴⁹ it does not seem to for digital works.¹⁵⁰

b. Contract in Japan

Japanese contract law is governed both by the Civil Code statutes and by cultural norms; in fact, the latter may dominate. Litigation is relatively rare in Japan due to a cultural bias against resolving disputes in court and structural impediments to suits.¹⁵¹ The predominant contractual element is a cooperative relationship among

¹³⁹ Art.s 112, 114, 115, Copyright Law of Japan. Art. 112 permits injunctive relief and monetary damages for infringement, and Art. 115 permits measures to recover the creator’s honor and reputation if moral rights are violated. Art. 114 criminalizes offenses such as infringement of moral rights or unlawful reproduction for profit-making purposes.

¹⁴⁰ Art.s 119-124, Copyright Law of Japan.

¹⁴¹ See Jack M. Haynes, *Computer Software: Intellectual Property Protection in the United States and Japan*, 13 J. Marshall J. Computer & Info. L. 245, 263 (1995) (describing *Shuwa Co. Ltd. v. Microsoft Corp.*); see also Eric A. Engle, *When is Fair Use Fair?: A Comparison of E.U. and U.S. Intellectual Property Law*, 15 *Transnat’l Law.* 187, n96 (2002). However, Japanese courts do not protect a computer software program’s underlying algorithm under copyright. See *Sys. Sci. Corp. v. Japan Technato, Co.*, 130 HANJI (Tokyo Dist. Ct., Mar. 31, 1989); *aff’d in part, rev’d in part*, (Tokyo High Ct., June 20, 1989) (finding no copyright protection for underlying structural design of a program); see also Crystal D. Talley, *Japan’s Retreat from Reverse Engineering: An Unnecessary Surrender*, 29 *Cornell Int’l L.J.* 807, 836 (1996). Since reverse-engineering is generally required to discern a program’s basic algorithm, Japanese law on this issue remains in tension.

¹⁴² See *Dow Jones & Co. v. Know-How Japan*, 1524 Hanrei Jihō 118 (Tokyo High Ct. Oct. 27, 1994); see generally Takashi B. Yamamoto, *Copyright Protection of Databases: The Wall Street Journal Case*, at http://www.cric.or.jp/cric_e/cuj/cuj.html. Note that these limitations do not affect moral rights. Art. 50, Copyright Law of Japan.

¹⁴³ Art. 30(1), Copyright Law of Japan.

¹⁴⁴ Art. 38, Copyright Law of Japan.

¹⁴⁵ See, e.g., art. 33 (permitting reproduction of public works in school textbooks and requiring reasonable compensation to the creator), Art. 34 (allowing broadcast of public works for school education and requiring reasonable compensation), and Art. 36, Copyright Law of Japan (providing for reproduction of public works in examinations and mandating royalty payment).

¹⁴⁶ See, e.g., art. 39 (allowing reproduction of Art.s on topical subjects in the press or via broadcast), and art. 41, Copyright Law of Japan (permitting reproduction of works involved in current events for reporting purposes).

¹⁴⁷ Art. 47bis, Copyright Law of Japan.

¹⁴⁸ Art. 67(1) (permitting exploitation based on compulsory license from the Commissioner of the Agency for Cultural Affairs if the copyright owner cannot be found); art. 68(1) (permitting broadcast under compulsory license if negotiations with the copyright owner fail or are not possible); and art. 69, Copyright Law of Japan (allowing sound recordings of public works under compulsory license once three years have passed since their initial release if negotiations with the copyright owner fail or are not possible).

¹⁴⁹ Art. 26(2), Copyright Law of Japan; see Teruo Doi, *The Territorial Principle of Patent Protection and Conflict of Laws: a Review of Japanese Court Decisions*, 26 *Fordham Int’l L.J.* 377, 386 (2003).

¹⁵⁰ For further discussion, see Part III on Digital First Sale Doctrine.

¹⁵¹ Andrew Sagartz, *Resolution of International Commercial Disputes: Surmounting Barriers of Culture Without Going to Court*, 13 *Ohio St. J. on Disp. Resol.* 675, 689 (1998); see Salil Mehra, *Copyright and Comics in Japan: Does Law Explain Why All the Cartoons My Kid Watches Are Japanese Imports?*, 55 *Rutgers L. Rev.* 155, 185 (2002).

the parties.¹⁵² Parties typically do not seek to specify all transaction details in the formal terms of a document because this “fine print” approach connotes a lack of faith in the other side.¹⁵³ Disputes or differences in interpretation are handled through negotiation and litigation over contracts is relatively rare.¹⁵⁴ This emphasis on flexible dispute resolution and reluctance to sue may benefit Apple, since it can resolve differences over the use of the iTunes informally at lower cost.¹⁵⁵ However, the premium placed upon negotiation of disputed contractual terms may benefit consumers who use the iTunes in ways violating the strict terms of the license agreement.¹⁵⁶

In drafting its iTunes Terms and License Agreements for Japan, Apple must consider the effect of Japanese laws that create mandatory contract terms. For example, the Consumer Contract Act voids contracts where a business misrepresents a material term of the transaction such as quality, uses, or price.¹⁵⁷ Apple must ensure disclosure of relevant information before customers purchase iTunes songs. If Apple sued a user who violated the iTunes Terms, the Consumer Contract Act could permit the user to escape liability if Apple’s contract did not meet its requirements.¹⁵⁸ Japanese consumer protection laws aid users by requiring clear enumeration of terms, and compel Apple to draft carefully user agreements.

Japanese law allows contracting parties to designate which legal regime covers their agreement.¹⁵⁹ Apple can thus specify which law (for example, the law of California in the United States¹⁶⁰) governs its contractual relationship with consumers within broad limits.¹⁶¹ Japanese courts respect choice of governing law as long as that law does not contravene “public order and good morals.”¹⁶² Apple gains greater certainty in drafting and enforcing contract terms by reducing the potential number of legal regimes that might apply to its agreements with iTunes consumers in Japan.

¹⁵² Sagartz, 13 Ohio St. J. on Disp. Resol. at 689.

¹⁵³ *Id.* at 688-89.

¹⁵⁴ *Id.* at 689. This negotiated approach applies even to specific terms in signed contracts—flexibility is a defining element in Japanese contracts.

¹⁵⁵ See generally *id.* at 695.

¹⁵⁶ See *id.* at 703-05 (discussing the role of Japanese courts in resolving disputes through conciliation and describing the statutory basis for this approach).

¹⁵⁷ See art. 4, Consumer Contract Act of May 12, 2000, but see art. 7, Consumer Contract Act (limiting the right to avoid to five years from the conclusion of a consumer contract).

¹⁵⁸ From a practical perspective, however, it seems unlikely that iTunes Japan would comply with these requirements.

¹⁵⁹ See Law No. 10 of June 21, 1898, as amended by Law No. 27 of 1989 Art. 7(1); see generally Paul Goldstein, 110 *International Copyright: Principles, Law, and Practice* (2001) (“Goldstein”) and Karen D. Untiedt, *International Contracts under the Conflict of Laws Rules of Great Britain and Japan*, 7 Loy. L.A. Int’l & Comp. L.J. 193, 193 (1984).

¹⁶⁰ See § 22, iTunes Terms of Service.

¹⁶¹ Note that analysis of choice of law and conflict of law, and their effects on iTunes, are beyond the scope of this study.

¹⁶² Art. 33 of Law No. 10 of June 21, 1898; see Goldstein at 297.

c. Contractual Modification of Copyright Entitlements in Japan

Japan permits contractual assignment of copyright entitlements such as reproduction, public transmission, and performance rights.¹⁶³ Moral rights cannot be transferred.¹⁶⁴ Hence, a contract cannot permit a distributor such as Apple to decide whether to include the creator's name on copies or whether to distort works (for example, by editing out parts of a song considered offensive).¹⁶⁵ Moral rights restrictions should not affect a Japanese iTunes—identifying the artist or composer helps customers locate songs, and preserving songs unaltered is FairPlay's function. Copyright entitlements, by contrast, may be transferred, though contracts assigning copyright protections must specify which rights are conveyed.¹⁶⁶

Contracts that re-allocate copyright entitlements to prevent uses of works otherwise permissible are common in Japan. For example, Japanese copyright law does not address the right to reverse-engineer software code¹⁶⁷, though case law on the issue argues against such a right.¹⁶⁸ It is likely but not certain that an agreement prohibiting reverse-engineering can be enforced.¹⁶⁹ Furthermore, licenses that forbid reverse-engineering are standard in Japan, increasing the probability a Japanese court would uphold such a contractual provision.¹⁷⁰ These contracts also prohibit users from re-selling, lending, or transferring the copy of the protected work¹⁷¹, overriding the Japanese copyright “first sale” doctrine.¹⁷² If enforceable, a similar iTunes restriction¹⁷³ would prevent development of a secondary market in “used” iTunes songs in Japan, bolstering Apple's business model but limiting user options and maintaining prices. Apple benefits from the limited, explicit exceptions to

¹⁶³ Art. 61(1), Copyright Law of Japan. Copyright owners can grant another the right to exploit their work, but this ability is limited to the boundaries of the specific authorization. Art. 63, Copyright Law of Japan.

¹⁶⁴ Art. 59, Copyright Law of Japan.

¹⁶⁵ However, Japanese copyright law does contain some flexibility regarding moral rights. One may omit the author's name from a work, for example, if doing so does not risk damaging the author's ownership claim and if the omission comports with fair practice (Art. 19(3)). Similarly, the right against modification or mutilation does not include modifying software to allow it to run on a computer (Art. 20(2)(iii)) or repairing an architectural work (Art. 20(2)(ii)).

¹⁶⁶ See, e.g., art. 61(2) (stating that rights of adaptation and creation of derivative works remain with creator unless expressly assigned) and art. 63(4), Copyright Law of Japan (stating that authorization to broadcast or transmit over wired network does not include the right to create recordings of the work unless the contract explicitly so provides).

¹⁶⁷ See Fred Chilton et al., *Computer and Telecommunications Law Update New Developments: Asia Pacific*, 15 J. Marshall J. Computer & Info. L. 99, 121 (1996) (noting that an advisory committee to the Japanese Cultural Affairs Agency considered legislation legalizing reverse engineering, but the U.S. opposed the change).

¹⁶⁸ *Information Technology, Internet and New Media*, Japan Law Digest (2003).

¹⁶⁹ *Id.*

¹⁷⁰ See, e.g., Paragraph 2, Sigma Corporation, Software License Agreement, available at http://www.sigma-photo.co.jp/english/downloads/license_e.html; “License,” RATO Systems, International, Software License Agreement, available at <http://www.rexpccard.co.jp/english/support/driver/>. Note that Japanese copyright law makes removing or modifying “rights management information” an infringement of copyright and of moral rights. See art. 113(3)(ii); see also art. 2(xxi), Copyright Law of Japan (defining “rights management information”). In addition, proposals to legalize reverse engineering in statute failed in Japan under pressure from the United States. See Talley, 29 Cornell Int'l L.J. 807. The lack of statutory basis for reverse engineering and U.S. pressure increase the likelihood that provisions barring this activity will bind.

¹⁷¹ See, e.g., “Restrictions,” RATO Systems, International, Software License Agreement, available at <http://www.rexpccard.co.jp/english/support/driver/> (stating that users may not “transfer, rent, lease, loan, [or] resell for profit” the software).

¹⁷² See art. 26bis(2)(i), Copyright Law of Japan.

¹⁷³ See § 13(a), iTunes Terms Service.

copyright protections in Japan—uses or actions that do not fall within a statutory limitation on copyright infringement.¹⁷⁴

d. Business Impact of Contract and Copyright on iTunes in Japan

If Apple can effectively enforce the terms of its agreements with Japanese iTunes consumers, contract, copyright, and technology can combine to reinforce its business model in that nation. The risk to Apple's business model, and a possible source of flexibility for iTunes users in Japan, derives from barriers to enforcement of contractual and copyright obligations through litigation. The emphasis placed on negotiation and long-term interaction, and the concomitant flexible approach to a contract's formal terms, may lead to less rigid application of terms between Apple and Japanese consumers—particularly since this transaction is impersonal and unlikely to form a lasting relationship. Cultural and structural barriers to litigation in Japan may make enforcing intellectual property or contract rights difficult.¹⁷⁵ Accordingly, contract may formally re-allocate copyright entitlements, but this arrangement may have less practical effect on users' actions.

2. China

Contract has strong potential to re-allocate copyright entitlements in China. While the scope of the “private use” exception is uncertain, most copyright limitations do not apply to online digital media services. Copyright entitlements are robust and contractual requirements for intellectual property licensing and transfer are relatively clear. However, the iTunes faces two significant business risks in China: widespread piracy of digital media and lack of precedent to guide legal arrangements.

a. Copyright in China

Copyright law is relatively new in China; the first Chinese copyright statute passed in 1990 as part of the nation's successful effort to enter the World Trade Organization.¹⁷⁶ Chinese copyright seeks to promote cultural development within a socialist framework; its goal is “encouraging the creation and dissemination of works which would contribute to the construction of socialist spiritual and material civilization, and promoting the development and prosperity of the socialist culture and science.”¹⁷⁷ Creators of protected works¹⁷⁸ enjoy personality and property rights that include publication, identification, alteration, reproduction, distribution, exhibition, performance, transmission, and broadcasting.¹⁷⁹ Copyright entitlements are protected

¹⁷⁴ See *Dow Jones*, 1524 Hanrei Jihō 118. Contrast Japanese Copyright Law, which lists actions and uses immune from copyright infringement suits (e.g., art.s 32-34, Copyright Law of Japan), with the United States regime that requires an ad hoc assessment of each use based on a generalized four-factor analysis (17 U.S.C. § 107).

¹⁷⁵ See William C. Revelos, *Patent Enforcement Difficulties in Japan: Are There Any Satisfactory Solutions for the United States?*, 29 GW J. Int'l L. & Econ. 503, 509 (1995); see also H. Stephen Harris, Jr., *Competition Law and Patent Protection in Japan: A Half-Century of Progress, a New Millennium of Challenges*, 16 Colum. J. Asian L. 71, 82 (2002). Structural barriers include high burdens of proof on plaintiffs and limited damages that make litigation unlikely to succeed from an economic perspective. See Mehra, 55 Rutgers L. Rev. at 185.

¹⁷⁶ Brent T. Yonehara, *Enter the Dragon: China's WTO Accession, Film Piracy and Prospects for Enforcement of Copyright Laws*, 22 DePaul-LCA J. Art & Ent. L. 63, 65 (2002).

¹⁷⁷ Art. 1, Copyright Act of China, translation available at <http://www.chinaiprlaw.com/english/laws/laws10.htm>. Chinese copyright law is explicitly tied to political ideology. See Matt Jackson, *Harmony or Discord? The Pressure toward Conformity in International Copyright*, 43 IDEA 607, 639 (2003).

¹⁷⁸ Art. 3, Copyright Act of China (listing protected works).

¹⁷⁹ Art. 10, Copyright Act of China.

by civil,¹⁸⁰ administrative,¹⁸¹ and criminal¹⁸² penalties for infringement. In November 2003, China's National Copyright Administration toughened the country's copyright laws with four new regulations, including ones that protect further the rights of network information distribution.¹⁸³

China balances copyright entitlements with limitations that permit uses without compensation or authorization, though even these must mention the author's name and work's title.¹⁸⁴ These limitations are enumerated (like the Japanese system), not general (like the American system). People may use published works for "private study, research or self-entertainment."¹⁸⁵ Authors may quote from a published work,¹⁸⁶ and journalistic use is protected if necessary for reporting current events¹⁸⁷ and for reprinting or re-broadcasting articles on current issues or public speeches.¹⁸⁸ Teachers and scientific researchers may translate or make a small number of copies of a published work for instruction or research.¹⁸⁹ China has not yet addressed whether reverse-engineering is permissible under its copyright law.¹⁹⁰

As a signatory to various WIPO Treaties, China recognizes the first sale doctrine of exhaustion in copyright protections; however, this limit is qualified in important ways. Creators' rights to control distribution and communication over networks survive first sale.¹⁹¹ While Apple would have to obtain these rights from creators of iTunes songs, the company could prevent distribution and transfer of songs even after purchase. Limits on digital first sale in China reduce the possibility of a secondary iTunes market and concomitant reduced prices.¹⁹²

¹⁸⁰ Art.s 46-55, Copyright Act of China. Art.s 46-48 establish monetary damages for acts of infringement, and art. 49 permits injunctive relief. Art. 52 shifts the burden of proof to publishers, distributors, and lessees to prove that copies are lawfully created for certain works in some circumstances.

¹⁸¹ Art. 47, Copyright Act of China.

¹⁸² *Id.* (establishing that infringing acts may be criminal).

¹⁸³ See *Rules tougher on copyright*, Xinhua Online, Nov. 13, 2003, at <http://www.infomonkey.com/edigest/125/2.1.1.75875.9.1006.1019.1.msp>.

¹⁸⁴ Art. 22, Copyright Act of China.

¹⁸⁵ Art. 22(1), Copyright Act of China.

¹⁸⁶ Art. 22(2), Copyright Act of China.

¹⁸⁷ Art. 22(3), Copyright Act of China.

¹⁸⁸ Art.s 22(4) & 22(5), Copyright Act of China (permitting this use unless specifically forbidden).

¹⁸⁹ Art. 22(6), Copyright Act of China.

¹⁹⁰ Pamela Samuelson, *Intellectual Property and Economic Development: Opportunities for China in the Information Age*, available at <http://www.sims.berkeley.edu/~pam/papers/chinaip.html>. Samuelson notes that Hong Kong considered enacting a reverse-engineering exception in 1997, but U.S. pressure convinced the territory to deal with the issue via fair use. She states this "suggests that China could adopt a general fair use provision to achieve the same goals of promoting innovation and competition in a balanced way." *Id.*

¹⁹¹ Art. 10, Copyright Act of China; see *Memorandum of Understanding Between the Government of the United States of America and the Government of the People's Republic of China on the Protection of Intellectual Property*, 4 D.C.L. J. Int'l L. & Prac. 403 (1995). Under this memorandum and art. 10, copyright owners for movies and computer software also retain the right to control rental of their works even after a first sale.

¹⁹² See generally Part III on Digital First Sale Doctrine.

The Supreme People's Court of China has interpreted copyright law in the context of Internet copyright disputes.¹⁹³ The Court reaffirmed that copyright protects digital embodiments of protected works and that creators may distribute their works over the Internet.¹⁹⁴ The Court also promulgated rules for direct and contributory copyright infringement by Internet Service Providers¹⁹⁵ and created generous rules for damages.¹⁹⁶ These interpretations usefully clarify how Chinese courts will apply copyright law for services like the iTunes.

b. Contract in China

China regulates contract law under the Code of Contract Law of 1999.¹⁹⁷ Contracts rest upon principles of fairness,¹⁹⁸ good faith,¹⁹⁹ and legality—in “concluding and performing a contract, the parties shall abide by the laws and administrative regulations, observe social ethics,” and “[n]either party may disrupt the socio-economic order or damage the public interests.”²⁰⁰ Parties may form a contract through written forms that include e-mail and Electronic Data Interchange.²⁰¹ If a party uses standard contract terms, it must fairly apportion rights and obligations, draw reasonable attention to restrictions or exclusion of liability, and explain the terms.²⁰² Contracting parties may select the law applicable to disputes if the contract involves foreign interests.²⁰³ Under Chinese law, contracts may be invalidated due to fraud, coercion, or collusion that damages state interests; concealed illegitimate purpose; damage to public interests; and illegality.²⁰⁴ Immunity clauses that damage the other party deliberately or through gross fault are void.²⁰⁵ Remedies for breach of contract include specific performance, cure of non-conforming performance, and damages.²⁰⁶ Parties may stipulate damages to be paid as a minimum for breach.²⁰⁷

¹⁹³ Judicial Committee of the Supreme People's Court, *Interpretations of the Supreme People's Court on Laws For Trying Cases Involving Internet Copyright Disputes* (Nov. 22, 2000), translation available at <http://www.chinaiprlaw.com/english/laws/laws3.htm>; see Wei Yanliang & Feng Xiaoqing, *Comments on Cyber Copyright Disputes in the People's Republic of China: Maintaining the Status Quo While Expanding the Doctrine of Profit-Making Purposes*, 7 Marq. Intell. Prop. L. Rev. 149, 181 (2003).

¹⁹⁴ *Interpretations of the Supreme People's Court on Laws For Trying Cases Involving Internet Copyright Disputes* at art 2.

¹⁹⁵ *Id.* at art.s 4-8.

¹⁹⁶ *Id.* at art. 10.

¹⁹⁷ See John S. Mo, *The Code of Contract Law of the People's Republic of China and the Vienna Sales Convention*, 15 Am. U. Int'l L. Rev. 209 (1999).

¹⁹⁸ Art. 5, Contract Act of China, translation available at <http://www.chinaiprlaw.com/english/laws/laws2.htm>.

¹⁹⁹ Art. 6, Contract Act of China.

²⁰⁰ Art. 7, Contract Act of China.

²⁰¹ Art.s 10 & 11, Contract Act of China.

²⁰² Art.s 39 & 40, Contract Act of China. Note that art. 40 imposes the threat of voiding the contract if the party supplying the standard terms fails to comply with these requirements.

²⁰³ Art. 126, Contract Act of China.

²⁰⁴ Art. 52, Contract Act of China.

²⁰⁵ Art. 53(2), Contract Act of China.

²⁰⁶ Art. 107, Contract Act of China.

²⁰⁷ Art. 114, Contract Act of China.

China's contract law contains explicit provisions for transfers of intellectual property.²⁰⁸ It also provides that sellers of goods bear no obligation to buyers to warranty complete rights in the transferred item when the buyer knows that a third party (such as a copyright holder) has some rights in the item.²⁰⁹ Contracts may forbid assignment of rights under that contract to a third party.²¹⁰

c. Contractual Modification of Copyright Entitlements in China

Contract appears to have robust potential to alter copyright entitlements in China, which would increase the viability of the iTunes there. Chinese copyright law explicitly contemplates contractual reallocation of its entitlements; it permits copyright holders to assign most rights in a work and to receive remuneration for the transfer.²¹¹ However, creators may not assign or license certain rights similar to moral rights.²¹² These limitations should not affect the iTunes, which offers only published works and does not seek to change songs or to hide their creators.

In addition, China's copyright statute requires that licensing²¹³ and assignment²¹⁴ contracts include clauses dealing with issues such as geographic limitations, price, and liability for breach. Assignment contracts must be in writing.²¹⁵ The creator must expressly license or assign a right for the other party to exercise it.²¹⁶ A licensee who violates a licensing or assignment contract faces copyright infringement liability.²¹⁷ If Apple includes provisions in its Chinese Terms of Service precluding sale or lease of the iTunes songs, these terms likely comply with China's contract law.²¹⁸

Most limitations on copyright would not affect a Chinese iTunes. Journalistic, educational, and state uses of iTunes songs should not displace market demand for downloads appreciably. The art. 22 private use/study exception may affect the iTunes depending upon the breadth of its scope. For example, it is not clear whether reverse-engineering FairPlay would qualify as study or research.²¹⁹ The Supreme People's Court seems to interpret the art. 22 exception narrowly to protect copyright holders,²²⁰ aiding Apple, but limiting users' scope of action.

²⁰⁸ See, e.g., art. 137, Contract Act of China.

²⁰⁹ Art.s 150 & 151, Contract Act of China.

²¹⁰ Art. 79(2), Contract Act of China.

²¹¹ Art. 10, Copyright Act of China (allowing the copyright holder to assign rights to another, or to authorize another to exercise them, in return for remuneration).

²¹² *Id.* (exempting rights in art.s 10(1) - 10(4) from the ability to assign or authorize exercise).

²¹³ Art. 24, Copyright Act of China.

²¹⁴ Art. 25, Copyright Act of China.

²¹⁵ *Id.*

²¹⁶ Art. 26, Copyright Act of China.

²¹⁷ Art.s 46 & 47, Copyright Act of China.

²¹⁸ See art. 79(2), Contract Act of China.

²¹⁹ See art. 22(1), Copyright Act of China; see also Samuelson.

²²⁰ See Wei & Feng, 7 Marq. Intell. Prop. L. Rev. at 178.

In drafting contracts to regulate what actions Chinese users may take with iTunes songs, Apple must meet disclosure and term requirements. China permits electronic contracting as a type of written agreement, but Apple needs to explain the clauses in its terms of service and license agreement clearly to users.²²¹ Apple can also include a provision mandating that a different legal contract regime apply to disputes as long as the contract involves foreign interests.²²² Using clear language forbidding redistribution, transfer, or use by entities other than the purchasing consumer could help Apple avoid distribution of iTunes songs through P2P file sharing networks and similar Web sites.²²³

d. Business Impact of Contract and Copyright on iTunes in China

Though contract and copyright law seem to interact to support a Chinese iTunes, their interplay occurs against a backdrop of rampant piracy and lax enforcement of intellectual property protections.²²⁴ These problems derive from a combination of cultural, historic, and economic factors and are further aggravated by inconsistent, weak enforcement by officials.²²⁵ Use of P2P networks has grown in China; the distributors of P2P software claim that P2P file sharing falls within the private use exception²²⁶ to copyright.²²⁷ While the Supreme People's Court of China rejected this interpretation,²²⁸ the dispute highlights uncertainty about the exception's scope. China's copyright and contract codes are new, and hence businesses such as Apple have less precedent to rely upon in drafting contracts and assessing business risks. China presents a sizeable potential market for Apple, and one in which legal protections as drafted facilitate and support an iTunes service. However, the risks of piracy and inadequate enforcement may undermine the legal and technological safeguards and weaken the lure of the Chinese consumer base.

F. Conclusion

Copyright creates an initial balance between the rights afforded creators (to recognize and reward their efforts) and consumers (to promote socially beneficial use) of certain works. Commercial ventures, such as the iTunes, benefit when they can use contractual agreements to re-arrange this balance. Users benefit from flexibility in using works and from access to a wide range of artistic creations. In the United States, Apple has strong power to re-allocate copyright entitlements and defenses since courts generally defer to arrangements among private parties. In Japan, the scope of contractual control over copyright is theoretically broad, but Apple's

²²¹ Art.s 10 & 11, 39 & 40, Contract Act of China.

²²² See art. 126, Contract Act of China. It is not clear that this provision would apply if the contract were between a Chinese Apple subsidiary and a Chinese user for a song whose copyright was held by a Chinese entity, since there would be no obvious "foreign interest."

²²³ *Interpretations of the Supreme People's Court on Laws For Trying Cases Involving Internet Copyright Disputes* at art. 3.

²²⁴ According to a USTR report, "rampant counterfeit and piracy problems ... plague China's domestic market," and "China has become a leading exporter of counterfeit and pirated goods to the world." See <http://www.ustr.gov/reports/2004-301/special301-306.htm>. See also Yonehara, 22 DePaul-LCA J. Art & Ent. L. at 62.

²²⁵ USTR report writes: "Administrative authorities routinely fail to refer cases involving commercial-scale IPR infringements for criminal investigation and prosecution. The number of criminal cases for counterfeit trademarks, while growing, remains inadequate, and the Government initiates very few criminal actions against copyright piracy. When such actions do result in convictions, the penalties applied are insufficient to deter further IPR infringement." See <http://www.ustr.gov/reports/2004-301/special301-306.htm>. See also *id.* at 75, 83.

²²⁶ Art. 22(1), Copyright Act of China.

²²⁷ Wei & Feng, 7 Marq. Intell. Prop. L. Rev. at 178.

²²⁸ *Id.* at 182.

ability to enforce its agreements is limited importantly by structural and cultural constraints on litigation. In China, contract can freely alter most copyright entitlements, but the relative novelty of the regulatory regime and the existence of widespread infringement and piracy threaten copyright holders and licensees.

Part II: Digital Rights Management

A. Introduction

In the previous part we explored how Apple's contracts can restrict the actions that consumers take with regard to the songs they download from the iTunes. Increasingly, copyright holders are also turning to technological protection measures—referred to in this paper as Digital Rights Management (DRM)—to constrain usage. Like contracts, DRM can upset the balance struck between copyright holders and the public, including fair use and first sale. Unlike contracts, DRM based restrictions are self-enforcing. In other words, if contract alone precludes the use of iTunes songs on six computers rather than five, Apple is unlikely to be able to stop that action. Apple's FairPlay DRM,²²⁹ on the other hand, disables the ability to make the sixth copy unless the user can remove the DRM.

Of course, evading DRM is possible, and, for that reason, the law provides additional support. Throughout the world, countries have relatively recently begun implementing laws that prohibit DRM circumvention and related circumvention devices. In this Part, we will discuss how Apple's business model depends on the DMCA. We will initially introduce the DMCA and survey relevant laws around the world. Then, we will turn our attention to the iTunes and two key issues.²³⁰ First, we will analyze how DRM and anti-circumvention laws can help prevent piracy. In this context, we will argue that DRM and the DMCA have practically no impact on piracy in the short run, and have an indeterminate long-term impact contingent on other technological measures and key variables. Second, we will analyze how these restrictions can help Apple control secondary markets, specifically the market for portable music players. Here, DRM and the DMCA play a crucial role in Apple's business model, allowing Apple to use the Store to drive Apple iPod portable player sales and *vice versa*. In the process of this analysis, we will also consider how relevant differences in legal regimes could affect Apple's business.

B. How is DRM Protected by Law?

In this section, we will introduce the various implementations of anti-circumvention laws in the US, EU, and Asia-Pacific region.

²²⁹ As stated in the introduction, FairPlay songs can be moved to an unlimited number of portable devices but can only be copied to five computers. Though users can make unlimited CD burns, they can only make burn the same playlist seven times. Originally, users were allowed to copy to three computers and burn an identical playlist 10 times. With the launch of iTunes version 4.5 at the service's one year anniversary, Apple made the above mentioned changes in addition to introducing several new features. See "Dark Side of the Tune", available at www.washingtonpost.com/ac2/wp-dyn/A6351-2004May6?lan.

²³⁰ DRM's relationship to fair use in general and first sale will be discussed in subsequent parts.

1. The United States

The US implemented the DMCA in 1998 to comply with two World Intellectual Property Organization (WIPO) treaties.²³¹ The treaties call for "adequate legal protections and effective legal remedies against the circumvention of effective technological measures."

The anti-circumvention provisions of the DMCA²³² forbid three specific offenses. First, the DMCA prohibits circumventing DRM that prevents someone from gaining access to a copyrighted work (hereafter, "access controls"). Second, it prohibits trafficking in devices that can circumvent access controls, and, third, trafficking in circumvention devices for DRM that protects the copyright holder's exclusive rights, like copying and distribution (hereafter, "copy controls"). In both trafficking instances, the device qualifies if it is primarily designed for, has limited commercially significant purposes aside from, or is marketed for circumvention. None of the typical defenses to infringement apply to DMCA offenses.²³³ In an attempt to balance this law with typical copyright exceptions, Congress decided not to prohibit circumvention of copy controls; after all, if the circumvention is not for a legitimate purpose, the individual will be liable for copyright infringement anyway. On the other hand, Congress reasoned that if access to the work is unauthorized, then subsequent legitimate uses should not be an excuse for circumvention.²³⁴

But what exactly constitutes unauthorized access? Consider two situations. First, someone descrambles cable channels without paying. Second, a consumer buys a DVD and wants to play it on his computer; and rather than buy a DVD player, he circumvents the DRM to view the disc's contents. In the first situation, the user's act could be analogized to breaking into another person's locked safe. However, in the second instance, one could argue that the user has authorization to access the DVD because he lawfully acquired it. For it to constitute unauthorized circumvention, the access control provision must be construed broadly to require authorization for each use that involves unlocking the DRM.

Though the ambiguous meaning of the statute has been extensively debated,²³⁵ nearly all courts have settled on the broader definition of access control.²³⁶ In *Universal v. Reimerdes*, which involved a situation similar to the DVD example above, the court affirmed that every act of decryption requires permission, and thus only

²³¹ WIPO Copyright Treaty, Dec. 20, 1996, art. 11, and WIPO Performances and Phonograms Treaty, Dec. 20, 1996, art. 18.

²³² 17 USC 1201 (1998).

²³³ *Universal v. Reimerdes*, 111 F. Supp. 2d 294, 321-324 (SDNY 2000).

²³⁴ Jessica Litman, *Digital Copyright*, 133 (Prometheus Books, 2001).

²³⁵ See, e.g., Jane C. Ginsburg, *From Having Copies to Experiencing Works: the Development of an Access Right in U.S. Copyright Law*, forthcoming in Hugh Hansen, ed., *U.S. Intellectual Property: Law and Policy* (2003); Ernest Miller, *Ancillary audiovisual works distributed on Digital Versatile Discs (DVDs) using the Content Scrambling System (CSS) of access control* Anti-circumvention Exemption Comments, at 19-26 (2003), available at <http://www.copyright.gov/1201/2003/comments/021.pdf>; Pamela Samuelson, *Intellectual Property and the Digital Economy: Why the Anti-Circumvention Regulations Need to Be Revised*, 14 Berkeley Tech. L. J. 519, at 539-540 (1999).

²³⁶ See, e.g., *Reimerdes*, 111 F. Supp. 2d 294; *Sony Computer Entertainment America Inc. v. Gamemasters*, 87 F.Supp.2d 976 (N.D. Cal. 1999); *Lexmark v. Static Control*, 253 F. Supp. 2d 943 (ED KY 2003). But, for contrary approach, see *Chamberlain v. Skylink Technologies*, 2003 U.S. Dist. LEXIS 15298 (ND Ill. August 29, 2003).

players authorized to unlock the DRM can be used.²³⁷ Consequently, the DMCA effectively creates a new exclusive right to control access and use of copyrighted works.

Because of this right's expansiveness, Congress created several limited exemptions and a triennial exemption petition process. Most important to the focus of this case study is the exemption for reverse engineering,²³⁸ "the scientific method of taking something apart in order to figure out how it works."²³⁹ As long as it is a fair use²⁴⁰ and performed exclusively to enable two computer programs to communicate with each other ("interoperability"), circumvention is allowed. Additionally, both trafficking bans can be avoided if devices are distributed solely to achieve interoperability. Still, courts have narrowly construed the exemption to exclude interoperability between a computer program and another type of work (e.g., movies or music) and circumvention devices that have uses beyond interoperability.²⁴¹

If a circumventor's actions do not fall within the statute's exceptions, the copyright owner and any other affected party can bring a civil action for actual damages plus violator's profits or statutory damages.²⁴² In addition, violators can be criminally prosecuted.²⁴³

2. European Union

Under the terms of the EUCD,²⁴⁴ the Member States were required to bring into force all laws, regulations or administrative provisions necessary to comply with the Directive before December 22, 2002. By November 6, 2003, only six of the fifteen Members of the EU had complied with the EUCD. In December 2003, the EU Commission referred the non-complying nations to the EU Court of Justice for failure to transpose the EUCD into national law.²⁴⁵ The complying countries—Austria, Denmark, Germany, Greece, Italy, and the United Kingdom—exhibit notably dissimilar implementations in part due to differences in interpretation and to the Directive's optional sections. These implementations only begin to reveal what might become a path of divergence within the Union.

Article 6(1) and (2) of the EUCD, in very similar terms as the DMCA, mandate that Member States should provide protection against the act of circumvention of technological measures as well as against the trafficking in circumvention devices and services. The Directive also lists discrete, significantly limited exceptions that countries must accommodate as well as optional ones for personal copying. Anti-circumvention protection regarding computer programs and access to services is provided specifically in the Software Directive and the

²³⁷ See *Reimerdes*, 111 F. Supp. 2d 294, 317-318.

²³⁸ See 17 USC 1201(f) (1998).

²³⁹ See *Reverse Engineering, Chilling Effects*, at <http://www.chillingeffects.org/reverse/>.

²⁴⁰ See *Sega Enterprises v. Accolade Inc.*, 977 F.2d 1510 (9th Cir. 1992).

²⁴¹ See *Universal v. Reimerdes*, 82 F. Supp. 2d 211, 217-218 (SDNY 2000).

²⁴² 17 USC 1203 (1998).

²⁴³ 17 USC 1204 (1998).

²⁴⁴ See *supra* note 83.

²⁴⁵ See "Internal Market: Commission acts to ensure eleven Member States implement EU laws," Brussels, December 17, 2003; IP/03/1752

Conditional Access Directive, respectively. Notably, the exceptions in the EUCD do not include reverse engineering, though such an exception exists in the Software Directive.

Additionally, the EUCD makes references to “access controls” and “copy controls,” but unlike the DMCA, it grants equal treatment to both types of controls. This fact has already generated the formation of diverging regimes such as the Danish system where circumvention of “access controls” might be considered fair use.²⁴⁶ While it is still not yet possible to rely on case law to predict how enforcement will actually differ among the EU, evidence of emerging differences can be found in the Danish Ministry of Culture's recent statement²⁴⁷ that circumventing “access controls” such as those used in DVD's region coding²⁴⁸ might be perfectly legal.²⁴⁹

More recently, an Italian court rejected Sony's limiting use of Playstation video game consoles through access controls. According to the court, article 171-ter of the Italian copyright law, which implements the EUCD, does not prohibit Playstation owners from disabling DRM in order to play disks marketed for other regions or from manufacturers other than Sony.²⁵⁰

In contrast, UK's Statutory Instrument No. 2498 implementing the EUCD²⁵¹ bans the circumvention of both “access” and “copy” controls assimilating them under the common label of “technological measures.”²⁵² Furthermore, even if technological measures prevent uses expressly permitted by the UK Copyright Act, it would still be illegal to circumvent them.²⁵³ The same is true in German law with regard to copyrighted works distributed on the Internet. While consumers are allowed to make copies of these works for private use²⁵⁴, the Act makes it unlawful for users to circumvent any copy protections put in place by the copyright owners.²⁵⁵

With regard to the sanctions imposed on circumventors or those trafficking in circumvention devices, diverging implementations have also taken place among different EU members. Under UK law, possibly the toughest jurisdiction for copyright infringers, violators of anti-circumvention provisions might be subject to both fines and imprisonment.²⁵⁶ Additionally, not only copyright owners and distributors have a cause of

²⁴⁶ See <http://www.fipr.org/copyright/guide/denmark.htm>.

²⁴⁷ *Id.*

²⁴⁸ See <http://www.techtv.com/callforhelp/features/jump/0,24331,3360484,00.html>. Finland has also considered not protecting region coding, see <http://www.fipr.org/copyright/guide/finland.htm>.

²⁴⁹ It is not yet clear how this declaration might fit the Danish Copyright Act's sec. 75(d), which confers upon a “Copyright License Tribunal” the authority to order copyright holders who have used “effective technological measures” to correct within a period of four weeks any undue restrictions. Once the four weeks have elapsed, if the copyright holder has still not complied with the order of the “Copyright License Tribunal” then users are automatically allowed to circumvent the technological measures protecting his or her work. For Danish Copyright Act, see Consolidated Act No. 164 of March 12, 2003 at <http://www.kum.dk/sw4550.asp>.

²⁵⁰ See http://www.ipjustice.org/media/release20040112_en.shtml.

²⁵¹ Statutory Instrument 2003 No. 2498 “The Copyright and Related Rights Regulations 2003” available at <http://www.legislation.hmso.gov.uk/si/si2003/20032498.htm#2>.

²⁵² See sec. 296ZF, Interpretation of secs. 296ZA to 296ZE, of the Statutory Instrument 2003 No. 2498.

²⁵³ See sec. 296ZE, Remedy where effective technological measures prevent permitted acts, of the Statutory Instrument 2003 No. 2498.

²⁵⁴ See § 53(1), UrhG, see *supra* note 118.

²⁵⁵ See § 95(a), UrhG.

²⁵⁶ See sec. 296ZB of the Statutory Instrument 2003 No. 2498.

action under UK law, but when infringement is related to the trafficking of devices or services with commercial purposes, also the owner or exclusive licensee of the intellectual property over the “effective technological measures” has a cause of action.²⁵⁷

On the opposite extreme, the Danish system provides for no criminal sanctions for those who violate its anti-circumvention provisions, only imposing civil damages and fines.²⁵⁸ Finally, Germany provides a third and distinct example. Both fines and prison sentences are contemplated, but infringers that have circumvented technological measures for personal non-commercial use are exempted from criminal prosecution.²⁵⁹

3. Asia-Pacific

a. Japan

To comply with the WIPO treaties, Japan enacted anti-circumvention provisions similar to the DMCA in its Copyright Law.²⁶⁰ However, the Japanese anti-circumvention laws differ in key respects to the DMCA. First, the provision is limited to devices and computer programs. Unlike the DMCA, which encompasses technologies and parts thereof, the Japanese statute requires a tangible circumvention measure to find liability.²⁶¹ Another difference is the Japanese statute's refusal to prohibit circumvention acts directly.²⁶² At the same time, if circumvention for the making of permitted private use copies inhibits the DRM's effectiveness to prevent infringement, then that copying is not lawful.²⁶³ Finally, the Japanese statute might be substantially less broad, only protecting "measures to prevent or deter such acts as constitute infringements."²⁶⁴ Because the law only covers devices whose primary purpose is to circumvent technological protection measures in the course of enabling acts prevented by the statute,²⁶⁵ the Japanese statute can be construed to employ the narrower definition of access controls discussed above.

On the other hand, Japanese copyright law does not provide much insight regarding the issue of reverse engineering; Japanese law does not explicitly prohibit or permit reverse engineering,²⁶⁶ and the Japanese courts have addressed it imprecisely in previous cases.²⁶⁷

²⁵⁷ See sections 296ZD and 296ZA of the Statutory Instrument 2003 No. 2498.

²⁵⁸ See *supra* note 246.

²⁵⁹ See <http://www.fipr.org/copyright/guide/germany.htm> and <http://www.germanamericanlaw.com/cgi-bin/amlaw/cgi/IP/z9262003UrhRG.html?seemore=y>.

²⁶⁰ Art. 120bis, 30, Copyright Law of Japan, see *supra* note 128.

²⁶¹ See Brian Bolinger, Focusing on Infringement: Why Limitations on Decryption Technology Are Not the Solution to Policing Copyright, 52 Case W. Res. 1091, 1108, Summer 2002.

²⁶² See *Id.*

²⁶³ Art. 30, Copyright Law of Japan.

²⁶⁴ Art. 2, Copyright Law of Japan.

²⁶⁵ See Bolinger at 1109.

²⁶⁶ In July 1993, the Japanese Council for Examination and Research responded to two United States Circuit Court decisions and recently adopted European Community legislation by suggesting relaxed copyright protection laws to permit reverse engineering of computer programs. However, despite the apparent unity of international principles, the United States government successfully urged Japan not to

b. China

China is also a signatory to the two relevant WIPO treaties, and those terms are reflected in its copyright laws. The Chinese Copyright Act outlines civil, administrative and criminal liability for anyone who “intentionally circumvent[s] or destroy[s] the technological measures taken by a right holder for protecting the copyright or copyright-related rights in his work ... without the permission of the copyright owner.”²⁶⁸

The Chinese law has also not yet directly addressed the issue of reverse engineering.²⁶⁹ However, it is likely that China may be amenable to adopting a fair use-reverse engineering provision to achieve the dual goals of innovation and competition.²⁷⁰

4. Future Implementers

As this comparative survey illustrates, most countries that protect DRM are heading in the same general direction, though there is still room for significant divergences along the way. Given the two WIPO treaties' vague language, there is likely to be a variety of future implementations among signatories²⁷¹ who have yet to implement them. Canada, for instance, is still investigating possible legal alternatives to the DMCA.²⁷²

C. The Interaction Between iTunes DRM and the DMCA

In this section, we will proceed with our analysis of how Apple's business model takes advantage of the DMCA to a) prevent music piracy and b) limit interoperability, thus controlling secondary markets. As noted, the ways DRM impacts other fair uses and first sale will be discussed in other sections.

Though we analyze these issues in terms of the iTunes Music Store, our reasoning has general applicability. Our analysis of the DRM and piracy is a universal issue for digital music stores, and though not all services

adopt the proposal. See Crystal D. Talley, *Japan's Retreat from Reverse Engineering: An Unnecessary Surrender*, 29 Cornell Int'l L.J. 807, 1996.

²⁶⁷ Japanese case law has addressed the issue of reverse-engineering, holding in one case that the process of decompiling a BASIC interpreter constituted copyright infringement, while finding in other cases that although literally copying code infringes copyrights, the copyright protection does not extend to the algorithms used in making the programs. However, the courts made no clear statements as to whether reverse engineering, in general, should be allowed or prohibited, and the Copyright Law does not directly address this issue.

²⁶⁸ Art. 47, Copyright Act of China, see *supra* note 177.

²⁶⁹ See Samuelson, *supra* note 190.

²⁷⁰ Interestingly, in early 1997, Hong Kong considered adopting a European Union-type special exception for decompilation, but was persuaded by U.S. industry groups and officials that a fair use rule was preferable in balancing the interests at stake when decompilation occurs. This history suggests that China may be amenable to adopting a fair use-reverse engineering provision. See *Id.*

²⁷¹ See lists of signatories, WIPO Copyright Treaty, available at <http://www.wipo.int/treaties/notifications/wct/0002.html>, and WIPO Phonograms and Performances Treaty, available at <http://www.wipo.int/treaties/notifications/wppt/0001.html>.

²⁷² On May 12, 2004 the Canadian Parliament's Heritage Committee issued a copyright report recommending that Canada ratify the two World Intellectual Property Organization (WIPO) treaties. Brian Robertson, the head of the Canadian Recording Industry Association (CRIA), has issued a statement declaring that Canada is viewed as “a copyright pariah for its inability to keep its copyright up to date.” For information regarding pending legislation in Canada see http://www.thestar.com/NASApp/cs/ContentServer?pagename=thestar/Layout/Article_Type1&c=Article&cid=1084399812009&call_pageid=968332188774&col=968350116467. For statement by Robertson see <http://www.globetechnology.com/servlet/ArticleNews/TPStory/LAC/20040413/RMUSI13/TPTechnology/>. For more information about Canadian copyright policy, see Copyright Policy Branch, *Technological Protection Measures: Part II – The Legal Protection of TPMS*, available at http://www.pch.gc.ca/progs/ac-ca/progs/pda-cpb/pubs/protectionII/tdm_e.cfm.

attempt to control secondary markets as arguably Apple does, the DMCA and DRM certainly allow others to do so.

1. Preventing Piracy

Apple uses its FairPlay DRM to limit distribution of iTunes songs over the Internet. Copied songs are inoperable until a particular computer has been authorized to play them, and each song only permits five authorizations.²⁷³ Unless an iTunes user is willing to trust strangers with sensitive information—his Apple ID and password—then even limited distribution over peer-to-peer (P2P) services or other file-distribution systems is unlikely.

The DMCA supports this impediment to infringement in three key ways. First, by creating unique penalties for trafficking in circumvention tools, the DMCA decreases the likelihood that anyone will acquire the means to create unencrypted copies. It is a truism that all DRM can be broken; however, most people do not have the technical knowledge to do so themselves. Before the DMCA, creators of circumvention devices bore little risk because they were judged under a rather lax standard: so long as their devices were "capable of substantial non-infringing uses," they were not liable.²⁷⁴ Because the DMCA creates a cause of action regardless of infringing or non-infringing uses,²⁷⁵ circumvention devices are less likely to be easily accessible to the public.

Second, the DMCA creates additional penalties for already infringing acts because FairPlay is an access control, if not also a copy control. Like the DVDs in *Reimerdes*, playing FairPlay songs requires using a device specially authorized to unlock the DRM. Furthermore, the Register of Copyrights recently clarified that access controls specifically include DRM that renders copies inoperable absent authorization.²⁷⁶

Third, the DMCA adds another party that can sue for copyright-related offenses. While only copyright holders can pursue infringement claims, both copyright holders and Apple can sue for DMCA violations.²⁷⁷

Because other countries' DMCA-like laws share these features to a significant extent, Apple could likely transplant its current model elsewhere. Certainly, the varying penalties for circumvention and definitions of access controls could make a country more or less attractive to Apple.²⁷⁸ However, these are more differences in degree than substance.

²⁷³ See *iTunes 4: About Music Store Authorization and Deauthorization*, Apple Support Site, at <http://docs.info.apple.com/Art.html?artnum=93014>.

²⁷⁴ See *Sony v. Universal*, 464 U.S. 417, 442 (1984). See also *Vault v. Quaid*, 847 F.2d 255 (5th Circuit 1985).

²⁷⁵ It is worth repeating that the DMCA only considers commercially significant purposes *aside from circumvention*, not commercially significant purposes in general.

²⁷⁶ Marybeth Peters, *Recommendation of the Register of Copyrights in RM 2002-4; Rulemaking on Exemptions from Prohibition on Circumvention of Copyright Protection Systems for Access Control Technologies*, 44-45 (Oct. 28, 2003), available at <http://www.copyright.gov/1201/docs/register-recommendation.pdf>.

²⁷⁷ 17 USC 1203(a) ("any person injured by a violation of section 1201 or 1202 may bring a civil action in an appropriate United States district court for such violation")

²⁷⁸ We acknowledge, of course, that enforcement, regardless of penalty, is also an issue, most notably in Japan and China. See, respectively, H. Stephen Harris, Jr., *Competition Law and Patent Protection in Japan: A Half-Century of Progress, a New Millennium of Challenges*, 16

Apple, of course, will not make its decisions based solely on the hypothetical impact of the DMCA and DRM, but rather on their practical impact. That is, if DMCA-like laws do little to stop piracy, then foreign legal differences may be irrelevant. Examined in this light, Apple's decision-making about transplanting its business model might change considerably. Today, every song in the iTunes catalogue can almost certainly be found on P2P. Indeed, even songs exclusively released using FairPlay DRM and not sold in unencrypted formats have been found on P2P mere minutes after release.²⁷⁹

Despite the DMCA, FairPlay is not an impermeable barrier to creating unencrypted copies. Even if people could only purchase songs through Apple—and thus could not create MP3s from CDs purchased in stores, which surely make up the bulk of infringing P2P files—they would still be able to create unencrypted copies. By burning to CD, ripping, and recompressing, or by exploiting the "analog hole,"²⁸⁰ consumers can create unencrypted copies without violating the DMCA.²⁸¹ Furthermore, recent history suggests that actual circumvention devices will not be completely inaccessible. DeCSS, the program at issue in *Reimerdes*, is still widely available online, though arguably less so than before. Indeed, one of DeCSS' developers, Jon Johansen, reverse engineered FairPlay, laying the groundwork for a recently developed FairPlay decryption program called Hymn.²⁸²

Moreover, even if the DRM and the DMCA were to stop nearly everyone from creating copies for infringing distribution, this would not necessarily translate into a reduction in illicit distribution. Though most people might not know how to evade the DRM, one unencrypted copy can quickly propagate throughout P2P services. Once that occurs, more people can become infringing P2P distributors ("uploaders") without ever evading the DRM.²⁸³

Thus, while DRM can accomplish a reduction in the initial number of infringing uploaders, it does not lead directly to a reduction in actual piracy.²⁸⁴ This is not to say that DRM will have absolutely no role in preventing piracy, but rather that it will be mostly confined to complementing other measures that benefit

Colum. J. Asian L. 71, 82 (Fall 2002), and Wang & Wang, *IP Enforcement in China: A General Overview*, available at http://www.wangandwang.com/china_enforcement.htm. However, we proceed for the sake of argument with the assumption that attempts at enforcement will occur.

²⁷⁹ Remarks of Eric Garland, Computers, Freedom & Privacy 2004, Berkeley, CA, April 22, 2004 (recording available at http://www.cmccg.com/cfp2004/422_Plenary_8.mp3)

²⁸⁰ As noted earlier in the case study, the "analog hole" refers to the fact that all songs must eventually be rendered as analog, unencrypted sounds. Users can capture sounds as they come out of speakers or are outputted to the soundcard, though this might constitute copyright infringement.

²⁸¹ See *Universal v. Corley*, 273 F.3d 429, 459 (2nd Circuit 2001). ("[T]he DMCA does not impose even an arguable limitation on ... recording portions of the video images and sounds on film or tape by pointing a camera, a camcorder, or a microphone at a monitor as it displays the DVD movie"). In fact, the Register of Copyrights even suggested that users use the analog hole to avoid DVD's restrictions; see Peters, 116.

²⁸² See <http://hymn-project.org/>.

²⁸³ For a discussion on the effectiveness of DRM in the context of P2P networks, see Peter Biddle et al. "The Darknet and the Future of Content Distribution" October 15, 2002, available at <http://crypto.stanford.edu/DRM2002/darknet5.doc>.

²⁸⁴ It is worth noting here that DRM might be far more effective in preventing small-scale, non-Internet distribution. If Apple and copyright holders were simply concerned with people distributing CDs or hard drives full of data files to friends, then the DRM might lead to actual reduction in piracy, even though evasion of the DRM would still be possible. Regardless, this is unlikely to be Apple's or copyright holders' major concern, so we do not go in further depth on this point here. For a brief discussion of how DRM's effect in this context can be distinguished from the Internet context, see Ed Felten, *DRM and the First Rule of Security Analysis*, Freedom-to-Tinker (March 19, 2003), at <http://www.freedom-to-tinker.com/archives/000317.html>.

from a reduced number of initial uploaders. DRM's value in this regard is rather unclear and in need of further study.²⁸⁵ For instance, DRM might complement other technological measures, like file "spoofing" or "interdiction" of P2P file-sharers.²⁸⁶ One uploaded copy can spread quickly, but one uploader might be easier to stop than one hundred. Also, DRM might aid a strategy of enforcement under copyright infringement laws. If copyright holders were targeting those who first put files on a P2P network, and a P2P user expected that he would be one of only a few to provide the file, then the threat of a lawsuit might act as a greater deterrent. Finally, by reducing the number of uploaders, DRM might reduce content diversity on P2P systems. This effect, unlikely to have any noticeable impact on popular materials (which are more likely to be provided by numerous sources), could arguably be perceived in availability of rare content.

On this basis, it is reasonable to question how much Apple and copyright holders actually gain from DRM and the DMCA. In the short run, the DMCA and DRM will have practically no impact on piracy because it is almost costless to evade DRM without implicating the DMCA as described above. If the DMCA and FairPlay cannot prevent availability of music on P2P networks, then they might do nothing but harm to the iTunes. By increasing transaction costs for iTunes users who want to make non-infringing uses that the DRM forbids, FairPlay could cause decreasing demand related to consumer dissatisfaction and thus create an incentive to turn to P2P systems.

In the long run, DRM and the DMCA might more effectively reduce the number of initial uploaders, if evading the DRM by burning to CD—and thus without implicating the DMCA—is no longer so commonplace and trivially easy. Consumers might not use CDs at all, or their music might simply be tied to whatever portable player they have directly downloaded it to.

Today, popular technologies such as those allowing CD or DVD burning have allowed for extremely low transaction costs in the copying and distribution of music on both the producer and the consumer sides. Due to their relatively low cost, CD/DVD burners have become a usual complement of home PCs and are ordinarily included by a large number of computer manufacturers as a standard device.²⁸⁷ Even when considering the use of new watermarking techniques that survive these methods, the implementation of devices that could monitor this type of watermarking would take years to replace the current devices unfit for such a task.

²⁸⁵ See Speed Bumps Scenario for Digital Media, at <http://cyber.law.harvard.edu/media/scenario2>.

²⁸⁶ See Randy Saaf, Written Testimony for the Oversight Hearing on "Piracy of Intellectual Property on Peer-to-Peer Networks," 26 Sept 2002, available at <http://www.house.gov/judiciary/saaf092602.htm>. Saaf describes a method called "interdiction," whereby an infringing file is purposely downloaded at a slow rate to inhibit others from downloading the same file. Whether this tactic is legal is uncertain; see *Comments on the Berman P2P Bill*, EFF.org, at http://www.eff.org/IP/P2P/20020802_eff_berman_p2p_bill.php. In addition, copyright holders can swamp P2P services with fake files ("spoofing"), aimed to frustrate users looking for infringing content; see <http://www.wired.com/news/digiwood/0,1412,57112,00.html>. Reducing the number of initial uploaders will lead to a greater ratio of spoofed to real files. For further discussion, see above reference to Speed Bump Scenario.

²⁸⁷ A sample of standard PC configurations from large computer manufacturers can be obtained from Dell, Compaq, Gateway and IBM at <http://www.dell.com>, <http://www.compaq.com>, <http://www.gateway.com> and <http://www.ibm.com>.

CDs and DVDs, however, are losing importance in music usage. Using micro hard drives or memory cards to store music, portable players like Apple's iPod have taken the lead in the introduction of technologies that replace CDs. The new devices are significantly more versatile than CD-based players, providing larger storage capabilities in smaller sizes, better management of song repertoires and longer battery life. In addition, music delivery methods are changing in ways that support portable players. In the Japanese²⁸⁸ and European²⁸⁹ markets, services are being developed to offer downloads direct to cell phones and mobile devices. In such services, rather than downloading a "portable" file, consumers might simply stream music to their multitude of devices.

If, in light of these changes, CDs are no longer widely used for music, then new technology and the evolution of market preferences might contribute to DRM's reducing initial uploaders. Having to turn to obsolete or complicated technology to overcome DRM would increase the transaction costs of piracy. It may become increasingly uncomfortable to burn CDs or create and convert an analog copy to overcome protections,²⁹⁰ especially if consumers become accustomed to downloading songs directly to their computers or portable players at a low price.

On the other hand, if burning to CD remains valuable in creating unencrypted copies, this long run trend will have a more attenuated benefit for DRM. People might retain old equipment simply to avoid DRM's usage restrictions. Given that most portable players also play unencrypted formats like MP3, and assuming that the iTunes (and other stores) continue to allow audio CD creation, consumers could still use CDs to create unencrypted copies without losing the flexibility of the newer portable players.

Even with these possible long run changes, the DMCA and DRM will still only reduce the number of initial uploaders, and thus much will still depend on the success of other deterrence measures to which DRM can be coupled. It bears repeating that DRM's relevance to these other measures is plausible, but far from certain. To the extent Apple's transplanting its business model overseas hinges on FairPlay reducing piracy, their strategy will depend on how they view the potential effect of a reduction in initial uploaders.

2. Reverse Engineering and Interoperability

Earlier in the case study, we mentioned how Apple's use of a proprietary DRM standard allows it to control secondary markets. Currently, only iTunes and Quicktime software can play FairPlay files, and the iPod is the only compatible portable player. Notably, RealNetworks might employ a similar tactic, implementing its own

²⁸⁸ This is the case for the example of Imode, the service offered by NNT Docomo. See <http://www.nttdocomo.com/corebiz/imode/services/imotion.html>.

²⁸⁹ See <http://www.3g.co.uk/PR/April2003/5150.htm>.

²⁹⁰ There is also the possibility of recording the output as it goes to the soundcard, though this can potentially be limited by not allowing DRMed music to use "untrusted" drivers. Even so, recording the output might be too complex for many users. See, e.g., Microsoft's Secure Audio Path feature, <http://msdn.microsoft.com/library/default.asp?url=/library/en-us/wmform/htm/microsoftsecureaudiopath.asp>

proprietary DRM for its music store.²⁹¹ Though WMA, used by most other digital music stores, is similarly proprietary, Microsoft has licensed its use more extensively than Apple has with FairPlay.

The DMCA enables Apple's control by restraining reverse engineering. Without the DMCA, skilled programmers could analyze how the DRM works to create compatible players without fear of liability. Because FairPlay is an access control, reverse engineers must work within the narrow confines of the DMCA's exemption. This exemption is of little help because the music files are not likely to qualify as computer programs under the statute. In a similar fashion, the EU CD also denies a reverse engineering exemption to those attempting to design compatible players, only allowing a limited safe harbor to those trying to achieve “software interoperability” as contemplated by the EU Software Directive.²⁹²

The increased protection that Apple's DRM is able to enjoy as a consequence of the DMCA and the EU CD implementations allows today for the deployment of a market strategy based on excluding competition through restricted interoperability. Assuming for the moment that iTunes Store's main purpose is to generate profits in iPod sales (even if operating at a loss),²⁹³ restricting interoperability is a sound business decision. In making this decision, Apple has to balance the trade-off between the possible increase in profits derived from expanding the iTunes Store's consumer base, and removing the strategic advantage the iPod has by way of its exclusive relationship to the iTunes service. Making iTunes songs exclusively compatible with iPod allows for the generation of noticeable entry barriers in the market of portable players and some barriers in the market of music downloading services (iTMS competitors).²⁹⁴ In so doing, this strategy ultimately reinforces Apple's price discrimination scheme, as Apple is able to fine tune prices more precisely to a consumer base that is more tightly linked to both products, and conveys information about intensity of usage or downloads more efficiently. More generally, digital dissemination of copyrighted works may have a number of effects on price discrimination and thus the affordability of online music depending on how a “digital first sale” doctrine²⁹⁵ evolves and on whether a competitive market, or one in which copyright holders behave monopolistically, develops. As noted earlier,²⁹⁶ one potential flaw in Apple's business model is that an *à la carte* purchasing method, coupled with restricted interoperability, may alienate consumers in the long term. Even if prices stay at \$0.99, the high costs of filling an iPod—\$5,000 for a 20-gig hard drive—may lead consumers to opt for a subscription model, once a service that matches the iTunes's portability emerges. Additionally, the Recording Industry is eager to encourage cooperation between online distributors. The fear is that restricted interoperability may frustrate consumers and squander a crucial opportunity to wean downloaders from P2P. Interestingly, Apple declined a plea to license its FairPlay technology to RealNetworks, reasoning that the

²⁹¹ See <http://news.com.com/2100-1027-5136275.html>.

²⁹² See Council Directive 91/250/EEC of 14 May 1991 on the legal protection of computer programs.

²⁹³ See Will iTunes Make Apple Shine?, at http://news.com.com/2100-1041_3-5092559.html.

²⁹⁴ It is interesting to note that the circumstance of Apple's initial business model for personal computer sales made use of the same exclusivity between software and hardware: Apple software was exclusively compatible with Apple hardware, and *vice versa*.

²⁹⁵ See Part III.

²⁹⁶ See Introduction Section C part 1.

increase in the sales of iPods, which already command a majority of the portable player market, would not be enough to offset the loss in downloads to the rival service.²⁹⁷

The readily available iTunes services increase the value of iPod by providing a well-developed, seamlessly integrated, complementary service. Users need only follow the instructions provided with the iPod and the included software to enjoy a variety of services not instantly available to other portable player users.

At the same time, by marketing iPods and the iTunes service as integrated products, Apple is able to price these complementary goods interdependently and discriminate between light and heavy users of its products. As noted earlier, Apple's main concern is maximizing overall profits inter-temporally, and not necessarily those of the iTunes or iPod independently. Depending on the strength of the ties between iPod and the iTunes service, Apple will be able to take advantage of pricing schemes that have long been used by others such as printer manufacturers. For instance, Lexmark consistently prices its printers taking into consideration the profits it will be able to realize through the sale of complementary cartridges. In the same way that Apple allegedly prices its iTunes songs at a loss,²⁹⁸ expecting to make profits from its iPod sales, Lexmark could very well price its printers even below their production cost expecting to make profit through cartridge sales. In both cases, restricted interoperability is the key factor that enables this kind of business strategy.²⁹⁹

Not only does integrating the iTunes and the iPod help leverage success from the portable mp3 market into the internet music store market (and *vice versa*), but the match reshapes each market altogether. In the portable mp3 player market, rivals to iPod must compete with the additional features added by the iTunes. A prospective buyer of a portable music device gains more features by purchasing an iPod than he or she would by purchasing another portable device which would not tie into iTunes. To compete, other portable mp3 players must either offer a reduced price to compensate users for the lost functionality, or must try and offer their own digital music store.

In this sense, by expanding the complexity of the product to an integrated service, Apple is actually increasing entry barriers in the portable players market. There are, however, forces operating against this strategic approach. First, there is still minor enforcement of copyright infringement with regard to file-sharing services. This fact allows for free downloading to remain the prevalent mode of music consumption³⁰⁰ and limits market power of the iTunes. At the same time, songs downloaded from P2P provide iPod competitors with attractive avenues to complement (at no cost to the producer) their competing portable players. Second, as discussed above, people can evade the DRM, creating copies that are playable on any portable player. Third, a

²⁹⁷ For a discussion of price discrimination in digital distribution see R. Anthony Reese, *The First Sale Doctrine in the Era of Digital Networks*, 44 B.C. L. Rev. 577, p. 625-627, available at http://www.bc.edu/schools/law/lawreviews/meta-elements/journals/bclawr/44_2/09_TXT.htm. For pricing information see *supra* Introduction Part C. For RealNetworks offer see <http://www.newsfactor.com/perl/story/23730.html&ConfigFile=Framelt.cfg>.

²⁹⁸ See *supra* note 29.

²⁹⁹ See *LEXMARK INTERNATIONAL, INC. Plaintiff v. STATIC CONTROL COMPONENTS, INC.* Defendant No. 02-CV-571. Feb. 27, 2003 for a good example of how restricted interoperability enables this business model.

³⁰⁰ See 10m Americans Pay For Music Downloads in Q2 at <http://theregister.co.uk/content/6/34206.html>.

few competitors already exist in the market (such as Dell's venture with the MusicMatch service),³⁰¹ that provide legal downloading alternatives for users of competing portable players.

Still, integration of the iTunes and iPod remains, from a business perspective, a promising strategy to prevail over the portable player market, and retain a minimum base of consumers supporting (even if not yet completely), the iTunes service. Additionally, iPod users not only find it easier to install iTunes software than any other competitor, but in some cases Apple has taken a more aggressive approach. For example, current versions of the iTunes desktop software disable the iPod's connection to MusicMatch.³⁰²

It is unclear at this point when, if ever, the iTunes will expand its service to all portable players based on the competitive rationales just described. Its recent expansion onto Windows secures an increasing demand for the service. This step, while still preserving iPod's advantage as an iTunes integrated device, allows the service to transform a broader base of consumers that includes PC users, into a bigger iTunes business, with a larger repertoire, and leverage this growth back in favor of Apple's privileged iPod users.

Anti-circumvention provisions support Apple's particular business strategy in at least two respects. As suggested earlier, it prevents Apple's competitors from reverse engineering the DRM to create competing portable players. Anti-circumvention laws will have a much stronger effect here than in the piracy context, because mass-marketing a compatible hardware player is far more difficult and noticeable than an individual's setting up a website with DeCSS. Second, and due to the preservation of the exclusive DRM, free riding of the iTunes by compatible players is also prevented. As a consequence of this, the product enhancing benefits of the iTunes with regard to iPod are preserved.

From a policy perspective, Apple's ability to limit interoperability in order to increase iPod sales might not render the optimal welfare enhancing result, and it is likely to harm consumers. The mere existence of different DRM and codec standards imposes additional costs on consumer and hardware producers.³⁰³ In many cases, several economies of scale are forgone through the separation of consumers into different incompatible subgroups.

This tension has been present in the case of DVD(+) and DVD(-) standards.³⁰⁴ At a higher cost, manufacturers might sometimes be able to re-unite their consumer base by attempting to pack several different sets of standards into a single device. Unlike current combo DVD(+)(-) recorders, however, this does not appear to be the likely outcome with regard to DRM standards under the DMCA. As a consequence of Apple's current business model, we should expect a more technologically fragmented market than if there

³⁰¹ See <http://www1.us.dell.com/content/topics/sectopic.aspx/brand/dell?c=us&l=en&s=gen>.

³⁰² See <http://www.pcworld.com/news/Art./0.aid.113336.00.asp>.

³⁰³ See <http://www.vialicensing.com/products/mpeg4aac/license.terms.html>.

³⁰⁴ DVD(+) and DVD(-) are industry standards that define how data is written to and read from DVD disks. Until very recently DVD readers were manufactured to recognize only one standard when reading DVDs. Disks recorded in one standard could not be read by devices compatible with the alternative standard. This design limitation in devices coupled with diversified DVD write/read standards caused widespread compatibility problems, market fragmentation, increasing transaction costs for consumers and finally increasing production costs for new devices that subsequently had to be built multi-standard ready.

were no DMCA protections. Derived from market fragmentation we should also expect companies being less able to compete in the production of alternative players (in this case against iPod) and slower development of compression standards to the detriment of consumers.

In a market where network effects³⁰⁵ are present, such as in the case of online music delivery services and the portable player markets, standards fragmentation or lack of interoperability is likely to be a welfare decreasing phenomenon, as the potential benefits of broadly available resources (in this case music) can not be realized by consumers. Just like having different standards of incompatible fax machines would reduce the value of all fax machines, having incompatible portable players and DRM is likely to affect the value of the players.

If, on the other hand, Apple's FairPlay were not protected from reverse engineering, and every other portable player manufacturer could play all formats, then more aggressive competition would exist both in the iPod and iTunes market and arguably more consumers would be likely to legally download music at lower costs. Paradoxically, the DMCA provisions that strongly protect the interests of the manufacturers of portable players could arguably be operating to the detriment of songwriters and composers, who would prefer portable players at lower prices, iTunes-like businesses to serve a broader demand, and consumers to pay more (or at least something) for the songs they download.

In this sense, the subsequent adoption of the EUCD into national legislation is likely to be directly affected by the observations made of current business practices, including Apple's current business strategy. If countries were to include clear reverse engineering and interoperability exceptions, then Apple would likely be unable to transplant its current model into markets outside the United States. In a still evolving normative environment, current exploitation of non-interoperability advantages in competition restrictive manners might work to the detriment of Apple's business model penetration in the EU.

D. Conclusion

In the preceding discussion, we have analyzed two broad questions: (1) what is the relationship between DRM and the iTunes business model? and, (2) how do the DMCA and related anti-circumvention laws reinforce this relationship? Specifically, we then addressed these questions with regard to piracy prevention and reverse engineering.

Notably, iTunes' arrival set the standard for DRM in all digital music services. Previous services' highly restrictive DRM made creating copies—digitally or through CD burns—more time-consuming. Now, almost all new services are starting with the assumption that DRM that is any more restrictive than iTunes' is out of the question. iTunes' success could provide the impetus to experiment with even more relaxed DRM restrictions, though getting the record labels' approval may remain difficult.

³⁰⁵ Network effects exist in a market where the benefits that an agent extracts from a particular good, increase as other agents consume the same kind of good. Operating systems such as Windows, or Fax machines provide good examples of markets with network effects, as the value of both Windows and Fax machines increase when the number of people that use these goods increases. See S. Liebowitz and S. Margolis, *Network Externalities (Effects)*, available at <http://www.utdallas.edu/~liebowit/palgrave/network.html>.

While in the short run the DMCA and DRM seem irrelevant in preventing piracy, their effect on secondary markets is both immediate and significant. Though the iTunes model takes an exceptionally restrictive approach with regard to portable players—tying the music store to one player—other services have employed slightly different tactics. Napster 2.0, for instance, uses the WMA DRM, which is proprietary but supported by many players. At the same time, Napster has teamed with Samsung to market an iPod-like player.³⁰⁶ In contrast, many implementers of OD2,³⁰⁷ Europe's premier online music distribution system, have little connection to player manufacturers. What's more, several OD2 outlets exist in countries that have yet to implement the EUCD.

One significant factor contributing to variation will be the several different parties—copyright holders, music services, and technology vendors—involved in determining DRM's constraints. For instance, Microsoft's control of WMA will affect Napster, for Napster cannot control who can create WMA players. Thus, the success and failure of DRM vendors will impact music business models.

Furthermore, variations in DRM use will continue despite, and because of, anti-circumvention laws. As described, the protection of DRM and provision of reverse engineering exemptions are, overall, heading in the same, restrictive direction. At the same time, the possibility of divergence subsists and could have substantial effects on business models. In some cases, the law itself might constrain the creation of such models. Music services might also opt not to create a restrictive model like Apple's even if the law allows them to. Indeed, several technology vendors are, with the aim of maximizing interoperability, developing DRM standards that anyone can license.³⁰⁸

For these reasons, we should continue to expect an ever-evolving relationship between the DRM, anti-circumvention laws, and digital music services. The relationship of proprietary DRM to secondary markets will be a key place of competition and division between services.

³⁰⁶ *Samsung Electronics and Napster Partner on New Portable Music Player Device to Debut Next Fall*, Napster press release (Sept. 16, 2003), at http://www.napster.com/press_releases/pr_030916.html. For an overview on the features see <http://www.pcmag.com/article2/0,4149,1366047,00.asp>.

³⁰⁷ See OD2's homepage, at <http://www.od2.com>.

³⁰⁸ See, e.g., <http://www.cforum.org/index.html>, <http://www.nytimes.com/2004/01/05/business/05share.html?ex=1388725200&en=a91c73054f2d133f&ei=5007&partner=USERLAND>, and <http://www.theregister.co.uk/content/4/34725.html>.

Part III: Digital First Sale Doctrine

A. Introduction

1. “Double Dutch Bus”

Part I on contract and copyright as protections for the iTunes business model outlined, among other issues, how copyright law is used by Apple (and similar providers of digital content) in order to control the actions consumers may take with digital content they have purchased. In this context, we discussed how copyright law, during the copyright term, protects certain works and rewards creators by providing a set of exclusive control rights such as the exclusive right of reproduction or the right of distribution. However, such exclusive rights are only granted within certain limits because copyright law conceptually aims at balancing between the rights of copyright holders on the one hand and the interest of the public on the other hand.³⁰⁹ This section will focus on one particular category of rights and limitations—the exclusive right of distribution and its limitation through the first sale doctrine (known as the principle of exhaustion in foreign jurisdictions). This doctrine has developed to balance authors’ rights and public access to works.

The following anecdote has received remarkable media coverage³¹⁰ and both introduces the subject matter and illustrates its relevance in the context of both online music distribution models in general and Apple’s iTunes in particular:

George Hotelling, a Web developer in Ann Arbor, Michigan, put the digital version of Columbia artist Devin Vasquez’ remake of “Double Dutch Bus” that he purchased online at Apple’s iTunes Music Store up for an auction on eBay to “see how this works out” and as “an experiment in property rights in the digital age, something that’s gotten surprisingly little attention.”³¹¹ eBay blocked the auction of the song shortly after its posting,³¹² arguing that the listing violated eBay’s Downloadable Media Policy.³¹³ These moves raised the question of whether the first sale doctrine as enacted in the U.S. Copyright Act applies to digitally distributed

³⁰⁹ The ultimate purpose of copyright legislation is reflected in the U.S. Constitution, which authorizes Congress to “promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.”, US Const. Art. I, § 8, cl. 8.

³¹⁰ See, e.g., http://news.com.com/2100-1025_3-5071108.html?tag=st_rn.

³¹¹ http://george.hotelling.net/90percent/geekery/does_the_right_of_first_sale_still_exist.php.

³¹² http://news.com.com/2100-1027_3-5071566.html?tag=cd_mh; <http://news.zdnet.co.uk/internet/e-commerce/0,39020372,39116149,00.htm>. However, according to a News.Com report, Hotelling finally managed it to sell the song, <http://news.com.com/2100-1027-5074086.html>.

³¹³ eBay’s Downloadable Media Policy is available at http://pages.ebay.com/help/index_popup.html?policies=downloadable.html.

works in the same way as offline distributed physical copies of works such as CDs or DVDs which, under the first sale doctrine, may lawfully be resold after purchase.³¹⁴ With regard to the *Hotelling* case, Apple has not answered this question nor addressed the issue of whether such a re-sale would violate iTunes' Terms of Service agreement. In an interview with CNET News.com, an Apple executive, arguing from a more practical than legal viewpoint, said that "it is impractical, though perhaps within someone's rights, to sell music purchased online."³¹⁵

To understand the crucial issue of the debate, whether the first sale doctrine applies to digitally transmitted works, we must briefly explore both the exclusive right of distribution and the first sale doctrine, and then discuss the relevance of the question to the iTunes business model and what it means for consumers in greater detail. With this fundamental framework in place, we will then address the key issue of the emergence of a digital first sale doctrine both under U.S. Copyright Law and from a comparative law perspective.

2. The Exclusive Right of Distribution and its Limitation: First Sale Doctrine

A copyright holder has a number of exclusive rights in her original work. The U.S. Copyright Act grants copyright holders the right "to distribute copies ... of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending."³¹⁶ However, this right to control the first public distribution of an authorized copy of the copyrighted work, as mentioned earlier, is limited by the so-called first sale doctrine as codified in Sec. 109(a) of the Copyright Act.³¹⁷ In essence, the doctrine provides that certain copyright holder's rights end after the first sale of a particular copy of the copyrighted work. On the basis of the first sale exception, an owner of books, for instance, is permitted to resell, rent, or lend these works, donate them to libraries, or share them among friends, without the need to obtain the permission of copyright holders or the need to make royalty payments. Based on this principle, a video rental store can rent videos to consumers or a library can lend its books without asking for the copyright holder's permission. However, to receive these privileges it is required that ownership of the copy is achieved. The mere possession (in contrast to ownership) of a work—for instance by rental—is not sufficient for the application of the first sale doctrine. Furthermore, the doctrine requires that the copy has been lawfully made such as when the copyright holder has authorized the making of a copy or that the law permits copying.

Moreover, the first sale doctrine traditionally limits no more than the copyright holder's distribution rights. Thus, it does not allow a purchaser of copyrighted material to copy it. In other words, a purchaser of a book, on the basis of the first sale doctrine, may well resell the book after its use, but is not permitted to make a copy of it. Consequently, the first sale doctrine only permits transfers with respect to the particular copy of the work that the purchaser owns. Likewise, the doctrine does not apply to other exclusive rights such as the

³¹⁴ See, e.g., US Copyright Office, DMCA Section 104 Report (Aug. 2001) (hereinafter DMCA Section 104 Report), p. xviii.

³¹⁵ See http://news.com.com/2100-1027_3-5072842.html.

³¹⁶ 17 U.S.C. § 106 (3).

³¹⁷ 17 U.S.C. § 109 (a) reads in part as follows: "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. ..."

copyright holder's right of public performance, or her right to prepare derivative works. Finally, the first sale exception is limited by law with regard to specific categories of copyrighted materials (e.g. Computer-Software)³¹⁸ and certain types of transactions (such as record rental)³¹⁹.

B. Potential Effects of the First Sale Doctrine

What are the (potential) effects of the first sale doctrine? Why do (or, at least, should) consumers and digital media providers—including online distribution services such as iTunes—care about this doctrine? That question must be answered in two steps. Initially, one must understand the effects of the doctrine in general. Against this backdrop, we can then discuss the relevance to digital media in particular.

The introductory remarks illustrate that the first sale doctrine is aimed at balancing the copyright holder's rights on the one hand and public access to copyrighted works on the other hand. Thus, the potential effects of the doctrine—as applied in traditional offline settings—have, broadly speaking, impacts on three layers:

- First, the doctrine has an important (societal) impact on the public layer. Traditionally, the first sale exception increases the overall availability of copyrighted work, for instance through used book markets or video rental stores and public libraries. In the same context, it ensures the continued availability of copyrighted works, including those that are out of print.
- Second, “first sale” affects users and consumers of information on an individual layer: The “first sale” enables both access to copyrighted works by different means than “purchase” (such as lending a book from the library), and lowers the costs because it leads to price competition. Additionally, it allows access to works without disclosure of the identity to the copyright holder. Thus, an individual enjoys (in non-technical terms) a kind of “right” to read, or watch, or listen anonymously under this doctrine.³²⁰ However, the doctrine does not only have effects on access, but also grants some additional exit options in the sense that a buyer of a CD, for instance, can sell it without copyright holder's permission to someone else when she is tired listening to it.
- Third, the doctrine has substantive effects on an economic layer: It has been observed that the first sale doctrine, generally speaking, leads to retail price competition, and that it fosters the emergence of new markets such as rental and secondary sale markets.³²¹ However, it is unclear to what extent these effects were intended when the doctrine was developed by courts and, finally, set forth in the copyright act by the legislature.

³¹⁸ See Computer Software Rental Amendments Act 1990.

³¹⁹ See Record Rental Amendment of 1984, and 17 U.S.C. §109(b)(1).

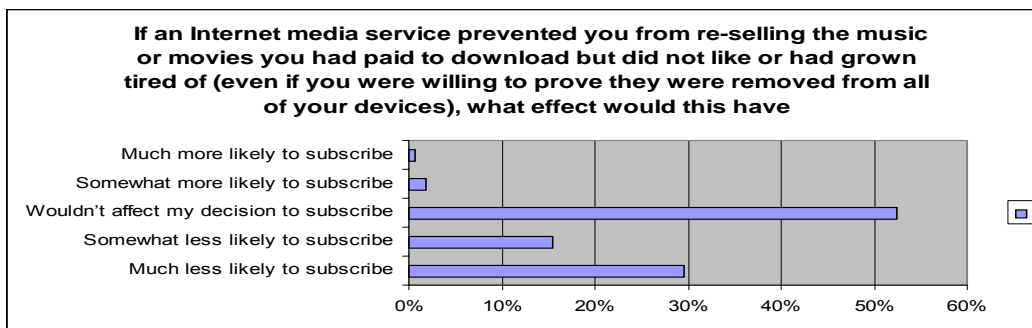
³²⁰ See Julie E. Cohen, *A Right to Read Anonymously: A Closer Look at “Copyright Management” in Cyberspace*, 28 Conn. L. Rev. 981 (1996); Julie E. Cohen, *Some Reflections on Copyright Management Systems and Laws Designed to Protect Them*, 12 Berkeley Tech. L.J. 161, 183–87 (1997); Joseph P. Liu, *Owning Digital Copies: Copyright Law and the Incidents of Copy Ownership*, 42 Wm. & Mary L. Rev. 1245, 1328–32 (2001).

³²¹ See, e.g., R. Anthony Reese, *The First Sale Doctrine in the Era of Digital Networks*, 44 B.C. L. Rev. 577, p. 585 *et seq.*

With these effects in mind, assume for a moment that the first sale doctrine applies both to tangible goods such as books, CDs or DVDs and to music or video files distributed over the Internet.³²² While the previous remarks have made it clear why the doctrine matters from the *consumer* perspective or from the viewpoint of the public, one might now explore the relevance of the (digital) first sale doctrine from business perspective (again, Apple’s iTunes serves as an example). Consider the following set of arguments:

In the context of peer-to-peer file sharing networks it has been argued that so-called “exposure effects”—or simply “advertising effects”—might lead to increasing revenues of the recording industry.³²³ Despite all the differences between the underlying distribution systems and the question of legality, one can think of somewhat similar effects with regard to online distribution systems such as the iTunes and the application of the (digital) first sale doctrine. Because the doctrine, as described above, increases the general accessibility of works such as songs, films, etc., it may result in advertising effects. For instance, a user who receives a song over the Internet from a friend who has previously bought it from the iTunes, may make—based on the sample song—the decision to buy the entire album online by downloading it from iTunes. Viewed from this angle, the current business model could benefit from digital first sale.

- Much less speculative than the previous argument are the following considerations. Focusing on the effects of the first sale doctrine as they have been observed with regard to individuals, one might investigate how these effects are valued by digital media users such as the customers of the iTunes online music store. From a business modeling perspective, it matters whether consumers of downloaded music have strong expectations that they can resell a song when they have grown tired of it. The following data of a survey conducted by GartnerG2 illustrates the relevance of the doctrine. GartnerG2 asked, in essence, whether a restriction to resell digitally distributed content would affect consumers’ decision to subscribe an Internet-based service distributing music/digital content. One result of the survey is the following:



Source: GartnerG2, February 2004

³²² The question whether the first sale doctrine does or does not apply to digitally transmitted works is discussed in greater detail in the sections below.

³²³ See, e.g., the discussion of such arguments in Stan Liebowitz, *Copyright, Piracy and Fair Use in the Networked Age -- A Cato Policy Analysis* (April 15, 2002), available at <http://ssrn.com/abstract=310023>.

The survey suggest that 28.8% of teenagers (and 32% of adults) are “much less likely to subscribe” if an online distribution system (such as the iTunes) restricts their ability to resell content. 17.6% of the teenagers (12.9% of the adults) in this sample are “somewhat” less likely to subscribe to digital media services. These figures illustrate that consumer expectations regarding one of the key components of the digital first sale doctrine, the possibility to resell lawfully obtained works, have immediate relevance to business models.

- A third argument also illustrates the importance of the first sale doctrine to the digital media industry. First recall two key characteristics of works in digital format distributed over the Internet: the persistent quality of digital information, and its low distribution costs. While physical copies of works degrade over time and with use, making used copies less desirable than new ones, digital information can be used or even reproduced without any changes in quality. Thus, the distinction between a “new copy” and a “used copy” of the same work is blurred. Moreover, the sale of physical works like books, CDs, and DVDs has required the transport of these goods. The need to transport physical copies creates transaction costs such as the effort to parcel it, bring it to the post office, and ship it. In contrast, comparable barriers are nonexistent in the context of digital copies that are transmitted over electronic networks, because any digital copy can be transferred nearly anywhere in the world with minimal efforts (a “mouse click”) and at comparatively low costs.³²⁴ As a consequence of these characteristics, a legal regime which allows—via the digital first sale doctrine—resale of online transmitted digital works such as songs obtained from the iTunes or movies downloaded from MovieLink, is likely to have a different effect on the copyright owner’s market than an alternative regime allowing only resale of tangible goods.

In fact, it has been argued that digital “used” works have a far greater ability to compete for market share with “new” copies in the digitally networked world.³²⁵ Under a legal regime protecting digital first sale, Apple would face decreased revenues due to the emergence of a secondary market in downloaded songs. These conditions, in turn, would shape Apple’s business model: Assuming that a digital first sale doctrine exists, and assuming that Apple could not preclude re-sales via contract or DRM,³²⁶ it would seek alternative distribution methods and develop alternative business models rather than lose sales to a secondary market in “used” songs downloaded from the iTunes.³²⁷

³²⁴ However, it should be noted that such transmission have a cost component as well. Consider, for instance, the transmission of a full-length movie between two computers over ISDN.

³²⁵ DMCA Section 104 Report, p. 83.

³²⁶ This question is discussed in greater detail in the previous section on “Contract and Copyright as Protections for the iTunes Business Model”.

³²⁷ At least to the extent that Apple is competing on price.

C. Digital First Sale Doctrine?

In order to describe the relevance of the doctrine and its possible effects on business models, we have assumed a legal framework that stipulates a first sale doctrine that applies both to tangible goods like CDs or DVDs and to digital works distributed over networks such as songs downloaded from the iTunes. However, the introduction illustrated that debate exists whether a first sale doctrine applicable to digital and/or digitally transmitted works exists. In the following paragraphs, we discuss this question under U.S. law and from a comparative law perspective.

To begin, let us briefly recapitulate the context in which this question has arisen: The first sale exception emerged almost hundred years ago from a doctrine created by courts which established a policy to prohibit restrictions on alienation of tangible property. Since then, information and communication technologies (ICT) have not only changed the methods by which copyrighted material is distributed, but also altered the form of the work as well as the way the work is used. Thus, this leads to the question, under what conditions, if any, does the first sale doctrine operate in digitally networked environments. With regard to this question, often discussed under the heading “digital first sale doctrine”, it is crucial to distinguish between two analytically different aspects: the new forms of appearance of copyrighted work, and the new forms of its distribution.

1. Digital Works

The first aspect, form, relates to the observation that modern information and communications technologies have made it possible to make information available and accessible in digitized format. “Digital” refers to communication signals or information presented in a discrete form, usually in a binary way (0 or 1). Thus, the first question is whether the first sale doctrine applies to digital works as such, assuming that the works are distributed “physically” rather than online. Unfortunately, there is no simple answer to this question.

However, the baseline understanding is that the first sale doctrine as codified in the Copyright Act does not distinguish between “analog” and “digital” works. Viewed from this angle, strong arguments exist that the first sale doctrine, in principle and generally speaking, does apply to both analog and digital works as long as the prerequisites outlined above are met and the limitations of the doctrine are respected. Hence, the physical resale of a purchased gramophone record (analog work) as well as of a 4D audio recorded Compact Disc (digital work) bought in a music store—assuming that all requirements are met and no contractual restrictions apply—are covered by the first sale doctrine as codified in the Copyright Act. Accordingly, one might argue that both a Compact Disc that contains a collection of songs previously downloaded from the iTunes and burned on the CD, as well as the hard drive on which all downloaded songs are stored, might be re-sold so long as all requirements of the doctrine are met.³²⁸ However, as mentioned in the previous section and discussed below, both contractual provisions such as iTunes’ Terms of Service and Digital Rights Management schemes such as Apple’s FairPlay limit what users are allowed to do with the digital content.

³²⁸ See, e.g., DMCA Section 104 Report, p. xviii.

2. Digital Dissemination of Works

The second aspect refers to the method by which (digital) works are disseminated in today's era of digital networks. While the traditional form of distribution is the physical transfer of possession of tangible works such as books, journals, newspapers, the electronic transmission in digital networks follows different patterns: All data and instructions processed by a computer—such as running a software program, browsing the WWW, or displaying information even without downloading it to the hard drive—are necessarily reproduced for a certain period of time in the computer's memory known as RAM. Moreover, by transmitting digital documents over the Net, several temporary copies are made not only on the RAM of the sender's computer, but also on the computers of the sender's ISP, on various routers on the Internet, on the addressee's service provider, and on the recipient's own computer. Despite the fact that RAM is volatile, (data stored in RAM erases when power is switched off) and that strong counterarguments exist, RAM reproductions have been qualified by several courts—following a Ninth Circuit's decision³²⁹—as “copies” under the Copyright Act. Thus, under current law, any computer-mediated network dissemination of digitized works necessarily entails the making of copies.

What are the consequences? As discussed above, the first sale doctrine grants an exception to the exclusive distribution right, but not to the copyright holder's reproduction right. Therefore, the electronic transfer of digitized work over a computed network, broadly speaking, is not covered by the first sale doctrine because even temporary reproductions might constitute a copyright infringement and result in liability. Consequently, a purchaser of a digital copy of a song that she has legitimately downloaded from a virtual music store and has paid for, cannot easily resell this piece of digital music and transmit it over the Net, because the transmission would require the making of a copy of the digital structure of the piece in the RAM of her own computer, on various other computers in the course of communication through the network, and on the recipient's computer.

As an alternative to the transfer over the Internet one might burn the music onto a CD, and then send the CD to the buyer. However, this procedure requires that numerous copies are made. For example, copies are made in the RAM of the re-seller while burning it onto the CD, on the CD, and in the purchaser's computer memory when she's listening to it. (However, it is noteworthy that such “burns” may explicitly be authorized by the copyright holder as it is in the iTunes example). Even the deletion of the original copy does not change the situation under current copyright law, because the user is not transmitting her particular copy of the music as the doctrine traditionally requires. This result contrasts with the scenario mentioned earlier where a CD purchased in a real-world music store can be re-sold under the first sale doctrine.

3. Further Limitations

The application of the first sale doctrine to digital works—as described in the previous section of this case study—is often restricted by license agreements (which are often imposed by the recording industry). The basic idea behind such licenses is to structure the “purchase” of digital content as a grant of a license instead of a sale that transfers ownership. However, in the offline context and with regard to shrink-wrap licenses,

³²⁹ MAI Systems Corp. v. Peak Computer, Inc., 991 F.2d 511 (9th Cir. 1993), *cert. dismissed*, 114 S. Ct. 671 (1994).

some courts have qualified such transactions as sales rather than licenses,³³⁰ thus preserving the applicability of the first sale doctrine, because “ownership”, as discussed above, is one of its prerequisites of first sale.

With regard to the iTMS, however, it is noteworthy that the relevant transactions have generally been perceived by users as sales rather than licenses.³³¹ However, Apple has evaded clarifying whether iTMS songs are sold or licensed. Nonetheless, contractual “terms of service” might foreclose³³² the application of the first sale doctrine to digital works where they impose restrictions on use, reproduction and transfer of the digital work by users.³³³ Interestingly, Apple’s iTunes Music Store’s Terms of Service do not expressly deny the transfer of files nor the transfer of accounts, although § 9(b) of the Terms of Service may be interpreted in such a way.³³⁴ However, it could be argued that the online transfer of a MPEG-4 file is a reproduction as described above, and thus violates the rights of copyright owners and the iTunes’ Terms of Service agreement. Moreover, § 13(a) can be read as an exclusion of the first sale exemption, although referring to the “Service” rather than the use or purchase of “products” (i.e. “songs”).³³⁵ As noted in the introduction to this section, Apple has avoided answering whether such a transfer would violate the agreement.

As discussed thus far, the application of the first sale doctrine to digital works, first and foremost, is limited by the interpretation and application of copyright law. Moreover, the application of the first sale doctrine with respect to digital works is limited by restrictive contractual agreements imposed by digital content providers such as online music stores. In combination with these two constraints, a third factor limits the application of the first sale doctrine to digital works: technical protection measures and the DMCA. (Technical protection measures were discussed in greater detail in the previous part on Digital Rights Management).

How does the DMCA’s anti-circumvention provision³³⁶ limit the application of the first sale doctrine to digital works such as AAC (MPEG-4) files downloaded from the iTMS? The effect can be illustrated when we imagine a scenario where the first sale doctrine applies to digitally distributed works and where no restrictive

³³⁰ See, e.g., *Softman Products Co., LLC v. Adobe Systems, Inc.*, 171 F.Supp.2d 1075 (C.D.Cal. 2001).

³³¹ This perception finds its basis, *inter alia*, in the Terms of Service itself, see, e.g., § 1 iTunes Terms of Service: “1. Definition of the iTunes Music Store Service. Apple is the provider of the iTunes Music Store (the “Service”) that permits you to purchase downloads of digital content—such as sound recordings—under certain terms and conditions as set forth in this Agreement.”; see also Apple’s Sale Policy at <http://www.info.apple.com/usen/itunes/policies.html>.

³³² For further discussion, see Part I on Contract and Copyright Interplay.

³³³ However, it is important to understand that the question of whether the first sale doctrine applies to digitally distributed works remains relevant even where it is contractually excluded, because such a contractual exclusion is only actionable against the contracting party, while the digital first sale doctrine (its existence assumed) would protect secondary re-sellers and re-purchasers “down the line”.

³³⁴ § 9(b), iTunes Terms of Service reads, in parts, as follows (emphases added): “Usage Rules. Your use of the Products is conditioned upon your prior acceptance of the terms of this Agreement. You shall be authorized to use the Products only for personal, noncommercial use. You shall be authorized to use the Products on three Apple-authorized computers at any time. You shall be entitled to export, burn or copy Products *solely for personal, noncommercial use*. Any burning or exporting capabilities are solely an accommodation to you and shall not constitute a grant or waiver (or other limitation or implication) of any rights of the copyright owners in any content, sound recording, underlying musical composition, or artwork embodied in any Product.”

³³⁵ § 13(a), iTunes Terms of Service reads, in part, as follows (emphasis added): “No portion of the Service may be reproduced in any form or by any means. You agree not to modify, rent, lease, loan, sell, distribute, or create derivative works based on the Service, in any manner, and you shall not exploit the Service in any unauthorized way whatsoever, including but not limited to, by trespass or burdening network capacity.”

³³⁶ Sec. 1201.

contractual agreements are in force. Under such a scenario, consider a customer who downloads a song from the iTunes and stores it onto the hard drive of his computer. As it has been discussed in the section on digital rights management (DRM), the downloaded file contains *code* that makes the song inoperable until a particular computer has been authorized to play them, and allows (only) five authorizations per song.³³⁷ Assume that the iTunes user wants to re-sell a song to a stranger, but—for obvious reasons—is not willing to share sensitive information such as her Apple ID and password with the buyer. If the user attempted to crack the restrictive code in order to make use of her “right” under the digital first sale doctrine and create an unencrypted copy of the file, she could be sued and held liable for an infringing act based on the circumvention provisions of the DMCA, because digital right management systems such as iTunes’ FairPlay that render copies inoperable are considered as access controls.³³⁸

D. International Perspective

So far, we have discussed the first sale doctrine from the perspective of U.S. law. Next, we explore this doctrine—or the principle of exhaustion, as it is called in the international context—from the viewpoint of international and comparative law. It should be noted that the rationale of the doctrine and its impacts—as described in the previous paragraphs—remain similar both under US law and foreign legal regimes. Thus, U.S. based digital media services such as Apple’s iTunes may want to explore how other legal regimes governing markets outside the US³³⁹ answer the question of whether the first sale doctrine applies to digitally transmitted works. Viewed from a business perspective, one can argue that a service like the iTunes would re-consider and, if necessary, adjust its business model to a different regulatory framework if the laws of a foreign country provide a digital first sale doctrine.

Since international norms for the treatment of copyright and related rights in the age of the Internet are set forth in the 1996 WIPO Copyright treaties, it makes sense to begin a comparative analysis there.

1. WIPO Treaties

With regard to the principle of exhaustion (or first sale), it is necessary to understand that the WIPO Copyright Treaty (WCT) and the WIPO Performances and Phonograms Treaty (WPPT)—in contrast to U.S. Law³⁴⁰—clearly distinguish between an exclusive “distribution right” with respect to tangible copies of works on the one hand, and an exclusive transmission right with respect to intangible copies, called “right of making

³³⁷ See <http://docs.info.apple.com/Art.html?artnum=93014>.

³³⁸ See, e.g., Marybeth Peters, Recommendation of the Register of Copyrights in RM 2002-4; Rulemaking on Exemptions from Prohibition on Circumvention of Copyright Protection Systems for Access Control Technologies, at 44 *et seq.* For further discussion, see the previous Part II on Digital Rights Management.

³³⁹ See, e.g., <http://media.guardian.co.uk/newmedia/story/0,7496,954544,00.html> (Europe), <http://www.asahi.com/english/business/TKY200312020130.html> (Japan), http://news.com.au/common/story_page/0,4057,8040831%255E15306,00.html (Australia).

³⁴⁰ As the DMCA Section 104 Report points out, no country “other than the United States ... has implemented the making available right through the application of a combination of the distribution, reproduction, public performance and public display rights”, see DMCA Section 104 Report, p. 94.

available to the public” on the other hand.³⁴¹ Thus, art. 6(1) WCT³⁴² as well as art. 8(1) and 12(1) WPPT provide exclusive distribution rights³⁴³ for tangible objects,³⁴⁴ while art. 8 WCT respectively art. 10 and 14 WPPT grant a separate exclusive right for transmission of digital works over networks such as the Internet to make them available to the public. In the context of this case study it is this latter right of making available to the public as defined in the WIPO treaties—and not the exclusive distribution right—that is of particular interest and relevance, since online music services such as the iTunes distribute music in digital file format over electronic networks.

Against this legal backdrop, it is important to recognize that the WIPO treaties mention the exhaustion principle exclusively in the context of the distribution rights. Art. 6(2) WCT³⁴⁵ and similarly art. 8(2) and 12(2) WPPT³⁴⁶ permit—but do not require—that the contracting parties limit the distribution right with an exhaustion principle that applies after the first sale or any other authorized transfer of ownership of the original or a copy of the work. In other words, legislatures must decide whether, and under what conditions, such a limitation of the distribution right for tangible works shall be implemented. In contrast, the treaties do *not* contain similar provisions with respect to the right to make intangible copies available (i.e. regarding digital transmission over networks). Consequently, the digital first sale doctrine or the principle of exhaustion applicable to works transmitted over the Internet cannot be derived from international copyright law.

2. European Union

At the European level, the issues raised in this section of the case study are, by and large,³⁴⁷ covered by the EUCD.³⁴⁸ In accordance with the WIPO treaties, the Directive distinguishes between a distribution right (art.

³⁴¹ The question of what right or rights should be applied to interactive, on-demand transmissions in digital networks was “one of the thorniest issues addressed during the preparatory work of the WCT and the WPPT”, see Mihaly Ficsor, *The Law of Copyright and the Internet*, The 1996 WIPO Treaties, their Interpretation and Implementation, Oxford University Press 2002, p. 146 et seq. with an in-depth analysis of the so-called “umbrella solution”.

³⁴² Art. 6(1) WCT on “Right of Distribution” reads as follows: “Authors of literary and artistic works shall enjoy the exclusive right of authorizing the making available to the public of the original and copies of their works through sale or other transfer of ownership.”

³⁴³ Art. 8(1) WPPT on the distribution rights of performers: “Performers shall enjoy the exclusive right of authorizing the making available to the public of the original and copies of their performances fixed in phonograms through sale or other transfer of ownership.”, and, finally, art. 12(1) WPPT on the distribution rights of producers of phonograms: “1) Producers of phonograms shall enjoy the exclusive right of authorizing the making available to the public of the original and copies of their phonograms through sale or other transfer of ownership.”

³⁴⁴ This limitation to tangible objects has been emphasized in the *Agreed Statements Concerning the WIPO Copyright Treaty* as adopted by the Diplomatic Conference. The Statements concerning art. 6 and 7 WCT reads: “As used in these Art.s, the expressions “copies” and “original and copies,” being subject to the right of distribution and the right of rental under the said Art.s, refer exclusively to fixed copies that can be put into circulation as tangible objects.” (emphasis added).

³⁴⁵ Art. 6(2) WCT: Nothing in this Treaty shall affect the freedom of Contracting Parties to determine the conditions, if any, under which the exhaustion of the right in paragraph (1) applies after the first sale or other transfer of ownership of the original or a copy of the work with the authorization of the author.

³⁴⁶ Art. 8(2) WPPT: “Nothing in this Treaty shall affect the freedom of Contracting Parties to determine the conditions, if any, under which the exhaustion of the right in paragraph (1) applies after the first sale or other transfer of ownership of the original or a copy of the fixed performance with the authorization of the performer.” Art. 12(2) WPPT: “Nothing in this Treaty shall affect the freedom of Contracting Parties to determine the conditions, if any, under which the exhaustion of the right in paragraph (1) applies after the first sale or other transfer of ownership of the original or a copy of the phonogram with the authorization of the producer of the phonogram.”

³⁴⁷ However, it should be noted that the *Rental Right Directive* has already harmonized the distribution right—i.e. the right to authorize and prohibit the distribution for tangible copies—for performers, broadcasters, phonogram and film producers. Similarly, Community harmonization has already been achieved for certain categories of works such as databases and computer programs.

³⁴⁸ See *supra* note 83.

4) dealing with the circulation of tangible works, and a right of communication to the public—including a right to make available to the public—that covers any means or process other than the distribution of physical copies. Thus, in essence, article 3(1) and 3(2) of the EUCD stipulate that the member states are obligated to provide authors, performers, producers, etc., with the exclusive right to authorize or prohibit any communication to the public of their works, by wire or wireless means. This includes the making their works available to the public in such a way that members of the public may access them from a place and at a time individually chosen.

Art. 4(2) of the EUCD stipulates that the distribution right shall not be exhausted within the European community in respect to the original of copies of the works, except where the first sale or other transfer of ownership in the EU of that object is made by the rightholder or with his consent.³⁴⁹ This exhaustion principle, however, is limited to the right of distribution of tangible copies such as books, CDs, DVDs, etc. Art. 3(3) of the EUCD indicates: “The rights referred to in paragraphs 1 and 2 shall not be exhausted by any act of communication to the public or making available to the public as set out in this Article.” The recital clauses of the Directive confirm this finding.³⁵⁰ Specifically, clause No. 29, summarizes the state of (European) law as follows:³⁵¹

“(29) The question of exhaustion does not arise in the case of services and online services in particular. This also applies with regard to a material copy of a work or other subject-matter made by a user of such a service with the consent of the rightholder. Therefore, the same applies to rental and lending of the original and copies of works or other subject-matter which are services by nature. Unlike CD-ROM or CD-I, where the intellectual property is incorporated in a material medium, namely an item of goods, every online service is in fact an act which should be subject to authorization where the copyright or related right so provides.”

Implementing the EUCD, member states have incorporated the principle of exhaustion in their national legal frameworks according to the principles outlined in the previous paragraphs.

- In Germany, art. 15 of the Law on the Regulation of Copyright in the Information Society (*Gesetz zur Regelung des Urheberrechts in der Informationsgesellschaft*)³⁵² differentiates between the exclusive rights of

³⁴⁹ The arguments why a harmonization of the exhaustion principle is necessary are discussed the Proposal for a European Parliament and Council Directive on the harmonization of certain aspects of copyright an related rights in the Information Society, presented by the Commission, December 10, 1997, COM(97) 628 final, p. 29 *et seq.*, available at http://europa.eu.int/comm/internal_market/en/intprop/news/copyen.pdf.

³⁵⁰ See, e.g., recital clause (28): “Copyright protection under this Directive includes the exclusive right to control distribution of the work incorporated in a tangible Art.. The first sale in the Community of the original of a work or copies thereof by the rightholder or with his consent exhausts the right to control resale of that object in the Community [...]”.

³⁵¹ In essence, the EUCD repeats what had been considered in the context of the *EU Directive on the Legal Protection of Databases* (see Recital 33) and what had been added to the Rental Right Directive (see art. 1(4). Moreover, the art. 3(3) of the EUCD has been seen “only as a clarification of the existing legal situation at Community level, recalling that the provision of services does not give rise to exhaustion of rights”, see Proposal for a European Parliament and Council Directive on the harmonization of certain aspects of copyright an related rights in the Information Society, presented by the Commission, December 10, 1997, COM(97) 628 final, p. 34 with references to case law, available at http://europa.eu.int/comm/internal_market/en/intprop/news/copyen.pdf.

³⁵² See *supra* note 118.

copyright owners regarding tangible works—including, among other things, the right of reproduction and distribution—and the right to make intangible works available to the public. The right of distribution as it applies to tangible works is encoded in art. 17, and art. 17(2)—in accordance with the EUCD and the WIPO treaties—stipulates the (community wide) principle of exhaustion. Thus, the statutory language as well as a systematic interpretation make it clear that the right of distribution and, as a consequence, the related exhaustion exception is limited to tangible works. However, scholars have argued that online transmissions, (i.e. transfers of intangible works), can also be subsumed under art. 17, based on either an extended interpretation of this provision or its analog application to online transactions.³⁵³

- In the United Kingdom, the Copyright and Related Rights Regulations 2003³⁵⁴ implement art. 3 of the EUCD by replacing former sec. 20 of the Copyright, Designs and Patents Act 1988 on “infringements by broadcasting or inclusion in a cable program service”. Former sec. 20 is replaced by a provision on infringements “by communication to the public”, including “the making available to the public of the work by electronic transmission in such a way that members of the public may access it from a place and at a time individually chosen by them.” (new sec. 20(2)(a)). Sec. 18(2)(a) of the Copyright, Designs and Patents Act 1988—with regard to infringement by issue of copies to the public (i.e. copies “put into circulation”)—sets forth an exhaustion principle. This principle, however, does not extend to the rights of communication to the public as now enacted in sec. 20(2)(a) and does not apply to digitally distributed (i.e. intangible) works. Accordingly, the U.K. Copyright Office has, in the course of the implementation of the Information Society Directive, stated that “no specific action has been taken as a result of paragraph 3 of Article 3 [EUCD], which is considered to be present simply for avoidance of any doubt on the matter to which it refers. Exhaustion of rights is a concept normally only associated with the right to control distribution of *tangible copies* of protected works.”³⁵⁵

Against this background, it can be concluded that neither European Law nor the laws of EU-member states—if in compliance with the EUCD—provide an exhaustion principle applicable to transmission of digital works over the Internet. Consequently, online media services such as the iTunes are unlikely to face digital first sale “claims” from users governed by European law. Further, the discussion of European contract law illustrates that any (potential) right to resell or lend downloaded songs might be excluded via contractual agreements as long as EU and national laws are respected. Moreover, strong arguments exist that, for instance, the iTunes service could restrict particular user practices via technical protection measures such as FairPlay as effectively as it does under U.S. law, because the EUCD contains provisions that prohibit circumventions in the same way as the DMCA does.³⁵⁶

³⁵³ See, e.g., B. Knies, *Erschöpfung Online? – Die aktuelle Problematik beim On-Demand-Vertrieb von Tonträgern im Lichte der Richtlinie zur Informationsgesellschaft*, GRUR Int. 2002, pp. 314 et seq.; PHILIPP KÖHLER, *DER ERSCHÖPFUNGSGRUNDSATZ DES ÜRHEBERRECHTS IM ONLINE-BEREICH*, München 1999, p. 72. From the practitioner’s perspective see, e.g., <http://www.internetrecht-rostock.de/musikverkauf.htm> (with further references).

³⁵⁴ See *supra* note 251.

³⁵⁵ See comment on the UK implementation of the EUCD available at <http://www.patent.gov.uk/about/consultations/eccopyright/impact.htm>.

³⁵⁶ See art. 6, EUCD on Obligations as to technological measures. For further discussion, see Part II on DRM.

3. Asia-Pacific

a. Japan

In general, although Japan does recognize the international “first sale” doctrine – the principle of exhaustion in copyright, preventing infringement liability for consumers who re-sell lawfully purchased, legally manufactured copies of protected works³⁵⁷, it has not addressed whether that doctrine applies to “intangible goods,” such as digital works that are transmitted over digital networks.

Following the lead of the WIPO treaties, the Japan Copyright Law also makes the distinction between a “distribution right” for tangible goods and the right of “making available to public”³⁵⁸ or “transmission”³⁵⁹ for digital works. The Copyright Law grants copyright owners the exclusive right of distribution; however, this right is limited to cinematographic works.³⁶⁰ The 1999 Amendment to the Japanese Copyright Act established art. 26bis in order to implement art. 6(2) of the 1996 WIPO Copyright Treaty, which outlines the right of member nations to determine how the first sale doctrine should be applied; in particular, art. 26bis(2) exempts copyright liability from the resale of lawfully manufactured copies.³⁶¹

In contrast to the United States and European countries, the boundaries of the first sale doctrine in Japan are not derived primarily from statutory authority, but rather are judicially created. Recent decisions by Japanese courts have clarified the international application of the Japanese first sale doctrine. A 1994 Tokyo District Court judgment indicates that Japanese copyrights will not be exhausted by first sales abroad.³⁶² In this case, the plaintiff imported from the United States copies of the movie “101 Dalmatians” to sell in Japan.³⁶³ The defendant, a seller of copyrighted video tapes and discs, distributed a paper to alert the business circles that parallel importation of video cassettes from the United States was illegal.³⁶⁴ Accordingly, the plaintiff sued, alleging that distribution of the paper interfered with its sales.³⁶⁵ The Tokyo District Court found for the defendant, reasoning that the importation into Japan of video cassettes of a movie not yet released in Japan or still in theaters, would seriously damage the market for the movie as well as sale of authorized video tapes.³⁶⁶

³⁵⁷ Art. 26(2), Copyright Law of Japan, see *supra* note 128. See Teruo Doi, *The Territorial Principle of Patent Protection and Conflict of Laws: a Review of Japanese Court Decisions*, 26 *Fordham Int'l L.J.* 377, 386 (2003).

³⁵⁸ Art. 26, Copyright Law of Japan. (1) The author of a cinematographic work shall have the exclusive rights to distribute copies of his work. (2) The author of a work reproduced in a cinematographic work shall have the exclusive right to distribute copies of his work.

³⁵⁹ Art. 23, Copyright Law of Japan. (1) The author shall have the exclusive right to make the public transmission of his work (including the making transmittable of his work in the case of the interactive transmission). (2) The author shall have the exclusive right to communicate publicly, by means of a receiving apparatus, his work of which the public transmission has been made.

³⁶⁰ Art. 26, Copyright Law of Japan.

³⁶¹ Teruo Doi, *supra* note 357, 386

³⁶² Darren E. Donnelly, *Parallel Trade and International Harmonization of the Exhaustion of Rights Doctrine*, 13 *Santa Clara Computer & High Tech. L.J.* 445, 485.

³⁶³ *Id.*

³⁶⁴ *Id.*

³⁶⁵ *Id.*

³⁶⁶ *Id.*

In a 2001 decision by the Osaka High Court, *Akuto etc. v. K.K. Sega*, the court applied the first sale doctrine to used video game software, finding no copyright infringement in the resale of these works.³⁶⁷ The court cited the BBS Supreme Court Decision³⁶⁸, finding the same policy reasons for applying the exhaustion theory in this case to copyrights, as to patents—in general, the exhaustion theory is only applicable when it interferes with the free flow of goods in the market.

It is important to note that while Japan recognizes the first sale doctrine, it treats the copyright and patent contexts differently: in the copyright context, the first sale doctrine applies domestically, except for the special case of copyrights for cinematographic works, which are not exhausted by first sales overseas; in the patent context, the first sale doctrine applies globally.³⁶⁹ Moreover, in the copyright context, it seems clear that the Japanese courts have not yet addressed the issue for intangible goods at all. Nevertheless, given that Japan is a WIPO signatory; the Japan Copyright Law makes the distinction between distribution and transmissions rights; and all the Japanese first sale doctrine case law deals with tangible goods and distribution rights, it is likely a safe conjecture that Japan is similar to the European members of the WIPO in not recognizing the first sale doctrine for intangible goods.

b. China

China does not have an explicit first sale doctrine such as the one codified in Sec. 109(a) of the U.S. Copyright Act. However, as a signatory to various WIPO Treaties, China recognizes the “first sale” doctrine of exhaustion in copyright protections. As noted previously, the WIPO treaties have left it up to national legislatures to determine the effect of the exhaustion right; recent amendments to China's Copyright and Patent Laws provide greater insight into the direction of China's intellectual property laws with respect to the first sale doctrine.

The “first sale” doctrine in Chinese copyright law is qualified in important ways: in particular, creators' rights to control the distribution of their works, and their communication over networks, survive first sale.³⁷⁰ Art. 10 of the Chinese Copyright Act, which enumerates the rights of copyright holders, was amended in 2001 to give copyright owners additional rights, including the exclusive rights of: (1) distribution—the right to make available to the public the original or reproductions of a work through sale or other transfer of ownership; (2) communication of information on networks—the exclusive right of delivering works over an information

³⁶⁷ Toshikio Takenaka, *Current Developments, Sales of Used TV Game Software is Legal*, CASRIP Newsletter, Winter 2001 available at <http://www.law.washington.edu/casrip/newsletter/newsv8i1jp1.pdf>.

³⁶⁸ The leading Japanese patent first-sale case is *Jap-Auto Products v. BBS Kraftfahrzeug Technik (BBS)*, where the Japanese Supreme Court, in 1997, adopted the principle of international exhaustion, holding that the first sale of a patented item exhausts the patent rights worldwide. The Japanese Supreme Court offered policy arguments in support of its decision: identifying a concern for the “development of industry” and how the continuation of rights beyond the first sale will hinder this development, as well as citing present “social and economic realities” in Japan as reasons to extend the first sale doctrine to international sales, despite the lack of authority in Japanese Patent Law. (Teruo Doi, *supra* note 357, 386).

³⁶⁹ See Teruo Doi, *supra* note 357, 386.

³⁷⁰ Art. 10, Copyright Act of China, see *supra* note 177; see *Memorandum of Understanding Between the Government of the United States of America and the Government of the People's Republic of China on the Protection of Intellectual Property*, 4 D.C.L. J. Int'l L. & Prac. 403 (1995). Under this memorandum and art. 10, copyright owners for movies and computer software also retain the right to control rental of their works even after a first sale.

system; and (3) rental—the right of rental over works such as movies and computer programs.³⁷¹ These exclusive rights survive the first sale doctrine—a copyright owner has the right to prevent others from the distribution, communication over the Internet, and rental of their works; the latter only applies if the work is a movie or computer program.³⁷²

In contrast, recent amendments to the Chinese Patent Law suggest that China is further adopting the principle of international exhaustion in the patent context.³⁷³

These amendments to China's intellectual property laws suggest that China is taking a selective approach in adopting the first sale doctrine. While China has continued to recognize and strengthen the exhaustion principle in the patent context, the first sale doctrine has become much more limited in the copyright context, as the copyright owner maintains exclusive rights over distribution, rental and communication over the Internet.

E. Summary and Outlook

The overview of the current U.S., European, and international legal framework regarding the first sale doctrine leads to the conclusion that the application of the doctrine in the digitally networked environment is unlikely. Under current U.S. and European Copyright Law, very strong arguments exist that the doctrine does not apply to digital works transferred over networks:³⁷⁴ In Europe, digital transmissions of works are addressed under the right of communication to the public, and the European legislature has explicitly restricted the application of the exhaustion principle to the right of distribution which refers to tangible works. In contrast, the U.S. the relevant provision of the Copyright Act itself does not distinguish between digitally transmitted and physically transferred works. However, because each communication of a digital work over a computer-intermediated networks requires, technically speaking, the making of reproductions (e.g. in the RAM of the host's computer), and because such reproductions are considered as "copies" under current law, the first sale doctrine—which grants an exception from the distribution right (in US terminology), but not the right of reproduction—is likely not to apply to digital works distributed over the Net. Moreover, both in the U.S. and in Europe restrictive contractual agreements as well as legally enforced technical protection measures frustrate the emergence and/or application of a digital first sale doctrine.

³⁷¹ Art. 10, Copyright Act of China.

³⁷² Memorandum of Understanding Between the Government of the United States of America and the Government of the People's Republic of China on the Protection of Intellectual Property, 4 D.C.L. J. Int'l L. & Prac. 403.

³⁷³ In anticipation of its accession to the World Trade Organization, China amended its Patent Law for the second time, with the changes becoming effective on July 1, 2001. (Andy Y. Sun, Executive Director, Asia Pacific Legal Institute, Intellectual Property Developments in the Greater China Region: National People's Congress Amended Patent Law, translation available at http://apli.org/apli_special.htm, August 2000.) One of the key features of the Patent Laws Amendment was clarification on non-infringement issues; in particular, under art. 63, it is now no longer deemed an infringement of patent rights where, "after the sale of a patented product that was made or imported by the patentee or with the authorization of the patentee, or that was directly obtained by using the patented process, any other person uses, offers to sell or sells that product." (art. 63, China Patent Law) Effectively, this new amendment adds importation and offer for sale as grounds for exhaustion. (Sun.)

³⁷⁴ See also J.A.L. STERLING, WORLD COPYRIGHT LAW, London: Sweet & Maxwell 1998, n 9.05 *et seq.*

However, it has also become clear that arguments in favor of a digital first sale doctrine exist both in the U.S. and in Europe. In Europe, such arguments are based on extensive interpretations or analogous applications of provisions incorporating the principle of exhaustion in the context of national laws implementing the EU Copyright Directive. In the U.S., numerous arguments in favor of a digital first sale doctrine can be made.³⁷⁵ First, from a normative perspective, it has been argued that the underlying objective of the first sale doctrine, facilitation of the continued flow of copyrighted materials throughout society, should prevail over concerns about IP rights. Second, arguments in favor of the digital first sale doctrine have referred to the spirit of the first sale doctrine and its focus on the scope of the transferred property interest rather than the (analog or digital) nature of the interest at stake. Third, other arguments are based on principles regarding the way the Copyright Act, according to the current law, should be applied to new technologies. Moreover, it has been argued that the legal qualification of reproductions through transmission as copies—lacking a decision of the Supreme Court and facing some Court decisions to the contrary—is not set in stone. Finally, from a technically oriented viewpoint, the concept of simultaneous destruction—requiring that the person transmitting the copyrighted digital work immediately erases her particular copy after the transfer is completed, (“forward and delete”-technology) supports first sale rights. These arguments have been used not only in litigation and in the context of scholarly contributions, but also in some highly controversial bills introduced to the Congress, either directly or indirectly designed to make a digital first sale exception feasible.³⁷⁶ The shift in the methods by which digital works are used and transmitted, however, might be seen as the strongest argument in favor of a digital first sale doctrine. Beyond these conceptual and legal arguments, persistent user practices—as history demonstrates—have the potential power to shape the legal and regulatory landscape and overcome laws.

With regard to the Japanese legal framework, it seems unlikely that a first sale doctrine has been or will be recognized for intangible goods transmitted over digital networks. In China, the fact that the government has explicitly stated that the exclusive right of communication over the Internet survives the first sale doctrine would suggest that the doctrine does not apply to digital works transferred over Internet networks.

Against this backdrop, we conclude that online media services like Apple’s iTunes face internationally harmonized copyright laws regarding the first sale doctrine. Under current U.S., International, and European Law, the first sale exemption (respectively the exhaustion principle) is unlikely to apply to digital works distributed over the Internet. While consumers, for the reasons outlined above, would welcome the emergence of a digital first sale doctrine, the opposite might be true from a business perspective, since the application of the doctrine could lead to unwanted price competition through the emergence of secondary markets resulting in decreased revenues for online services such as the iTunes. However, the analysis also illustrates that economic, legal, and technical arguments, as well as persistent user expectations, may be seen as early precursors of a tendency towards a digital first sale doctrine. Thus, a re-consideration of business models

³⁷⁵ See, e.g., DMCA Section 104 Report, p. 44 *et seq.*, Victor F. Calaba, *Quibbles ‘n’ Bits: Making a Digital First Sale Doctrine Feasible*, 9 Mich. Telecomm. Tech.L. Rev. 1 (2002), available at <http://www.mttl.org/volnine/calaba-pdf>.

³⁷⁶ See, e.g., Benefit Authors without Limiting Advancement or Net Consumer Expectations (BALANCE) Act of 2003 (H.R. 1066, introduced March 4, 2003), and Digital Media Consumer’s Rights Act (H.R. 107, introduced January 7, 2003).

such as the iTMS with regard to first-sale-issues is meaningful not only from a legal perspective and the consumer's viewpoint, but even more so from the business standpoint.

Part IV: Fair Use Doctrine

A. Introduction

In the preceding parts of this case study, we have discussed the first sale doctrine aimed at limiting the copyright holder's exclusive right of distribution, and balancing author's right and public access to works. This Part focuses on another significant limitation on an author's or copyright holder's prerogatives: the "fair use" doctrine. In the most general sense, fair use is a "privilege in others than the owner of a copyright to use the copyrighted material in a reasonable manner without his consent, notwithstanding the monopoly granted to the owner."³⁷⁷ The specific implementations of fair use rights or privileges can vary significantly from country to country. Fair uses traditionally include copies for private study, parody, criticism, news reporting, copies for limited personal uses, and reverse engineering for interoperability.³⁷⁸ Some fair uses—reverse-engineering in particular—as well as the extent to which the iTunes's terms of services and/or its DRM system FairPlay allow or prohibit fair uses, have already been outlined in previous Parts of this paper.³⁷⁹ This Part of the case study, however, provides a more comprehensive overview of the fair use doctrine, explores the ways in which online music distribution business models such as the iTunes might be affected by "fair use," and describes current fair use laws of the United States, the United Kingdom, Germany, France, Canada, Japan, and China.

B. Brief Overview of Fair Use

The broad idea of fair use embodied in 17 U.S.C. § 107 is unique to the United States. Both Canada³⁸⁰ and the United Kingdom³⁸¹ have a "fair dealing" exemption for specified activities such as news reporting, parody, criticism, etc. Civil code countries such as Germany and France specifically enumerate similar exemptions to copyrights.³⁸² Because the implementation of fair use doctrine varies so much from country to country, for the purposes of this paper, fair uses will be those uses that U.S. courts would allow under 17 U.S.C. § 107.

³⁷⁷ *Rosemont Enters., Inc. v. Random House, Inc.*, 366 F.2d 303, 306 (2nd Cir. 1966) (citation omitted).

³⁷⁸ All of these uses and their existence or lack thereof in various countries will be discussed in section C. of this module on a country-by-country basis.

³⁷⁹ See *supra* Part II on reverse engineering and DRM, and, more generally, *supra* Part I on the interaction between fair use and contract law.

³⁸⁰ See Copyright Act, R.S.C. ch. C-42, § 29 (1985) (Can.), available at <http://laws.justice.gc.ca/en/C-42/>.

³⁸¹ § 29-30 of the U.K. Copyright, Design and Patents Act 1988 (CDPA); available at http://www.legislation.hmso.gov.uk/acts/acts1988/Ukpga_19880048_en_1.htm.

³⁸² See § 45-53, UrhG; *supra* note 118. For France, see Intellectual Property Code, Art. L. 122-5, available at <http://clea.wipo.int/clea/lpext.dll/Folder/Infobase/1d80a/1d911?fn=document-frame.htm&f=templates&2.0>.

The idea of fair use appeared in England at the beginning of the 19th century in the case of *Cary v. Kearsley*,³⁸³ where the court recognized a right to “fairly adopt part of the work of another” in order to avoid putting “manacles upon science.”³⁸⁴ Later in the 19th century, the U.S. Supreme Court Justice Joseph Story largely set out the modern fair use test in his decision in *Folsom v. Marsh*.³⁸⁵ Moving beyond only a general conception of the need for exceptions to the copyright law, Story provided a set of factors that he thought would help determine if a particular use was fair: “[W]e must often, in deciding questions of this sort, look to the nature and objects of the selections made, the quantity and value of the materials used, and the degree in which the use may prejudice the sale, or diminish the profits, or supersede the objects, of the original work.”³⁸⁶ These factors were codified in the United States by the Copyright Act of 1976 as the key factors in determining if a use is fair, with the addition of only “the purpose and character of the use”³⁸⁷ as a factor.

The main justification presented for the fair use doctrine in the United States, and the related rights internationally, is that it “permits courts to avoid rigid application of the copyright statute when, on occasion, it would stifle the very creativity which that law is designed to foster.”³⁸⁸ This theory justifies the so-called transformative use, which appropriates a copyrighted work such that it “adds something new, with a further purpose or different character, altering the first with new expression, meaning, or message.”³⁸⁹ In so doing, it provides “some added benefit to the public beyond that produced by the first author’s work.”³⁹⁰ More generally, another justification for fair use is that it balances the public’s interest in accessing and manipulating copyrighted works freely with its interest in ensuring production of creative works.³⁹¹ In this vein, fair use can be seen as balancing the First Amendment with copyright’s prohibition on using others’ speech.³⁹²

Turning to other jurisdictions, the Canadian Supreme Court framed the notion of fair dealing in a recent decision as a balancing of public and copyright owners’ rights.³⁹³ Similarly, the European Parliament stated, in preface to recent legislation, that “a fair balance of rights and interests between... different categories of rightholders and users of protected subject-matter must be safeguarded.”³⁹⁴ Under this theory, copying for the sake of convenience is sometimes authorized, especially if the copying does not damage the producer’s interests³⁹⁵ and, at least under U.S. law, does not have negative effects on the present and future markets for

³⁸³ 170 Eng. Rep. 679 (1802).

³⁸⁴ *Id.* at 680.

³⁸⁵ 9 F. Cas. 342 (C.C.D.Mass. 1841).

³⁸⁶ *Id.* at 348.

³⁸⁷ 17 U.S.C. § 107(1).

³⁸⁸ *Iowa State Univ. Research Found., Inc. v. American Broad. Cos.*, 621 F.2d 57, 60 (2nd Cir. 1980).

³⁸⁹ *Campbell v. Acuff-Rose Music*, 510 U.S. 569, 579 (1994), citing Pierre Leval, *Toward a Fair Use Standard*, 103 Harv.L.Rev. 1105, at 1111 (1990).

³⁹⁰ *Sony v. Universal*, 464 U.S. at 478 (Blackmun, J., dissenting).

³⁹¹ See, e.g., Glynn Lunney, *Fair use and Market Failure: Sony Revisited*, 82 B.U.L. Rev. 975 (Oct. 2002) (interpreting *Sony v. Universal* to mean and normatively supporting an idea of fair use as “public interest balancing”)

³⁹² *Eldred v. Ashcroft*, 123 S.Ct. 769 at 219-221 (2003)

³⁹³ *Id.* at n 48.

³⁹⁴ Recital 31, EUCD, *supra* note 83.

³⁹⁵ See *id.* See also § 53 of the German UrhG, which allows single copies of a copyrighted work to be made for private use.

the copyrighted works.³⁹⁶ It is the latter justification that allows certain fair uses of interest to online music distributors.

C. How Fair Use might Affect iTunes, its Users, and Copyright Holders

The fair use doctrine and its counterparts are aimed at balancing the potentially divergent interests of copyright holders and users. What, then, are the doctrine's potential effects on individuals and the public, copyright holders, and online distribution services such as Apple's iTunes? The following paragraphs outline some of the effects that are relevant in the context of this case study:

- Consumer perspective: As described in the previous paragraphs, the fair use doctrine sometimes excuses transformative uses, in which a second author appropriates a work in some way to give it additional value or meaning. In the past few years, the Internet and new software applications³⁹⁷ have made it much easier for consumers to engage in appropriative, creative activities. Indeed, by enabling consumers to edit, excerpt, remix, and "mash-up" media at will, these technologies blur the line between consumers and creators.³⁹⁸

Applied to the context of this case study, one might imagine an iTunes consumer, herself a musician, who seeks to use the opening part of a song downloaded from the online music store to create a new piece of music. Or, perhaps a student wants to excerpt a clip for an educational presentation on music. Fair use might protect these actions under certain circumstances. In such cases, the fair use doctrine benefits not only the user, but also the public as a whole by fostering creativity, thus furthering copyright's core objective. As a matter of fact, however, iTunes' FairPlay limits transformative uses because users cannot extract and redistribute copied sound clips. Moreover, iTunes' Terms of Service include language that, as discussed in Part I, might preclude fair use of downloaded songs.³⁹⁹

The fair use doctrine also benefits consumers by promoting some non-transformative uses, including private-use copying. For instance, it might—if all legal requirements are met—be fair use to make a copy of a song in one's music library in order to transfer it to another listening device.⁴⁰⁰ In this way, fair use can increase consumers' enjoyment, enabling them to listen to music in ways of their

³⁹⁶ *A&M Records, Inc. v. Napster, Inc.*, 239 F.3d 1004 (9th Cir. 2001).

³⁹⁷ See, e.g., Apple's GarageBand software at <http://www.apple.com/ilife/garageband/>.

³⁹⁸ See, e.g., Yochai Benkler, *From Consumers to Users: Shifting the Deeper Structures of Regulation Towards Sustainable Commons and User Access*, 52 Fed. Comm. L.J. 561 (2000).

³⁹⁹ § 13(a), iTunes Terms of Service: "You agree that the Service [the iTunes Music Store], including but not limited to graphics, audio clips, and editorial content, contains proprietary information and material that is owned by Apple and/or its licensors... and that you will not use such proprietary information or materials *in any way whatsoever* except for use of the Service in compliance with the terms of this Agreement." (emphasis added).

⁴⁰⁰ In the United States, the right to make copies for private use falls under the fair use doctrine, which is an open-ended, vague body of law that leaves even legal professionals uncertain of what constitutes fair use, see, e.g., Pamela Samuelson & Randall Davis, *The Digital Dilemma: A Perspective on Intellectual Property in the Information Age*, 12-13, available at <http://www.sims.berkeley.edu/~pam/papers/digidilsyn.pdf> (stating that when it comes to matters of copying for personal use in the United States, "even legal professionals disagree about answers to such questions."). As discussed in the next section, laws of foreign countries specifically allow copying for private purposes.

choosing. To the extent that iTunes users can use their purchases on multiple computers and burn their music onto CDs,⁴⁰¹ the iTunes service allows at least some—albeit not all—of such usage practices that might be covered by the fair use doctrine.

- Copyright holder perspective: Typically, copyright holders have a strong interest in controlling the distribution and use of copyrighted material. This interest, generally speaking, has found legal protection under copyright law as discussed in Part I and is also reflected in the four requirements of the fair use exemption as discussed in section D1 below. Therefore, the fair use doctrine is in tension with the copyright holder's interests to the extent that it excuses uses for which the copyright holder could otherwise charge. Thus, fair use privileges and, in turn, the control of such privileges by means of contract law and DRM schemes,⁴⁰² might affect copyright holders' willingness to license or sell their works. However, the decision to license copyrighted works depends on many (other) contextual factors, too. If P2P traffic, for example, is already ubiquitous, the fair uses implemented or excluded by an online music service such as the iTunes might be a less important determinant than in an alternative setting without significant activities on P2P networks.
- The iTunes Business perspective: Apple provides music with usage restrictions under contract and DRM as negotiated with copyright holders. By preventing uses that consumers consider to be fair, usage restrictions might depress consumer interest.⁴⁰³ In fact, users will make a decision on which music service to use based at least in part on the relative restrictions present in the individual services. According to the October 2003 GartnerG2 Fair Use Survey, 49.4% of adults and 42.5% of teens would be much less likely to subscribe to a service that only let them use downloaded music on their computers. Another 13.9% of adults and 23% of teens would be somewhat less likely to subscribe.⁴⁰⁴

For the iTunes to succeed in new markets, Apple and copyright holders will need to carefully determine the required, permitted, and expected fair uses, and how to provide for those uses. On the international front, those uses differ greatly from one country to the next. Generally speaking, a market with no expectation of fair use would be an unproblematic target for expansion. On the other hand, a market with a large number of permitted—or strongly expected—fair uses might make a transition difficult if copyright holder demand significant usage restrictions. In certain cases, the fair uses of a country might be mandatory, overriding even contract and/or anti-circumvention of DRM laws. Apple and copyright holders, for example, might consider not establishing an iTunes in a country where its DRM would not be sacrosanct. Likewise, even if Apple did choose to establish an iTunes in

⁴⁰¹ See *supra* Introduction.

⁴⁰² See the discussion in *supra* Part I and Part II on the interplay between fair use on the one side and contract law as well as DRM on the other.

⁴⁰³ The expectations of users as to what constitutes fair use have diverged from the legal reality. An October 2003 Online Fair Use Survey performed by GartnerG2 suggests, for instance, that 60.5% of teenagers and 56.3% of adults think that it is okay to copy pre-recorded music that you own for use in another device. [On file with authors.] According to a report entitled *The Digital Dilemma*, released by the National Research Council, "[o]rdinary people at times... resist following [intellectual property law] on the grounds that it violates their common sense." (National Research Council, *The Digital Dilemma: Intellectual Property in the Information Age*, 126 and 129 [2000].)

⁴⁰⁴ See *supra* note 385.

such a marketplace, it might not be able to encourage a sufficient number of licensors to provide music.

Apple has convinced all major and many independent labels to sell their music via the iTunes, and, in allowing users to “burn and export” their downloaded files “for personal, non-commercial use,”⁴⁰⁵ Apple has created a music service that seems to meet many consumers' expectations with regard to “fair use.” At the same time, however, Apple does not provide for transformative uses or for a full range of private copying. In the future, as more and more services providing digital music enter the market, the different uses each allows might become a major selling point.

D. Fair Use Laws in Several of the Premiere Global Marketplaces

Ideally, an interested company would be able to design one online music store that could be expanded quickly and simply into every global market. Before a company can design such software, it will need to know what is considered fair use in each country of interest, both to gauge user expectations, and also to ascertain if it can assure music providers of a safe environment for online music distribution. While international treaties exist that are intended to harmonize copyright law on a global basis, their treatment of fair use is too vague to be helpful on this front.⁴⁰⁶ This section will describe the current state of fair use laws in several of the most significant global markets: the United States, the United Kingdom, Germany, France, Canada, China and Japan.

1. United States

As noted above, the general fair use doctrine, little changed from the time of Justice Story,⁴⁰⁷ is codified in 17 U.S.C. § 107. In the United States, each potential fair use is decided on a case-by-case basis under the four factors set out by 17 U.S.C. § 107.⁴⁰⁸ The four factors are:

- (1) the purpose and character of the use, including whether such use is of commercial nature or is for nonprofit educational purposes;
- (2) the nature of the copyrighted work;

⁴⁰⁵ See § 9(b) iTunes Terms of Service. See, for further discussion, the Introduction to this case study, and *supra* Part I.

⁴⁰⁶ There are three main international treaties that are intended to harmonize copyright law among nations. All of the treaties are very vague as to what uses can be allowed as fair uses. The Berne Convention is the oldest, adopted in 1886 though not signed by the United States until 1988. The Berne Convention for the Protection of Literary and Artistic Works, available at <http://clea.wipo.int/clea/lpext.dll/Folder/Infobase/48c66/48c67?fn=document-frame.htm&f=templates&2.0>. Art. 9 of the Berne Convention authorizes parties to the Convention to allow any fair uses to reproduce that do not “conflict with a normal exploitation of the work” and do not “unreasonably prejudice the legitimate interests of the author.” Both the United States' vague fair use doctrine and Germany's exhaustive list of copyright limitations meet this standard. The other two main treaties are the 1994 Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPs Agreement, available at http://www.wto.org/english/tratop_e/trips_e/t_agm0_e.htm) and, as already mentioned elsewhere in this case study (see, e.g., *supra* Part III), the 1996 World Intellectual Property Organization Copyright Treaties (WCT). These treaties, however, essentially use the Berne Convention language to specify which limitations to copyright countries may allow. Art. 13 TRIPs Agreement. See also Art. 10 WCT.

⁴⁰⁷ See *supra* note 385.

⁴⁰⁸ *Campbell*, 510 U.S. 569, 581 (1994).

- (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.⁴⁰⁹

No one of the factors is decisive; the court must weigh all the factors and compare them “in light of the purposes of copyright.”⁴¹⁰ The only way to determine whether a particular use is protected as a fair use is to find a judicial decision on similar facts. While 17 U.S.C. § 107 does list categories of uses that might be fair, “such as criticism, comment, news reporting, teaching..., scholarship, [and] research,”⁴¹¹ that list is not intended to be exhaustive.

When judging transformative uses, courts must consider the extent to which the second work either simply replaces the first or contributes something additional,⁴¹² perhaps by pursuing § 107's example purposes. Courts have found to be fair use, for instance, quoting documents for a news report;⁴¹³ excerpting of a boxing match film for inclusion in a biography;⁴¹⁴ and using a portion of a political candidate's ad to criticize it.⁴¹⁵ On the other hand, courts have ruled against defendants who used more than large excerpts, and defendants who used an excerpt that amounted to the most important part of the original, where the use would undermine the market for the original work.⁴¹⁶ The practice of sampling music recordings for use in another commercial recording has also been deemed infringement.⁴¹⁷ Whereas parodies that comment on the original and do not copy more than necessary are protected, satires or appropriating to comment on society at large are not.⁴¹⁸

At issue in many transformative use cases is the commerciality of the second work, for a commercial use seems to overtly harm the original work's market potential by depriving it of potential revenue. Under *Sony Corporation of America v. Universal City Studios, Inc.*,⁴¹⁹ courts treat non-commercial uses much more favorably. The Court stated that “every commercial use of copyrighted material is presumptively an unfair exploitation of... copyright.”⁴²⁰ However, the Court proceeded to assert that a “challenge to a noncommercial use of a copyrighted work requires proof either that the particular use is harmful, or that if it should become

⁴⁰⁹ 17 U.S.C. § 107, (1)-(4).

⁴¹⁰ *Campbell*, 510 U.S. at 578.

⁴¹¹ 17 U.S.C. § 107.

⁴¹² *Campbell*, 510 U.S. at 575.

⁴¹³ *Religious Tech. Ctr. v. Lerma*, 897 F.Supp. 260 (E.D.Va.,1995).

⁴¹⁴ *Monster Communications, Inc. v. Turner Broad. Sys. Inc.*, 935 F. Supp. 490 (S.D.N.Y. 1996).

⁴¹⁵ *Keep Thomson Governor Comm. v. Citizens for Gallen Comm.*, 457 F. Supp. 957 (D.N.H. 1978).

⁴¹⁶ See, e.g., *Harper & Row v. Nation Enters.*, 471 U.S. 539 (1985) (magazine quoted "heart" of unpublished memoirs, thus "pos[ing] substantial potential for damage to the marketability of first serialization rights"); *Love v. Kwitny*, 706 F.Supp. 1123 (S.D.N.Y. 1989) (author quoted 50% of unpublished manuscript).

⁴¹⁷ *Grand Upright v. Warner*, 780 F. Supp 182 (S.D.N.Y. 1991)

⁴¹⁸ *Dr. Seuss Enters., L.P. v. Penguin Books USA, Inc.*, 109 F.3d 1394 (9th Cir. 1997).

⁴¹⁹ 464 U.S. 417 (1984).

⁴²⁰ *Id.* at 451.

widespread, it would adversely affect the potential market for the copyrighted work.”⁴²¹ The potential market need not exist presently, however. *A&M Records, Inc. v. Napster, Inc.* suggests that “lack of harm to an established market cannot deprive the copyright holder of the right to develop alternative markets for the work.”⁴²² *American Geophysical Union v. Texaco, Inc.* similarly noted that “impact on potential licensing revenues for traditional, reasonable, likely developed markets” is relevant.⁴²³

Sony is particularly important to the online music context because it potentially protects many personal uses of music. In treating “time-shifting”—taping a television show to watch it once later—as fair use, the Court opened the fair use doctrine to private, non-transformative copying of entire works. For instance, burning downloaded songs to a CD or shifting to a portable player for personal use would be non-commercial and thus would put the same burden of proof on copyright holders that *Sony* did. Indeed, *Recording Industry Association of America v. Diamond Multimedia Systems, Inc.*⁴²⁴ theorized that copying a legally purchased CD into a new format to listen to it while walking or driving is “space-shifting,” and that, like “time-shifting” in *Sony*, it would probably be considered a fair use. However, *Diamond* was not a fair use case, and the court’s discussion of “space-shifting” was dictum. In fact, the Register of Copyrights argues that such use would not be considered a fair use because it could interfere with copyright holders’ creation of download services that limit further redistribution of purchased works.⁴²⁵ Similarly, following the sentiments of *Napster* and *American Geophysical*, space-shifting could be considered a potential licensing opportunity. Copyright holders could use DRM to limit and charge for such actions.⁴²⁶

Another fair use that could have a significant effect on the success of an online music store is the fair use to reverse engineer. In *Sega Enterprises, Inc. v. Accolade, Inc.*,⁴²⁷ the court held that reverse engineering, in this case making a copy of Sega’s copyrighted material solely to determine how to create interoperable programs, is a permitted fair use.⁴²⁸ As noted, music downloaded from the iTunes can only be played on Apple’s iPod. If reverse engineering were permitted, programmers could determine how the Apple software worked and design new software to allow other portable players to play iTunes music. For a more in depth discussion of this issue, see Part II on DRM.

Indeed, DRM, as backed by the DMCA, can override many fair uses. Moreover, DRM preempts the careful balancing of interests that every case entails. Fair use is a contextual, evolving doctrine whereas DRM’s

⁴²¹ *Id.*

⁴²² *A&M Records, Inc. v. Napster, Inc.*, 239 F.3d at 1017.

⁴²³ 60 F.3d 913 (2d Cir. 1995).

⁴²⁴ 180 F.3d 1072 (9th Cir. 1999).

⁴²⁵ See Recommendation of the Register of Copyrights in RM 2002-4, 129-131 available at <http://www.copyright.gov/1201/docs/registers-recommendation.pdf>. And it is a clear violation of the DMCA to circumvent most DRM in order to “space-shift.” *Id.*

⁴²⁶ See, e.g., Tom W. Bell, *Fair Use Vs. Fared Use: The Impact of Automated Rights Management on Copyright’s Fair Use Doctrine* 76 N.C. L. Rev. 557 (1998). See also Wendy Gordon, *Fair Use as Market Failure: A Structural and Economic Analysis of the Betamax Case and Its Predecessors*, 82 Colum. L. Rev. 1600 (1982).

⁴²⁷ 977 F.2d 1510.

⁴²⁸ *Id.* at 1527-28.

restrictions are rigid; necessarily, the two can never perfectly align.⁴²⁹ With Apple's FairPlay, this is clearly the case. FairPlay judges that the sixth computer (but not the previous five) cannot store a copy of a song and that no excerpt—no matter its size, purpose or impact on the original's market or the original's nature—can be made. Whereas fair use is typically a judicial decision, copyright holders and Apple have full discretion with DRM.

2. Countries of the European Union

One of the major provisions of the EUCD⁴³⁰ is its requirement that no member of the EU allow any exemptions to copyright outside of those exhaustively specified in art. 5.⁴³¹ Art. 5(2)(b) defines the exceptions allowed for “reproductions on any medium”, including digital media.⁴³² Art. 5(2)(b) permits exceptions allowing “natural person[s]”⁴³³ to make reproductions “for private use” and “for ends that are neither directly nor indirectly commercial,”⁴³⁴ so long as those uses “do not conflict with a normal exploitation of the work.”⁴³⁵ Such “private use” exceptions must fairly compensate the rightholders.⁴³⁶ Other allowed exceptions include “use for the sole purpose of... scientific research,”⁴³⁷ uses for the purpose of news reporting,⁴³⁸ uses for the purpose of criticism,⁴³⁹ and uses for the purpose of parody.⁴⁴⁰ While no country is allowed to implement any exceptions other than the ones listed in art. 5, it is also true that no country is required to implement most of these exceptions. Only one exception is mandatory, and that is an exception for “transient” copies that are “an integral and essential part of a technological process... whose sole purpose” is to allow either a network transmission by a third party or a lawful use.⁴⁴¹ The purpose of this exception is to prevent ISPs, router operators, etc. from being liable for copies that pass through their equipment *and* to allow people to make use of software legally because running a piece of software requires it to be “copied” temporarily into RAM. As the majority of the exceptions and limitations listed in art. 5 are optional, an examination of the EUCD alone is not enough to provide a good picture of the laws of any individual state.

⁴²⁹ See Fred von Lohmann, "Fair Use and DRM," *EFF.org* (Nov. 1 2003) at http://www.eff.org/IP/DRM/fair_use_and_drm.html.

⁴³⁰ See *supra* note 83.

⁴³¹ Art. 5, EUCD.

⁴³² Art. 5(2)(a), on the other hand, specifies exceptions allowed for “reproductions on paper or any similar medium.” *Id.* Unlike the general provision for all media set out in 5(2)(b), the limitations allowed for paper reproductions can be extended to non-natural entities (such as corporations) and can be allowed even when the reproductions are carried out for commercial ends.

⁴³³ By using this language, the EUCD prohibits legal entities such as corporations or organizations from making copies for internal, “private,” use.

⁴³⁴ Art. 5(2)(b), EUCD.

⁴³⁵ Art. 5(5), EUCD.

⁴³⁶ Art. 5(2)(b), EUCD.

⁴³⁷ Art. 5(3)(a), EUCD.

⁴³⁸ Art. 5(3)(c), EUCD.

⁴³⁹ Art. 5(3)(d), EUCD.

⁴⁴⁰ Art. 5(3)(k), EUCD.

⁴⁴¹ Art. 5(1), EUCD.

a. United Kingdom

On October 31, 2003, the U.K.'s implementation of the EUCD, the Copyright and Related Rights Regulations 2003 (CRRR),⁴⁴² came into force. As mentioned in Part II and Part III of this case study, the CRRR makes many significant amendments to the United Kingdom's main source of copyright law, the Copyright, Designs and Patents Act of 1988 (CDPA).⁴⁴³ Most of the rights that would be considered fair uses under U.S. law are found in Chapter III of the CDPA. Sec. 29 of the CDPA states that "Fair dealing with a literary, dramatic, musical or artistic work for the purposes of research for a non-commercial purpose does not infringe any copyright,"⁴⁴⁴ and also permits "fair dealing... for the purposes of private study."⁴⁴⁵ It is important to note, however, that under the CDPA "musical work" means a composition and not a sound recording of that composition. Sound recordings are not covered by sec. 29. This "fair dealing" provision is indicative of the majority of the U.K.'s "fair use" provisions. While it does leave some leeway for the courts to decide if a particular action is "fair dealing," it is much more specific than the U.S. statute. Sec. 30 provides for "fair dealing... for the purpose of criticism or review" and secs. 32 through 36 provide exceptions for infringements that take place for the purpose of education.⁴⁴⁶ To a certain extent, these rights are judicially determined rights. For example, in *Hyde Park Residence Ltd v Yelland*,⁴⁴⁷ the court looked at the "extent of the use", the "good faith" of the defendants, the type of use, and other criteria in determining whether the publishing of certain photos was protected under the fair dealing provisions.⁴⁴⁸ Nonetheless, the relative specificity of the CDPA renders a careful look at judicial decisions in the United Kingdom less important.

Sec. 56 of the CPDA deals with the transfer of works in electronic form. Sec. 56 applies "where a copy of a work in electronic form has been purchased on terms which, expressly or impliedly or by virtue of any rule of law, allow the purchaser to copy the work, or to adapt it or make copies of an adaptation, in connection with his use of it."⁴⁴⁹ Sec. 56(2) sets forth:

"If there are no express terms—

- (a) prohibiting the transfer of the copy by the purchaser, imposing obligations which continue after a transfer, prohibiting the assignment of any licence or terminating any licence on a transfer, or
- (b) providing for the terms on which a transferee may do the things which the purchaser was permitted to do, anything which the purchaser was allowed to do may also be done without infringement of copyright by a transferee; but any copy, adaptation or copy of an adaptation made by the purchaser which is not also transferred shall be treated as an infringing copy for all purposes after the transfer."

⁴⁴² See *supra* note 251.

⁴⁴³ See *supra* note 381.

⁴⁴⁴ § 29(1), CDPA

⁴⁴⁵ § 29(1C), CDPA

⁴⁴⁶ § 30(1), 32-36, CDPA

⁴⁴⁷ [2001] Ch 143 (Court of Appeals).

⁴⁴⁸ *Id.* at ¶ 40.

⁴⁴⁹ § 56, CDPA.

It seems likely that sec. 56(2) applies to an iTunes user, because iTunes' Terms of Service, as discussed in the previous Part III on digital first sale, have not definitively addressed the issue of transfers of purchased songs. In any case, however, an iTunes purchaser who sent a copy of an iTunes song to a friend would infringe the copyright under the CPDA unless he transferred all copies.

The main effect of the CRRR, as briefly discussed in Part II, is to amend the CDPA to include provisions protecting DRM technologies. In so doing, it largely allows for copyright holders to override fair dealing. The only specific exception is for cryptography researchers, and even that research is prohibited in any case where such research “prejudicially [affects] the rights of the copyright owner.”⁴⁵⁰ A special provision also exists to provide a remedy for users whose permitted acts (such as the copies made for private use mentioned above) are prevented by DRM.⁴⁵¹ This complicated provision creates a complaint system through which a person “prevented from carrying out a permitted act” can notify the Secretary of State of the limitation, who can then choose to force the copyright holder to relax or circumvent the DRM to allow the permitted use. However, according to sec. 296ZE(9) this procedure does not apply “to copyright works made available to the public on agreed contractual terms in such a way that members of the public may access them from a place and at a time individually chosen by them.”⁴⁵² It is possible that U.K. courts would find that users of the iTunes, a sort of on-demand service, do not have the remedy set forth in sec. 296ZE.

These provisions are tailor-made for providers of an online music service as they generally prohibit any tampering with its DRM, while also prohibiting any scientific research that has “prejudicial” effect. On the other hand, consumers may find themselves unable to use their purchases in ways generally considered to be fair.

b. Germany

Germany is another of the few members of the European Union to have presently implemented the EUCD. German copyright law is codified in the Law on Copyright and Related Rights, or in German, the *Gesetz über Urheberrecht und verwandte Schutzrechte* (UrhG).⁴⁵³ Chapter I.6 of the UrhG sets what would be considered fair uses in the United States. §§ 44a-63a UrhG provide limitations on copyright for many of the normal reasons such as instructional use (§ 46 UrhG), school broadcasts (§ 47 UrhG), public speeches (§ 48 UrhG), newspaper articles (§ 49 UrhG), quotations (§ 51 UrhG), and public communication (§ 52 UrhG). § 53 UrhG governs “Reproduction for Private and Other Personal Uses.”⁴⁵⁴ According to § 53(1), natural persons (but not legal entities) can make single copies (according to case law, up to seven) of a work, digital or analog, for private use as long as such copies are not used—neither directly nor indirectly—for commercial purposes, and given that such copies are not made from obviously illegal originals. Thus, it would be a copyright

⁴⁵⁰ § 296ZA (2), CDPA.

⁴⁵¹ § 296ZE, CDPA.

⁴⁵² § 296ZE(9), CDPA.

⁴⁵³ See *supra* note 118.

⁴⁵⁴ *Id.* at § 53.

infringement to download songs for personal use from P2P networks which distribute works without permission of the copyright holder. While copies of newspapers and out of print works can be lent, it is impermissible to lend copies of any sort of recordings.⁴⁵⁵

With the implementation of the EU CD, German copyright law also now includes a provision preventing circumvention of “effective technological measures for the protection of a work protected by [copyright].”⁴⁵⁶ This blanket statement, however, is complicated by § 95b UrhG, which states that there are certain copyright limitations which shall not be eliminated by technical protection measures. There are only a small number of these limitations, for example § 45a that allows handicapped people to modify a work so they can use it. Importantly for iTunes, § 95b(3) UrhG states that such allowed private uses do not apply to works distributed over the internet. This means that, as already discussed in Part III, the iTunes can use DRM to exclude all copying of its music. But according to § 108(1) UrhG, circumvention of DRM in order to make a private copy will not be criminally punished. The companies whose DRM has been circumvented, however, can still bring private lawsuits.⁴⁵⁷ To summarize, circumventing DRM in Germany in order to make a private copy is almost always illegal and can be the basis for a private suit, though the government will not pursue such copying with criminal sanctions. Note that this exemption from criminal liability only applies to downloaders, not distributors. According to the Federal Justice Minister, Brigitte Zypries, “Anyone – irrespective of whether commercially or privately, for money or not – who offers and distributes music, films or computer games for download from the internet without being entitled to do so, will make themselves criminally liable.”⁴⁵⁸

Germany also has a constitutional exemption for scientific research and learning.⁴⁵⁹ According to the German government, the anti-circumvention provision of the UrhG will not prohibit “acts of circumvention committed solely for scientific purposes (e.g. cryptography).”⁴⁶⁰ Copyright holders’ eternal worry, however, is that if one person is allowed to crack a DRM technology, then the DRM will be rendered useless.⁴⁶¹ However, while such scientific research might be widely published, it would not enable the average user to circumvent the DRM as it would first need to be implemented as some sort of software or device. Programmers and other advanced users might be able to create their own circumvention devices, but they would not be allowed to distribute them and the widespread circumvention copyright holders fear would likely

⁴⁵⁵ “Copies may neither be disseminated nor used for public communication. It shall be permissible, however, to lend out lawfully made copies of newspapers and works that are out of print...” *Id.* at § 53(6)

⁴⁵⁶ The full text is: “Effective technological measures for the protection of a work protected by this law or of any other subject matter protected by this law may not be circumvented without the consent of the rightsholder, when the person concerned acts with the knowledge or with reasonable grounds to know, that the circumvention takes place to gain access to such a work or protected subject matter or to make use of it.” § 95(a), UrhG.

⁴⁵⁷ See “Piracy” Banned – New Copyright Law Entered into Force, at <http://goethe.de/kug/mui/int/akt/enindex.htm>.

⁴⁵⁸ *Id.*

⁴⁵⁹ “Art and Science, Research and Teaching are Free.” Art. III(5) Grundgesetz.

⁴⁶⁰ See http://www.urheberrecht.org/topic/Info-RiLi/ent/RegE_UrhR_InfoG.pdf.

⁴⁶¹ Consider the case of DeCSS, where one teenage Norwegian researcher who wanted to find a way to play his DVDs in Linux cracked the CSS code used by the industry to prevent copying of DVDs. Soon after, the code to get past the CSS encryption was ubiquitous both on and off the internet. See <http://en.wikipedia.org/wiki/DeCSS>.

not materialize. It is doubtful, then, that a simple exception solely for scientific research would discourage an online music service from expanding into the German market.⁴⁶²

c. France

France also must implement the EUCD. France's implementation, however, is pending.⁴⁶³ Note, however, that in the coming years, French copyright law will likely change significantly and become more like German and U.K. copyright law. Currently, French copyright law is codified in the Intellectual Property Code (IPC) of 1992.⁴⁶⁴ The limitations of the rights granted to the copyright holders, the "fair use privileges" of the people, are stated succinctly in Art. L. 122-5 of the IPC:

The beneficiaries of the rights afforded by this Title may not prohibit:

1. Private and gratuitous performance carried out exclusively within the family circle;
2. Reproductions strictly reserved for private use by the person who has made them and not intended for any collective use.
3. [Brief quotations in criticism, education, news reporting contexts.]
4. Parody, pastiche and caricature, observing the rules of the genre.⁴⁶⁵

These provisions are quite similar to the United States', the United Kingdom's and Germany's. One key difference is that reproductions for private use are not limited in number in France.⁴⁶⁶

3. Canada

Canadian copyright law is codified in the Copyright Act of 1985.⁴⁶⁷ Sec. 29 provides "fair dealing" privileges for "research or private study,"⁴⁶⁸ for the "purpose of criticism or review" so long as the source is mentioned,⁴⁶⁹ for the "purpose of news reporting."⁴⁷⁰ In *CCH Canadian Ltd. V. Law Society of Upper Canada*,⁴⁷¹ the Supreme Court of Canada has given a broad interpretation to the fair dealing exception under the Canadian Copyright Act. According to this Court, the "fair dealing exception, like other exceptions in the Copyright Act, is a user's right. In order to maintain the proper balance between the rights of a copyright owner and users' interests, it must not be interpreted restrictively. As Professor Vaver [...] has explained [...]:

⁴⁶² Especially considering that even if a workaround was found by a researcher for a particular DRM technology, trafficking or broadcasting that workaround would still be illegal. § 95 UrhG.

⁴⁶³ See Ian Brown, *Implementing the European Union Copyright Directive: France*, at <http://www.fipr.org/copyright/guide/france.htm>.

⁴⁶⁴ See *supra* note 382.

⁴⁶⁵ IPC, Art. L. 122-5. *Id.*

⁴⁶⁶ Reverse engineering rights are specified by Art. 122-6-1 of the IPC. While the actual requirements that must be met before reverse engineering becomes legal are somewhat complicated, the key provision is that reverse engineering can only be used "to achieve the interoperability of [software]." (IPC, Art. L 122-6-1 (IV)). For further discussion of this issue, see *supra* Part II.

⁴⁶⁷ *Supra* note 380.

⁴⁶⁸ *Id.* at § 29.

⁴⁶⁹ *Id.* at § 29.1.

⁴⁷⁰ *Id.* at § 29.2.

⁴⁷¹ 2004 SCC 13.

'Users rights are not just loopholes'. Both owner rights and user rights should therefore be given the fair and balanced reading that befits remedial legislation."⁴⁷² The fair use exception as set forth in sec. 29 has been given a large and liberal interpretation as far as the privileges for "research" are concerned. In *Law Society*, the Supreme Court held that research is not limited to non-commercial or private contexts. With regard to the effects of the dealing on the work, the Court focused its analysis on the question whether the reproduced work is likely to compete with the market of the original work.⁴⁷³

Copying for private use is also allowed by the Canadian Copyright Act. According to sec. 80 of the Act, "the act of reproducing all or any substantial part of [a recording] onto an audio recording medium for the private use of the person who makes the copy does not constitute an infringement of the copyright." As was the case in France, there is no limit on the number of copies a Canadian citizen can make of a particular recording. Likewise, a music service's limitation of the number of allowed copies might bother Canadian users.

4. Asia-Pacific

a. Japan

Japan has no generalized "fair use" concept as a defense to infringement or affirmative right – restraints on copyright entitlements are specifically enumerated in the Copyright Law; Japan's Copyright Law also does not contain a broad, generalized fair use provision like that in 17 U.S.C. § 107.⁴⁷⁴ The Tokyo High Court explicitly affirmed this principle in a 1994 case between Dow Jones & Co. and Know-How Japan.⁴⁷⁵ This case, widely known as the "Wall Street Journal" case, involved a copyright infringement suit against a Japanese corporation for selling abstract services of "The Wall Street Journal" and "New York Times" to the Japanese public.⁴⁷⁶ The High Court denied the defendant's arguments, stating that it was "not reasonable to conclude" from the purpose of the Copyright Law, as outlined in art. 1 and the limitations on copyright, as outlined in art. 30, that the Japanese courts "generally recognize the principles of fair use."⁴⁷⁷ The court continued that, "as limitation to copyright by fair use is based on the balance of conflicting interests, namely the interests of author and public necessity, conditions to apply the principle of fair use must be clearly set out...under our legal system where such provision[s] do not exist, we cannot find general principle of fair use." However, the Japanese Copyright Law does contain a "laundry list" of permitted use of copyrighted material, which may provide a limited basis for fair use.⁴⁷⁸ Among the permissible uses include reproduction for educational, political, judicial or newsworthy purposes.⁴⁷⁹ In particular, the Copyright Law permits reproduction for private use,⁴⁸⁰

⁴⁷² *Id.* at n 48.

⁴⁷³ *Id.* at n 59.

⁴⁷⁴ Japanese Copyright Act, *see supra* note 128. *See also* Salil Mehra, *Copyright and Comics in Japan: Does Law Explain Why All the Cartoons My Kid Watches Are Japanese Imports?*, 55 Rutgers L. Rev. 155, 175 (2002).

⁴⁷⁵ *See Dow Jones & Co. v. Know-How Japan*, 1524 Hanrei Jihō 118 (Tokyo High Ct. Oct. 27, 1994); *see also* Nadine Rosevear, Guidelines for the Creation of Web Sites at Schools in Japan: Copyright Implications, available at <http://asijonline.net/exp/copyright/japancopyright.htm>. Rosevear.

⁴⁷⁶ *See generally* Yamamoto, *supra* note 142.

⁴⁷⁷ *Id.*

⁴⁷⁸ Mehra at 176; Art.s 30-49, Copyright Law of Japan.

⁴⁷⁹ Art.s 30-49, Copyright Law of Japan.

performance for non-profit-making purposes,⁴⁸¹ and reproduction by the owner of a copy of a software program.⁴⁸²

b. China

Although China does not have a general fair use provision like that in U.S. copyright law, it does provide a limited fair use doctrine in art. 22 of its Copyright Law.⁴⁸³ Art. 22 lays out specific circumstances where “a work may be exploited without permission from, and without payment of remuneration to, the copyright owner, provided that the name of the author and the title of the work shall be mentioned and the other rights enjoyed by the copyright owner by virtue of this Law shall not be prejudiced.”⁴⁸⁴ Embodied in this Article is a private use exception: it allows a party to use a copyrighted work, without the copyright holder’s permission, only for “the purposes of the user's own private study, research or self-entertainment.”⁴⁸⁵

E. Conclusion

Fair use has the potential to affect the business model of an online music service in at least two ways: (1) creating expectations on the part of the customer and (2) increasing or decreasing the willingness of copyright holders to supply music, or in other words, increasing or decreasing the amount of effort and care a music provider must put into designing its DRM system to protect copyright holders or even causing a music provider to decide no DRM system would be sufficient. Fair use is copyright law's attempt to codify reasonable exceptions and limitations to the exclusive rights normally granted to copyright holders. If a use is considered "fair" by the law, customers might expect it and are likely to make a decision whether or not to use a particular system based on to what extent that system allows the use. As the market for online music distribution grows, competition between distributors could result in an ever increasing set of allowed uses. Fair use can also be seen as a work-around of the copyright. As such, copyright holders—depending on the context—might see fair uses as dangers to their rights. As a general rule, the more fair uses allowed, the more danger a copyright holder may perceive.

While each country has a different method of implementation, every country has some sort of "fair use" limitations/exceptions incorporated into its copyright law. These define the reasonable extent of the monopoly granted to copyright holders. Internationally, the trend seems to be toward fair use laws that encourage business models like the iTunes, at the expense of traditional fair uses. The EU CD specifically limits the available "fair use" exceptions and makes it generally illegal to circumvent DRM. While some countries have not yet implemented the EU CD, soon the trend toward "harmonization" in the EU will be complete. In the U.S., laws like the DMCA are creating the same trend.

⁴⁸⁰ Art. 30, Copyright Law of Japan.

⁴⁸¹ Art. 38, Copyright Law of Japan.

⁴⁸² Art. 47bis, Copyright Law of Japan.

⁴⁸³ Art. 22, Copyright Act of China, *supra* note 177. See Samuelson, *supra* note 190.

⁴⁸⁴ Art. 22, Copyright Act of China.

⁴⁸⁵ Art. 22, Copyright Act of China.

Part V: Findings and Tentative Assessment

A. Summary

The purpose of this case study of Apple’s iTunes Music Store has been twofold:⁴⁸⁶ First, the study has explored how critical doctrines and principles of copyright and contract law, DRM systems (including anti-circumvention laws), and online media distribution models interact with each other. Some of the observations made in the previous Parts are recapitulated in the following section.

The second objective of the paper is to expand the knowledge base of the Digital Media in Cyberspace Project beyond U.S. law and to include a more detailed coverage of legal frameworks in Europe as well as in nations such as Japan and China. This comparative law analysis has been integrated in Parts I-IV and will not be reproduced in this final Part V. The following Section 2, however, summarizes some of the general findings.

1. Critical Interactions

In this study, the following four interactions between law, DRM, and business models—among others—have been identified as key issues and have been analyzed in greater detail both from a U.S. as well as a comparative law perspective:

- **Contract-Copyright Intersection:** Online media services such as the iTMS use two legal strategies to govern the actions consumers may take with purchased digital content: limitations through contract and/or copyright law. The extent of the content provider’s ability to control its business model depends on how contract and copyright doctrine interact. Copyright law typically provides exceptions to its protections that effectively create greater freedom of action for consumers who purchase copies of protected works. However, if contracts can re-allocate copyright’s entitlements, the content provider can use license agreements with its consumers to support its business model by limiting what they can do with the content—even to the extent of overriding rights consumers would otherwise enjoy under copyright. Hence, where contract law can override copyright, and governments do not impose mandatory contract terms in favor of consumers, license agreements can plug holes copyright creates.⁴⁸⁷
- **Digital Rights Management (DRM) and Anti-Circumvention Laws:** Like contracts, DRM can upset the balance struck between copyright holders and the public, including fair use and first sale. Unlike

⁴⁸⁶ See *supra* Introduction.

⁴⁸⁷ See *supra* Part I.

contracts, DRM's restrictions are self-enforcing. In this case study, we have illustrated how Apple's Online Music Store, iTunes, takes advantage of its DRM system, FairPlay, and legal provisions such as those set forth in the DMCA to prevent music piracy on the one hand, and to limit interoperability—thus controlling secondary markets—on the other hand.⁴⁸⁸

- **First Sale and Business Model-Interaction:** The first sale doctrine is aimed at balancing the copyright holder's rights on the one hand and public access to copyrighted works on the other hand. Therefore, the doctrine has an important impact both on consumers and on the public at large. It has been demonstrated, however, that the first sale exemption in its current interpretation is unlikely to apply to digital works distributed over the Internet. The emergence of a digital first sale doctrine, by contrast, would likely lead to secondary markets in downloaded content such as music and movies. These secondary markets would, in turn, likely have a significant impact on online business models such as the iTunes as well as on users' opportunities—and costs—to gain access to copyrighted digital content.⁴⁸⁹
- **Fair Use and Business Model-Interaction:** Generally speaking, fair use is a privilege to use an individual's copyrighted material in a reasonable manner without her consent. The specific implementations of fair use rights or privileges can vary significantly from country to country. Fair uses traditionally include copies for private study, parody, criticism, news reporting, limited personal uses, and reverse engineering for interoperability. While one Part of this case study explored the reverse engineering and interoperability aspect of fair use,⁴⁹⁰ another Part has demonstrated that online business models such as the iTunes have to balance between broad consumer expectations of fair use on the one hand and a copyright holder's desire to control the distribution and use of copyrighted works by means of contract law and DRM schemes on the other hand.⁴⁹¹

2. Comparative Law Perspective

The comparison of important provisions of several international and national legal and regulatory frameworks—in essence in the domain of copyright, contract, and anti-circumvention law—leads to a conclusion that is typical for comparative law as such. On one hand, the paper has identified and described a trend towards convergence between different legal frameworks with regard to some of the key issues up for debate. For instance, the research has identified an overall trend towards convergence between the analyzed legal frameworks with regard to the following issues.

- In the US as well as in Europe and Asia-Pacific, contract law—in the digital media context appearing in form of “terms of service” or “license agreements”—limits what consumers can do with purchased digital content such as online music, movies, or e-books. License agreements often override rights

⁴⁸⁸ See *supra* Part II.

⁴⁸⁹ See *supra* Part III.

⁴⁹⁰ See *supra* Part II.

⁴⁹¹ See *supra* Part IV.

consumers would otherwise enjoy under copyright law. Thus, for instance, license agreements of online music services both in Europe and Japan often prohibit users from re-selling, lending, or transferring songs—rights usually granted by the first sale doctrine or fair use in the U.S.⁴⁹²

- Increasingly, digital content providers are turning to technological protection measures to constrain usage of e-content. The iTunes, for instance, restricts transformative use of music and limits the number of burns with the exact playlist via FairPlay. Technological protection measures are increasingly supported with strong laws prohibiting the circumvention of DRM that protects copyright holders' exclusive rights. At the international level, the WIPO treaties, among other requirements, call for “adequate legal protections and effective legal remedies against the circumvention of effective technological measures.” Legislatures around the globe have enacted statutes and provisions—such as the DMCA in the U.S., or the European Union's Copyright Directive—to implement the WIPO treaties. Accordingly, copyright holders and online music stores here and abroad can, by and large, rely both on self-enforcing technical protection measures and strong anti-circumvention provisions.⁴⁹³
- Moreover, the paper has identified and analyzed a trend towards convergence between national legal frameworks in legal doctrines such as the first sale doctrine, or, in terms of international law, the principle of exhaustion. The application of the first sale doctrine to digital works distributed over the Internet, despite strong arguments to the contrary, is denied both under current U.S. and European Union Law, and has not emerged in Asian-Pacific jurisdictions. The WIPO treaties in particular apply the first sale doctrine to tangible goods only—such as books, CDs, and the like—but not to “intangible” content distributed over the Internet.⁴⁹⁴

On the other hand, however, a comparative law analysis of different national legal frameworks unveils that significant differences among jurisdictions persist despite a larger trend towards convergence of regulatory frameworks which govern online media. This study has identified and discussed four key areas where copyright holders, online media providers, and consumers might face important differences between a specific country's governing laws on the one hand and foreign contract, copyright, and anti-circumvention laws on the other. It remains an open question whether these differences will reshape evolving and expanding business models. The four key areas are anti-circumvention laws, fair use exemptions to copyright law, consumer protection laws, and law enforcement practices:

- Using programs or hardware to unlock content protected by DRM tools or selling or supplying such technologies is forbidden by the DMCA and the EUCD. At the European level, however, an initial analysis of national laws of the EU member states that have already implemented the EUCD reveals differences with regard to fair use rights and circumvention of access and copy controls. While it is

⁴⁹² See *supra* Part I.

⁴⁹³ See *supra* Part II.

⁴⁹⁴ See *supra* Part III.

not yet possible to rely on significant case law to predict how the interpretation of the anti-circumvention provisions will differ among the EU member states, one can conclude from interpretative statements of government officials that there might be significant disparities, for instance, with regard to the qualification of circumvention of certain “access controls” such as those used in DVD’s region coding.⁴⁹⁵

- While the basic idea of the fair use doctrine as it has emerged in the U.S.—i.e. to codify reasonable exceptions and limitations to the exclusive rights normally granted to copyright holders—appears in one form or another in most foreign copyright regimes, the specific implementations of fair use rights or privileges vary significantly from country to country. These regional differences may affect online music services in two ways: First, extensive fair use privileges may have an impact on the record industry’s willingness to license their music to online music stores such as iTunes. Second, fair use might play a role in shaping users’ expectations of what they can and should be able to do with their music.⁴⁹⁶
- Compared to U.S. consumer-protection laws, online music providers will have to master a very different set of consumer-protection laws in various EU countries, as well as those in the Asia-Pacific region. The EU-legislature, for instance, has enacted two important directives that govern online contracts, including agreements between an online music service and its users. Both the Distance Contract Directive and the E-Commerce Directive stipulate specific provisions aimed at consumer protection that are distinct from other jurisdictions. The Distance Contract Directive, for instance, grants consumers a right of withdrawal from any distance contract—a right that cannot be waived by contract. It states that consumers have at least seven business days to withdraw from the contract without penalty and without giving any reason. Accordingly, European music stores such as Tiscali Music Club grant customers a right to “return” downloaded digital music within seven days. Some EU member states, however, do not grant such a right of withdrawal for online purchase of music and videos. Whether these unique consumer protection provisions apply to U.S.-based online music services such as the iTMS is not certain and depends on the location of the store’s European business center. The E-Commerce Directive, following the principle of control by the country of origin, applies to e-commerce services established within the EU. A service provider with an EU subsidiary or branch, like Napster UK Limited, will therefore be covered by the Directive. The Distance Contract Directive, by contrast, applies to any contract for goods or services involving an EU consumer, regardless of whether the supplier has a physical or virtual presence in the EU. Thus, even U.S. online music services without a subsidiary or branch abroad must comply with the consumer protection provisions as set forth in the E-Commerce Directive.⁴⁹⁷
- There remain significant disparities between jurisdictions about enforcement of contract and copyright obligations. The lawsuits filed by the RIAA against individual file sharers indicate relatively

⁴⁹⁵ See *supra* Part II.

⁴⁹⁶ See *supra* Part IV.

⁴⁹⁷ See *supra* Part I.

low litigation barriers in the U.S. The European Music Industry, by contrast, has seemed to be more reluctant to bring lawsuits. Although the European recording industry has frequently mentioned a desire to start a campaign similar to the RIAA's in the U.S., no specific suits were lodged against file-sharers prior to March 2004. The foreign recording industries' emphasis has been on the use of DRM-protected content, public awareness programs highlighting the illegality of file-swapping and the damages it causes, and on cooperation with ISPs, rather than legal actions against individual file-sharers. The reasons for this different approach were considered to be at least threefold: First, it has been argued that illegal file-sharing is a less severe problem outside the U.S. due to the lower penetration of broadband internet services, which makes large-scale file-sharing more difficult. It is also possible that news coverage of the U.S. lawsuits have deterred would-be file-sharers living outside the U.S. Second, structural differences in the law among the different legal systems must be considered. Structural barriers include high burdens of proof on plaintiffs or limited damages that make litigation unlikely to succeed from an economic perspective.⁴⁹⁸ Third, cultural barriers to litigation might vary, too. In Japan, for instance, the emphasis is placed on negotiation and long-term interaction rather than enforcement of obligations through litigation.⁴⁹⁹ On March 30, 2004, however, the International Federation of the Phonographic Industry (IFPI)⁵⁰⁰ announced that legal actions against 247 alleged file-sharers have been taken in Denmark, Germany, Italy, and Canada by the national record associations on behalf their member record companies, and in some cases by record labels.⁵⁰¹ Recently, the IFPI announced the first conviction of a music file sharer by a German criminal court. In addition to a criminal fine for sharing via KaZaA, the convicted party agreed to pay the German music industry compensation of EUR 8,000.⁵⁰²

As mentioned above, the comparative law analysis has focused on legal issues which directly govern and shape the relationship between a particular online business model and its users. While the study has diagnosed a general trend toward convergence between different legal and regulatory frameworks, despite differences in detail, it also supports the notion that laws and markets governing relevant relationships reflect important differences among nations and jurisdictions. These differences, in turn, may have an impact on the question of how online media business models are structured, implemented, and fine-tuned across the globe. Consider, for instance, the fact that artists in Europe are likely to have regional contracts with record labels. In such a market, it becomes more difficult and expensive for a U.S.-based online media provider such as iTunes to

⁴⁹⁸ It remains to be seen how these and similar factors will be affected by the soon-enacted European Copyright Enforcement Directive; see, e.g., http://europa.eu.int/rapid/start/cgi/guesten.ksh?p_action.gettxt=qt&doc=IP/04/316|JRAPID&lg=EN&display=. The latest version of the Directive is available at http://www3.europarl.eu.int/omk/omnsapir.so/pv2?PRG=CALDOC&FILE=20040309&LANGUE=EN&TPV=PROV&LASTCHAP=33&SDOCTA=25&TXTLST=1&Type_Doc=FIRST&POS=1.

⁴⁹⁹ See, e.g., *supra* Part I and Appendix.

⁵⁰⁰ See <http://www.ifpi.org/site-content/press/20040330.html>.

⁵⁰¹ For further discussion, see <http://cyber.law.harvard.edu/media/uploads/72/7/breakingnews.htm>.

⁵⁰² <http://cyber.law.harvard.edu/media/home?wid=25&func=viewSubmission&sid=35>.

negotiate license agreements.⁵⁰³ Or, one might consider the impact of different compensation regimes among different jurisdictions on business models.⁵⁰⁴

B. Tentative Assessment

In this study, the analysis of the interplay between key legal issues of copyright and contract law, DRM schemes, and digital media business model has focused on the relationship between an online media service—in this case study Apple’s iTunes—and its customers. This section of the paper aims to summarize and assess some of the (potential) impacts of the digital music store model as implemented in Apple’s iTMS on key players in the digital media marketplace besides online media services. Due to a lack of a comprehensive set of data and a relatively limited set of experiences with new online services such as the iTMS, this assessment is tentative in nature.⁵⁰⁵ A forthcoming research paper by the Berkman Center’s Digital Media Project will discuss the effects of both online music stores such as iTunes and of alternative business models on consumers, artists, and labels in greater detail.

1. Impacts on Consumers

As measured by market share, legitimate pre-iTunes online music services such as Pressplay and MusicNet have failed to succeed in the market.⁵⁰⁶ The reasons for this failure are manifold. From the consumer’s perspective, one might argue that complicated user interfaces, the limited size of song catalogs, comparatively high up-front costs imposed by monthly subscription fees, and restrictive DRM schemes were (at least in part) responsible for the rather limited success of iTunes’ precursors.⁵⁰⁷ As it has been discussed in this paper,⁵⁰⁸ Apple’s iTMS changed the online music landscape by offering an easy-to-use online store with a broad song catalog, a consistent, uniform, and cheap pay-per-download scheme rather than a subscription service, and a relatively liberal DRM system. Moreover, the iTMS has added additional features to its service in order to attract consumers and “compete with free” music distributed over P2P networks. At a glance, all these characteristics benefit consumers, as compared to the offerings of older online music services.

However, the analysis has also made clear how contracts, code, and supporting laws, along with reluctant application of traditional exemptions (like first sale), can limit users’ access to, and use of, digital content. Such limits are troublesome because they significantly shift the delicate balance between copyright holders’ interests on the one hand, and the public’s interests on the other hand. To summarize:

⁵⁰³ See, e.g., http://www.forbes.com/home_europe/newswire/2004/01/24/rtr1225563.html.

⁵⁰⁴ *Id.*

⁵⁰⁵ Comments are welcome at digital-media@cyber.law.harvard.edu.

⁵⁰⁶ After two years of existence, these services only managed one million combined downloads. See <http://www.pro-music.org/viewpoints/billboard.htm>.

⁵⁰⁷ See <http://www.unlimited.co.nz/unlimited.nsf/0/C6E22337C5431D6CCC256D4300745D3B?OpenDocument>. For some reactions to the launch of MusicNet, see <http://www.geek.com/news/geeknews/2001dec/gee20011204009143.htm>.

⁵⁰⁸ See *supra* Introduction.

- FairPlay and contract:⁵⁰⁹ Through DRM, the delicate balance between the interests of copyright holders and the public can not only be upset, but completely overridden. Because the DMCA and many similar international laws do not provide exceptions for fair use and first sale, copyright holders and Apple can use DRM to unilaterally determine users' freedoms. Contract law can aim towards similar results, but, unlike DRM, its impact is not self-enforcing. Fair Use: By allowing consumers to access and manipulate copyrighted works freely, the fair use doctrine provides important social benefits. As discussed in this Case Study, FairPlay and DMCA-like laws limit numerous potential fair uses, including making copies on additional computers and extracting clips for transformative uses.⁵¹⁰ Of particular importance in Part II, FairPlay limits users' ability to space-shift and format-shift music for players of their choosing. Inasmuch as its contractual terms and FairPlay allow for CD burning and archival copying, it seems to have been designed to follow some common notions of fair use. But no DRM system can completely map fair use. Fair use is not a set of binary rules, but rather an evolving doctrine based on a case-by-case balancing test. While DRM can be built to be more responsive to evolving uses,⁵¹¹ it can never truly mimic the analog world's leeway for spontaneous uses. First Sale: Online media services such as Apple's iTunes face internationally harmonized laws regarding the first sale doctrine or principle of exhaustion, respectively. Since this doctrine—aimed at limiting copyright holders' distribution rights—is unlikely to apply to digital works distributed over electronic networks, consumers are unlikely to benefit from emerging new markets such as rental and secondary sale markets in digital content. While the importance of secondary markets may be questionable with regard to online music in general and single songs downloaded from the iTunes in particular, the analysis might look different in the case of movies or e-books purchased online. Overall, the lack of a digital first sale doctrine, or, alternatively, the exclusion of its applicability by contractual or technological means decreases the overall availability of copyrighted works and is likely to hamper retail price competition at the expense of individual consumers and the public as a whole.⁵¹² An initial comparative law analysis conducted in this paper suggests that this shift of the legal and regulatory balance in favor of copyright holders' interests and, *vice versa*, at the expense of users' freedom, by and large, is global in its reach as far as the analyzed key issues are concerned. Against this backdrop, it remains an open research question where and to what extent alternative regulatory regimes can and will emerge. Beyond the question of further developments of substantive law aimed at governing digital media, one must also pay close attention to the evolution of enforcement practices. This case study has revealed that similar substantive laws ("laws in the books") might be enforced in different ways from jurisdiction to jurisdiction ("law in action"). Such divergent enforcement practices, in turn, might re-shape the increasingly globalized digital media marketplace.

⁵⁰⁹ See *supra* Part I and *supra* Part II.

⁵¹⁰ See *supra* Part IV.

⁵¹¹ See <http://www.law.berkeley.edu/cenpro/samuelsong/projects/drm/20020906-OASIS-SLTPPC-EPIC.pdf>

⁵¹² See *supra* Part III.

2. Potential Impacts on Labels

Online music stores such as iTunes are likely to have several positive impacts on both major and independent labels. First, online music stores might be seen as attempts to (re-)build new structures for selling copies of music in the digital realm in the aftermath of Napster and *vis-à-vis* its successors. With rich song catalogs, ease-of-use interfaces, permissive DRM schemes, relatively low prices, and special features such as recommendation systems, information on live concerts, etc. online music stores try to compete with free.

Second, the distribution of songs and albums via online music stores—in contrast to traditional distribution channels—eliminates costs such as packing, breakage, and so forth. Given the cost-savings, the labels' revenue streams are comparable to offline distribution schemes. In the case of Apple's iTMS, sources have speculated that Apple takes a 35% cut from every song and every album sold, while record labels receive 65% of each sale, with payments every month.⁵¹³ The difference between 54% of 15 dollar CDs (\$8.10) and 65% of 10 dollar downloaded albums (\$6.50) is mostly made up by removing manufacturing costs (8%, \$1.20). Essentially all of the lower cost comes from a lesser cut for the retailer (typically 38%, \$5.70) and absence of a distributor (8%, 1.20).⁵¹⁴

Particularly, independent labels might—at least indirectly—benefit from emerging online music services such as the iTMS. The architectural constraints of offline music stores, which often result in a less prominent in-store placement of works by independent artists, do not apply to their online counterparts. Due to ease-of-use search functionalities and autonomous recommendation systems,⁵¹⁵ consumers are more likely to find lesser known artists and music. The basic idea is known as the “80/20” rule. Generally, any business gets 80 percent of its revenues from a dedicated contingent of consumers, the “20%”. With online distribution, a more focused approach may supplant a maximum exposure marketing strategy. As of July 2003, the Nielsen Soundscan ratings service introduced a new category, “non-traditional sales” into its analysis. A glance at the Internet charts, which are available at billboard.com, provides some support for the proposition that online distribution helps lesser known music reach a wider audience. Often, albums in the top 20 of the Internet charts fail to break the top 100 in the offline Billboard 200 ranking—sometimes they are not even listed.⁵¹⁶

Online music stores such as iTunes may also have a further impact on existing licensing schemes and marketing practices. The long-standing practice of staggered release cycles in Europe, for instance, which prevents music labels from a pan-European launch of an artist, conflicts with the functionality of music services in global cyberspace. It seems likely that the expansion of online music services such as the iTMS to other markets will lead to a modification of such regional business practices.⁵¹⁷

⁵¹³ See, e.g., <http://www.delvianrecords.com/onesheets/Billboard.pdf>. See <http://news.com.com/2009-1027-1009538.html?tag=toctnav>

⁵¹⁴ See William Fisher, *Promises to Keep*, (forthcoming, Stanford University Press, 2004) at Chapter 2

⁵¹⁵ See, e.g., <http://www.futureofmusic.org/itunes2.cfm>.

⁵¹⁶ See <http://vybr8r.com/articles/focus-marketing.php> for discussion of 80/20 rule in internet sales. For Nielsen service see http://www.undercover.com.au/news/2003/20030713_internet.html. For internet sales compared to offline see <http://www.billboard.com/bb/charts/internet.jsp>

⁵¹⁷ See http://www.forbes.com/home_europe/newswire/2004/01/24/rtr1225563.html.

3. Potential Impacts on Artists

The potential impacts of online music stores such as iTunes on artists is difficult to evaluate since information about the contracts between artists and labels, respectively, and the iTMS have not been made public. Moreover, since no blanket contracts exist, one cannot assume any homogeneity in the allocation of revenues between label and artists. Still, it seems likely that the iTMS business model has not significantly changed the revenue streams between the key players—despite the efficiencies created by online distribution.⁵¹⁸

However, emerging online music stores such as iTunes might benefit at least some categories of artists in other ways: First, the iTMS and its competitors have widened their offerings through deals with independently distributed labels and free-standing imprints.⁵¹⁹ Based on such contracts between independent music labels and the iTMS, independent artists can place their music more easily in online stores rather than traditional (offline) music stores.⁵²⁰ Indeed, with distribution and manufacturing costs reduced, more artists can go directly to the iTMS to release their music rather than working with a label. Second, iTMS advanced search functions and recommendation systems might help users to find songs by lesser known artists more easily than in brick-and-mortar stores. Earlier sales data suggest that the iTMS has sold more than 95% of the songs in its catalog at least once.⁵²¹ Thus, it seems that consumers, in fact, are downloading songs from lesser known artists and encouraging new entrants.

C. Final Remarks

In 2003, consumers spent a little more than \$70 million purchasing online music, and current estimates project that spending will rise to \$169 million for 2004.⁵²² In the first half of 2003, this development was driven by Apple's iTunes Music Store, launched in April for Macintosh and in October for PC users. Due to the characteristics of the iTunes music store as sketched in the Introduction of this study, and due to Apple's iconic portable music player iPod, the iTMS has become the pacesetter in the U.S. online music marketplace. Since iTunes' launch, services such as Napster 2.0, RealNetworks and Wal-Mart online music stores have entered the market. Some of these online music pioneers—including Roxio's Napster, MusicMatch, Real Networks' Rhapsody and the iTMS—have stated they will launch services in Europe (in fact Napster is currently available in the UK) and, eventually, the Asia-Pacific region in 2004.

Despite these early successes and the promise of services such as the iTMS, it remains an open question whether the underlying business models can sustain the traditional structures of the music industry in the online environment. In any case, it is necessary to gain a deeper understanding of the complex relationships between the increasingly global laws of cyberspace aimed at governing digital media services on the one hand and business modeling processes on the other. Such an analysis will require ongoing assessments of the impacts of emerging and evolving business models on various stakeholders with potentially divergent

⁵¹⁸ See, e.g., <http://www.futureofmusic.org/itunes2.cfm>.

⁵¹⁹ See, e.g., *supra* Introduction.

⁵²⁰ See the Independent Online Distribution Alliance homepage for an overview of issues facing independent artists. http://www.iodalliance.com/guide_independents.html and http://www.iodalliance.com/guide_future.html.

⁵²¹ See "Post-Conference Report on Midem 2004," *Digital Media Wire*, at <http://www.digitalmusicforum.com/midemreport2004.htm>.

⁵²² Source: GartnerG2 2004 Online Music Forecast <http://www.gartnerq2.com/rpt/rpt-0504-0044.asp#dynamics>.

interests, including consumers, artists, (independent) labels, and the public at large. This study is intended as one contribution to such an endeavor.

Appendix: International Jurisdiction – The European Example

A. Introduction

The previous modules—focusing on the relationship between an online content provider and its users—have analyzed crucial copyright doctrines (such as fair use, first sale) and related legal issues (such as DRM and the intersection between contract and copyright law), as well as their interaction with the business modeling processes. The analysis in the modules illustrates that the substantive law, at least with regard to the key issues discussed in the context of this case study, is partly harmonized through international treaties or is similar among different jurisdictions through technological, societal, or economic convergence. However, it has also become clear that the substantive law, due to the underlying principle of territoriality of the private international law of intellectual property, differs when compared in greater detail. Such differences between legal regimes may have an impact on the design of media business models where digital content is distributed over a global communication infrastructure such as the Internet. Certainly, the question of what law applies becomes a crucial one once a conflict between a digital media provider such as the iTunes and a customer has arisen.

However, it is important to note that the question of the substantive law is only one element of the problem related to the global reach of the Internet. In this context, consider the following hypothetical. Imagine that the iTunes offers its service not only in the U.S., but also has a branch of the music store in Europe. Further, suppose that a French iTunes customer has hacked the iTunes DRM system FairPlay and posted encoded songs and albums on the bulletin board of a German-headquartered commercial service that can be accessed from anywhere in Europe. Subscribers from Italy, Greece and Sweden, on a large scale, downloaded the hacked tracks and shared them among friends and strangers on peer-to-peer networks.

From a legal perspective, both copyright holders and users are likely to ask who might be pursued for copyright infringements and for the circumvention of technical protection measures. Possibilities include the hacker, the commercial service running the bulletin board, downloaders, and file sharers. Moreover, it is crucial to analyze under which nation's law and where the suit can be filed in order to stop the infringements and prosecute lawbreakers.

The first issue is related to what is discussed as the “choice of law” problem (i.e. what is the applicable law), while the second aspect addresses the question of jurisdiction (i.e. whether a particular court has jurisdiction to adjudicate). This question of international jurisdiction is a complex issue. For instance, in the hypothetical

outlined above, would the fact that Apple offered the iTunes service to European customers solely from the U.S. without any domicile in Europe—in order to circumvent European consumer protection laws—influence the willingness of a European court to hear the case? Would it make a difference if the iTunes server were located, for example, in Austria? Would a European court be satisfied that it has jurisdiction if the iTunes online store has a branch in Amsterdam?

This Appendix addresses some of these issues and provides an initial overview of international jurisdiction in Europe.

B. Why jurisdiction matters

In the hypothetical described above, Apple performs via the iTunes cross-border transactions and interactions by electronic means through the global, borderless and potentially uncontrollable multi-jurisdictional reach of the Internet. Given that the dispute has a connection to more than one country and assuming that Apple decides to seek redress through court litigation, the dispute is considered an international rather than national dispute. This distinction makes it mandatory—according to the legal instruments in EC law governing the international legal order—to first determine which country’s courts have the competence to adjudicate (jurisdiction), and second determine which country’s law must be applied (choice-of-law).⁵²³ After this two-step inquiry in private international law, the competent court has to determine the subject matter according to the designated national law(s), which may, depending on the court’s national choice-of-law rules, be the court’s own national law, foreign law or both.⁵²⁴ As mentioned in the introduction section, this module focuses on the first step—the question of jurisdiction. This issue matters for at least three reasons:

- First, the international legal framework of jurisdictional rules is a portal for digital media enterprises such as Apple as well as for its customers to predict and foresee its rights, obligations and responsibilities when launching services on to the European market and thus to assess *ex ante* legal risks and identify necessary adjustments of the business model, terms of service, etc.
- Second, the predictability of which court has the competence to adjudicate and which law applies in the case of a dispute is likely to lower transaction costs and increase the efficiency of countermeasures in the event of copyright infringement such as outlined in the hypothetical.
- Third, *ex ante* predictability of what might happen once a dispute occurs has effects on the relationship between an online music store such as iTunes in our example and its users by contributing to consumer confidence and fostering a climate of trust between the parties. A climate of trust is a crucial factor in e-commerce.

⁵²³ It is not within the scope of this Appendix I to comment on the question which national law(s) applies (choice-of-law).

⁵²⁴ If the national law designated is not the law of the forum State, this foreign law shall as a main rule apply unless it is in conflict with the forum State’s mandatory and overriding rules or *Ordre Public*. See, e.g., ‘Study on the conditions applicable to contracts relating to intellectual property in the European Union’, final report, study commissioned by the EC (May 2002), by L.M.C.R. Guibault and P. Bernt Hugenholtz, available at <http://www.ivir.nl/staff/hughholtz.html>.

Predictability, in the context of court litigation, can be achieved by two means.

- First, providers such as Apple can make use of forum-selection clauses⁵²⁵ in order to designate by contractual means which court in Europe shall adjudicate a dispute.⁵²⁶ Apple’s freedom to include forum-selection clauses in a transaction contract, however, is restricted in an important way: If the contracting iTunes user is considered to be a “consumer” in terms of EU law, a forum selection clause can only be agreed on after the particular dispute between the parties has arisen.⁵²⁷ Thus, Apple may include a forum-selection clause in the contract only if the user is not considered as a consumer rather than a user purchasing an iTunes song from Apple inside her trade or profession.⁵²⁸
- Second, predictability can be achieved—in the European context—by exploring the European legal framework that governs questions of international jurisdiction.⁵²⁹ Jurisdiction in international civil and commercial matters within the territory of the European Union and between its Member States are (except from clearly defined matters) exhaustively regulated by three instruments:⁵³⁰
 - the Brussels Convention of 27 September 1968,⁵³¹
 - the Council regulation (EC) No 44/2001 of 22 December 2001, entered into force on 1 March 2002 (hereinafter “the Brussels Jurisdiction Regulation”),⁵³² and
 - the Lugano Convention of 16 September 1988, which regulates international jurisdiction in civil and commercial matters within the territory and between the Member States of EFTA or between the EFTA States and the Member States of the EU.⁵³³

⁵²⁵ See, e.g., § 22 of iTunes Terms of Service.

⁵²⁶ Regularly, such clauses are connected with provisions setting forth which country’s law shall apply to determine the subject matter (choice-of-law clause).

⁵²⁷ See Art. 17 the Council regulation (EC) No 44/2001 of 22 December 2001. For further reading, see, e.g., “Restrictions on Jurisdiction Clauses in Consumer Contracts within the European Union” at Oxford University Comparative Law Forum: <http://ouclf.iuscomp.org/Art.s/anoveros.shtml>.

⁵²⁸ Art. 23 and 24 the Council regulation (EC) No 44/2001 of 22 December 2001 provide such a derogation from the jurisdictional rules through forum selection clauses if certain conditions are met.

⁵²⁹ It is assumed here that most of iTunes’ users are consumers in the sense described above, and that most consumers do most likely not agree on a forum-selection clause after the dispute has arisen.

⁵³⁰ [References to Hague Conference on Private International Law, <http://www.hcch.net/e/workprog/e-comm.html>]; see, e.g., Ronald A. Brand, *Intellectual Property, Electronic Commerce and the Preliminary Draft Hague Convention on Jurisdiction and Foreign Judgments in Civil and Commercial Matters*, CASRIP Publication Series: Rethinking International Intellectual Property (2000), 35, available at <http://www.law.washington.edu/casrip/Symposium/Number6/Brand.pdf>]; Reference to

⁵³¹ Available at http://europa.eu.int/servlet/portail/RenderServlet?search=RefPub&lg=en&nb_docs=25&domain=&in_force=NO&year=1998&month=1&day=&coll=JOC&nu_jo=27&page=1.

⁵³² Available at http://europa.eu.int/servlet/portail/RenderServlet?search=RefPub&lg=en&nb_docs=25&domain=&in_force=NO&year=2001&month=1&day=&coll=JOL&nu_jo=12&page=.

⁵³³ Available at <http://www.curia.eu.int/common/reccdoc/convention/en/c-textes/lug-idx.htm>.

Except from some Articles, the three instruments⁵³⁴ are equal in wording, substantive content and editorial outline.

Against this backdrop, the following sections will discuss⁵³⁵ in greater detail the relevant provisions of the Brussels Jurisdiction Regulation⁵³⁶ and assess as to what extent this piece of regulation, in accordance with its intention,⁵³⁷ creates certainty as to jurisdiction and, thus, fosters a climate of trust in e-commerce in general and with regard to digital media transactions such as provided by the iTunes in particular.

As it will be revealed, the relevant provisions of the Regulation do not create certainty for either the courts, in their function to delimit and localize the legal relationship in the sphere of a jurisdiction and determine the attribution of competence to adjudicate the subject matter by a unitary application of the jurisdictional rules, or for the disputing parties (Apple and the defendant in our case), in their purpose to create predictability of the applicable law in international matters enabling the parties to clarify their respective rights, obligations and responsibilities.

C. Brussels Jurisdiction Regulation: Overview and Areas of Uncertainty

1. Introduction

Apple may file a suit against users on various legal grounds, many of which are regulated either uniformly in the EU or by national regulations specific to each Member State. Which jurisdictional rule applies may depend on the subject matter of the dispute. Each rule has a specific area of application and the plaintiff may choose the forum freely only to a certain extent. Consequently, Apple's freedom to sue the defendant pursuant to location is determined by the specific scheme and system of the jurisdictional regulations and each provisions' respective *ratione loci*.

⁵³⁴ Some general requirements must be fulfilled in order for the Brussels and Lugano Convention and the Jurisdiction Regulation to apply. In short, these requirements are the following: 1) territorial scope, 2) material scope (civil and commercial matters), 3) international scope, 4) personal scope, and 5) scope in time. The jurisdictional regulations in EC law are exhaustive. Consequently, once the general requirements of the Brussels Convention, the Jurisdiction Regulation and the Lugano Convention are fulfilled, their jurisdictional rules demand mandatory application. It follows that the court cannot alternatively apply other rules of jurisdiction, e.g. in domestic law.

⁵³⁵ **Note:** For the purpose of this discussion, it is assumed that Apple/iTunes will have a physical branch, an agency or the like within the European Union. If Apple would offer its service without any physical presence in Europe (i.e. exclusively from the US), the question arises as to whether the website would be considered as a branch or the like according to Brussels Jurisdiction Regulation art. 5.5 and art. 15.2. The focus is on art. 15.1c) Brussels Jurisdiction Regulation which covers a variety of consumer contracts.

⁵³⁶ The focus is on art. 15.1c) Brussels Jurisdiction Regulation which covers a variety of consumer contracts.

⁵³⁷ Especially art. 15 (see *supra* note 536) was designed to take into account the development of electronic commerce. In this context, the Economic and Social Committee stated that "[t]he question is whether promoting its services on the Internet means that a company is deliberately seeking to expand beyond its traditional marketing area. Unlimited access to the entire planet is peculiar to the Internet. It is perfectly understandable, however, that the prospect of being brought before foreign courts could deter small and medium-sized enterprises from using the Internet to promote their services. The European Union is, therefore, facing a two-fold challenge: guaranteeing the best possible legal protection for its citizens in relation to the development of electronic commerce and its risks (particularly since it generally requires an advance payment by the consumer), while at the same time not deterring European businesses, particularly SMEs, from using this channel to promote their services. This challenge relates primarily to the European judicial area, but also involves an international dimension, particularly in terms of consumer protection, as the majority of proposals on the "web" originate from businesses established in third countries", see Opinion of the Economic and Social Committee on the 'Proposal for a Council Regulation (EC) on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters', Official Journal C 117, 26/04/2000 P. 0006 – 0011.

There are several provisions relevant for determining the attribution of jurisdiction to court regarding transactions through Apple's iTunes. The jurisdiction rules laid down by the Brussels Jurisdiction Regulation are contained in Chapter II, which consists of art.s 2 to 31. The Brussels Jurisdiction Regulation lays down a system and scheme of rules governing 1) general, 2) special, 3) mandatory or 4) exclusive jurisdiction,⁵³⁸ which are relevant for the purpose of determining jurisdiction in disputes concerning unauthorized use of music downloaded from the iTunes.

Since presumably most iTunes users are consumers in the sense described above, the focus of the following remarks is on the conditions that determine which European court has competence to adjudicate a consumer dispute, and on the question of whether these conditions are satisfied when a consumer dispute arises between an iTunes customer and Apple.

The Brussels Jurisdiction Regulation⁵³⁹ Sec. 4 art.s 15 to 17 sets out mandatory jurisdictional rules in certain situations when a contract has been concluded by a consumer for a purpose regarded as being outside his trade or profession. The underlying policy⁵⁴⁰ and purpose of the special regime introduced by the provisions regarding consumer contracts is to ensure adequate protection for certain categories of buyers such as consumers. Thus, these provisions cover only a private final consumer, not engaged in trade or professional activities, who is bound by one of the three types of contract listed in art. 15.1 a), b) and c) and who is also personally a party to the action, in accordance with art. 16.⁵⁴¹ The reason for the provision is that the consumer as the contracting party is considered to be economically weaker⁵⁴² and less experienced in legal matters than his professional co-contractor. The protection afforded the consumer is to grant him the privilege of not being hauled into court in a foreign country.⁵⁴³ Art. 15 of the Brussels Jurisdiction Regulation reads as follows:

Article 15

1. In matters relating to a contract concluded by a person, the consumer, for a purpose which can be regarded as being outside his trade or profession, jurisdiction shall be determined by this Section, without prejudice to Article 4 and point 5 of Article 5, if:

⁵³⁸ Art. 2: general rule of jurisdiction - domicile of the defendant; art. 5.1: matters relating to contract; art. 5.3: matters relating to tort, delict and quasi-delict; art. 5.5: operations of a branch, agency or other establishment; art.s 15 - 17: consumer contracts; art.s 23 - 24: party autonomy. Under Section 2 art. 5.4 and 6.1 may apply. Note that each rule has a specific area of application and there is no overlapping application.

⁵³⁹ Since the Brussels Jurisdiction Regulation is fairly new of date, the European Court of Justice has not yet given any judgments on this new community legislation. The case-law pursuant to the Brussels Convention is relevant for its interpretation (cf. recital 5 and 19 of the Preamble to the Brussels Jurisdiction Regulation).

⁵⁴⁰ As art.s 15 to 17 constitute a *lex specialis* in relation to Art 5.1, and subsequently derogates from the general principles of the system laid down by the Brussels Jurisdiction Regulation in matters relating to contract, such as may be derived in particular in Art 2 and 5.1, Art 15 to 17 must be strictly limited to the objectives proper to Section 4 of the said Regulation.

⁵⁴¹ See Shearson Lehmann Hutton Inc. v TVB Treuhandgesellschaft für Vermögensverwaltung und Beteiligungen mbH, paragraphs 19, 20, 22 and 24.

⁵⁴² Many of the national laws incorporate the idea of protection for the customer, or the consumer, since he/she is the weaker party in economic terms in comparison with the seller. Certain laws are also based on considerations of economic, monetary and other policies, which are intended to control the sales to consumers.

⁵⁴³ The protective role fulfilled by those provisions implies that the application of the rules of special jurisdiction laid down to that end by the Brussels Jurisdiction Regulation should not be extended to persons for whom that protection is not justified.

- a) it is a contract for the sale of goods on instalment credit terms; or
- b) it is a contract for a loan repayable by instalments, or for any other form of credit, made to finance the sale of goods; or
- c) in all other cases, the contract has been concluded with a person who pursues commercial or professional activities in the Member State of the consumer's domicile or, by any means, directs such activities to that Member State or to several States including that Member State, and the contract falls within the scope of such activities.

2. Where a consumer enters into a contract with a party who is not domiciled in the Member State but has a branch, agency or other establishment in one of the member States, that party shall, in disputes arising out of the operation of the branch, agency or establishment, be deemed to be domiciled in that State.

3. This Section shall not apply to a contract of transport, other than a contract which, for an inclusive price, provides for a combination of travel and accommodation.

2. The Requirements of Art. 15.1 c) Brussels Jurisdiction Regulation

Art 15.1 c), as discussed below, stipulates three general and two special (but alternative) requirements that determine the jurisdiction of a court in potential disputes between Apple and iTunes end customers. In this context, it must be emphasized that no condition exists that the consumer must take the steps necessary to conclude the contract between her and the iTunes online music store in the forum state. The place where the consumer takes these steps—consider a French business man traveling outside the EU and downloading songs via his iTunes account from his hotel room—may be difficult or impossible to determine, and in any event they may be irrelevant to creating a link between the contract and the consumer's State.⁵⁴⁴ Consequently, the Brussels Jurisdiction Regulation art. 15.1c) is not concerned with the location from where the consumer, in fact, has placed an order. Rather, art. 15.1c) is concerned with where or whereto Apple pursues its commercial activities. Thus, the philosophy of the new art. 15 is that the co-contractor (Apple) creates the necessary link when directing his activities towards the consumer's State.

The five (general and special) conditions and requirements of art. 15.1 c), in short, are the following:

- Art. 15.1 c) applies only if the actions are related to a contract,
- which has been concluded between a co-contractor such as Apple and a consumer within the meaning of Art. 15.1 c),
- and where, in turn, the co-contractor pursues commercial or professional activities either
- in the Member State of the consumer's domicile, or,
- by any means, directs commercial or professional activities to the Member State of the consumer's domicile or to several states including the consumer's.

⁵⁴⁴ This removes a proved deficiency in the text of old art. 13 in the Brussels Convention, namely that the consumer could not rely on this protective jurisdiction when he had been induced, at the co-contractor's instigation, to leave his home State to conclude the contract. See Proposal for a Council Regulation (EC) on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters /^{*} COM/99/0348 final - CNS 99/0154 */ Official Journal C 376 E , 28/12/1999 P. 0001 – 0017.

Each requirement raises important and complex questions as the following analysis will illustrate.

a. What constitutes a “contract”?

It follows from the actual wording of art. 15.1c) that it is applicable only when the action relates generally to a contract⁵⁴⁵ concluded by a consumer for a purpose outside his trade or profession. For jurisdictional purposes, it is generally considered that the consumer and the professional vendor—in our case Apple with its iTunes music store—will be indubitably linked contractually once the consumer has ordered goods/services offered by the vendor. Thereby, the consumer demonstrates his acceptance of the offer—including all conditions attaching thereto—which Apple displays on the website of its online music store iTunes.

Furthermore, concordance of intention between two parties gives rise to reciprocal and interdependent obligations within the framework of a contract. Thus, in regard to the iTunes, a contract should be considered as concluded for the purposes of jurisdiction once the consumer has gone through all the steps in the iTunes to buy and download music through the website on the basis of Apple’s offer and at a price specified by Apple.

b. Who is a “consumer”?

The second general requirement is that the customer who concludes the contract must be regarded as a consumer within the meaning of art. 15.1c). Most of the customers who will purchase music through the iTunes will presumably be consumers. Thus, the following paragraphs only roughly outline the substantive content of this term.

Art. 15.1 provides itself an autonomous definition of “consumer”, stating that each person is a consumer who concludes a contract “for a purpose which can be regarded as being outside his trade or profession.”⁵⁴⁶ However, this definition, for instance, does not answer the question as to whether this person, in order to be considered as a consumer, must conclude the contract with a view and purpose to use the object of the contract outside his trade or profession, or if the person concludes the contract at a time when she is outside her trade or profession regardless of use. The answer of this question is significant from a business perspective since a contract concluded by a person who is not considered as a consumer is regulated by different provisions of the Brussels Jurisdiction Regulation (see art. 5.1). The European Court of Justice has ruled, interpreting art. 13 of the Brussels Convention, that the person—in order to be considered a consumer

⁵⁴⁵ It must be observed that art. 5.1 relates to contractual matters in general, whereas art.s 15 to 17 specifically cover various types of contracts concluded by consumers. As art. 15 to 17 constitute a *lex specialis* in relation to Art 5.1, and subsequently derogates from the general principles of the system laid down by the Brussels Jurisdiction Regulation, such as Art 2 and 5.1, it is first of all necessary to determine whether an action with its characteristics can fall within the scope of the former of those provisions. Since the concept of a contract of sale of goods and services varies from one Member State to another in accordance with the objectives pursued by their respective laws, it is necessary, in the context of the Brussels Jurisdiction Regulation, to consider that concept as being independent and therefore to give it a uniform substantive content allied to the European Community order. This will eliminate obstacles to legal relations and to the settlement of disputes in the context of intra-community relations. Therefore, it is indispensable for the coherence of the provisions to give the expression “contract” a uniform substantive content. Consequently, it should be noted at the outset that the meaning of the expression “contract” is to be interpreted autonomously, and thus assumingly the same as in the general rule of jurisdiction in contracts laid down in Art 5.1 to which a body of case-law is relevant. According to settled case-law, the concept of matters relating to tort, delict or quasi-delict within the meaning of Art 5.3 covers all actions which seek to establish the liability of a defendant and which are not related to a contract within the meaning of Art 5.1.

⁵⁴⁶ See *Bertrand v Paul Ott KG*, ECR 1978 Page 01431.

and enjoy the mandatory jurisdictional rules—must conclude the contract in the capacity of a private final consumer when buying the product for personal use.⁵⁴⁷ Consequently, only contracts that are concluded in order to satisfy an individual's own needs in terms of private consumption come under the provisions designed to protect the consumer as the party deemed to be the weaker party.

Thus, for instance, a German executive director of an international entertainment group who purchases songs via the iTunes in order to relax after a busy day would be considered as a “consumer” in the sense of art. 15.1c).

c. Who pursues commercial and professional activities?

The third general requirement is that the vendor concluding the contract with the customer is a legal or natural person who pursues commercial or professional activities within the meaning of art. 15.1c). Again, the devil is in the detail, because art. 15.1c) doesn't make it clear whether “commercial or professional activities” refers to any such activity, including the commercial operation of a website pursuing, for example, the sale of music, or whether it refers to activities with certain characteristic properties. This question is discussed in the next paragraph.

d. What does “pursue ... in the Member State ...” actually mean?

The remarks so far have made it clear that the so-called general requirements of Art. 15.1 c) Brussels Jurisdiction Regulation provoke interesting questions. However, the following problems related to two special, although alternative requirements, are even more important in the context of online digital media services such as the iTunes. Among other issues, we will discuss in the next paragraphs whether it is required for the application Art. 15.1c) that Apple has a physical branch or agency in Europe, or that at least the server is located within the EU.

The first special requirement set forth in the first part of the sentence of Art 15.1c) is that the contract has been concluded with a person who pursues commercial or professional activities *in* the Member State of the consumer's domicile.⁵⁴⁸ Immediately, the question arises of what is meant by the term “pursue”, and what by the phrase “in the Member State of the customer's domicile”.

⁵⁴⁷ *Bertrand v Paul Ott KG*, ECR 1978 Page 01431, paragraph 21. See also *Shearson Lehmann Hutton Inc. v TVB Treuhandgesellschaft für Vermögensverwaltung und Beteiligungen mbH*, Case C-89/91, ECR 1993 Page I-00139, paragraph 22. This interpretation has two important consequences:

- In the light of art. 13 of the Brussels Convention, a plaintiff who is acting in pursuance of his trade or professional activity may not enjoy the benefit of the rules of special jurisdiction laid down by the Convention concerning consumer contracts, see *Shearson Lehmann Hutton Inc. v TVB Treuhandgesellschaft für Vermögensverwaltung und Beteiligungen mbH*, Case C-89/91, ECR 1993 Page I-00139.
- In order to determine whether a person has the capacity of a consumer, reference must be made to the position of the person concerned in a particular contract, looking at the nature and aim of the contract. Thus, the same person may be regarded as a consumer in relation to certain transactions and as an economic operator in relation to others. *Francesco Benincasa v Dentalkit Srl.*, Case C-269/95, ECR 1997 Page I-03767, paragraph 16.

⁵⁴⁸ This condition was designed to ensure that there are close connections between the contract in issue and the State in which the consumer is domiciled.

- Art 15.1c) doesn't make it clear whether "pursue" means any commercial or professional activity, or commercial or professional activities with certain quantitative features. On one hand, the verb "pursue" is wide in its semantic reference, and thus could be understood in accordance with the first alternative. On the other hand, the noun "activities" is formed in plural showing that a certain quantitative activity must be present, or at least more than one activity, in order for Art 15.1c) to apply. However, according to the European Court of Justice's case law in the context of art. 13 of the Brussels Convention,⁵⁴⁹ this condition is fulfilled when a consumer has been addressed and contacted at his home by one or more letter(s) sent by a professional vendor for the purpose of bringing about the placement of an order for goods offered under the conditions determined by that vendor.⁵⁵⁰ It follows from this precedent that the expression "pursue" within the meaning of Art 15.1c) quantitatively may refer to one activity. Moreover, the preparatory works illustrates that it was intended to cover all forms of commercial and professional activities carried out in the Member State in which the consumer is domiciled, regardless of market channel. Since Apple maintains a continuous commercial activity through the iTunes online music store's website, it seems clear and indisputable that Apple pursues commercial activities within the meaning of art. 15. 1c) by offering music for sale via the iTMS or by using other distribution channels.⁵⁵¹
- As mentioned, art. 15.1c) fails to answer the question of what the expression "*in* the Member State of the customer's domicile" exactly means. Is it, for instance, required that Apple as a legal entity has to be physically present in the Member State either by a branch or agency, or does the application of art. 15.1c) require that Apple provides its Internet sales on a server physically placed in the Member State? Or, in contrast, is it sufficient that Apple's iTMS website is accessible from the Member State? A comparison with the second alternative requirement set forth in Art 15.1c)⁵⁵² favors the interpretation according to which physical presence is required under this alternative requirement as formulated in the first sentence of Art 15.1c). Thus, the second special but alternative condition of art. 15.1c) becomes crucial with regard to the applicability of this provision.

e. What does it mean to say "by any means, directs... to"?

The second special, alternative requirement set forth in the second part of the sentence of art. 15.1c) is that the contract has been concluded with a vendor who, "by any means," "directs" commercial or professional activities to that Member State of the consumer's domicile or to several States including that Member State, and that the contract falls within the scope of such activities.

⁵⁴⁹ See Rudolf Gabriel, Case C-96/00, ECR 2002 Page I-06367, paragraph 53.

⁵⁵⁰ This precedent gives no definite answer as to the quality and specific content of the commercial and professional activity.

⁵⁵¹ It is noteworthy that it doesn't make a difference, for instance, whether the songs are offered generally by the press, radio, television, cinema, Internet or any other medium, or addressed directly, e.g. by means of catalogues sent specifically to that Member State, as well as commercial offers made to the consumer in person, either by a physical letter or an e-mail, an agent or door-to-door salesman etc.

⁵⁵² Art. 15.1 c) second sentence: "... the contract has been concluded with a person who by any means, directs commercial or professional activities to the Member State of the consumer's domicile or to several States including the Member State of the consumer's domicile, and the contract falls within the scope of such activities".

It is relatively simple to answer the question whether the means by which the activities are directed are limited, because the provision itself indicates, as discussed above, that all forms of directions shall be covered. Thus, the use of the Internet as a distribution channel in the case of Apple's iTunes falls under art. 15.1 c) second sentence. More troublesome is the interpretation of the term "directed to." The question up for debate is whether there is any limitation by subject, quantity or quality. While the provision itself doesn't provide guideline, the preparatory work of the European Parliament⁵⁵³ indicates that only a "substantial" direction triggers the protective consumer jurisdiction.⁵⁵⁴

Against this backdrop, one might assume that all of Apple's commercial activities related to digital music that can be considered as "directed" are relevant, but insufficient to trigger art. 15.1 c) second sentence unless they are substantially directed. Thus, the complicated question is up for discussion what the substantive contents of "directs" are. Based on preparatory works both by the EU-Commission and the European Parliament, the following keywords provide some guidance:

- The customer's mere knowledge of an accessible website itself is insufficient to ground jurisdiction.⁵⁵⁵ Thus, an Italian college student and Internet user who knows that the iTunes exists is not, due to her mere knowledge, automatically protected by art. 15.1 c) second sentence.
- Furthermore, the mere entry into a contract between a consumer and the vendor is, in itself, insufficient to ground jurisdiction. However, the existence of a contract might be seen as an (rebuttable) indicator that vendors' activities are directed towards a Member State.⁵⁵⁶

Thus, something more than actual knowledge of an accessible website, and something in addition to the mere entry into a contract, grounds jurisdiction. The puzzling question, however, is what exactly meets the "substantive direction" criterion. The preparatory reports are unclear. The following criteria might be considered in this context:

- An important question is whether it is sufficient to ground jurisdiction when a person factually accesses the iTunes website without any other actions, or whether the consumer must engage in additional activities such as the conclusion of a contract to download music. The preparatory reports are ambiguous on this point, but, by and large, suggest that the user, in order to enjoy the protection of Art 15.1c), must do something more than accessing the iTunes website (i.e. she must engage in

⁵⁵³ See Amendment 36 EP opinion 1st reading Proposal for a Council regulation on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (COM(1999) 348 - C5-0169/1999 - 1999/0154(CNS)) C 146 (2001) pages 0094 – 0101.

⁵⁵⁴ However, the preparatory work of the EU-Commission may lead to the conclusion to the contrary that there exists no requirement as to the substantiality in direction of the commercial or professional activity.

⁵⁵⁵ The EU-Commission, for instance, stated in its initial proposal that "[t]he fact that a consumer simply had knowledge of a service or possibility of buying goods via a passive website accessible in his country of domicile will not trigger the protective jurisdiction". See Proposal for a Council Regulation (EC) on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters /* COM/99/0348 final - CNS 99/0154 */ Official Journal C 376 E , 28/12/1999 P. 0001 – 0017.

⁵⁵⁶ See, e.g., Amended proposal for a Council Regulation on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (presented by the Commission pursuant to art. 250 (2) of the EC-Treaty)/* COM/2000/0689 final - CNS 99/0154 */ Official Journal C 062 E , 27/02/2001 P. 0243 – 0275, paragraph 2.2.2.

contractual activities such as the conclusion of a contract to download songs from the iTunes).⁵⁵⁷ This interpretation is supported by the fact that Art 15.1c), as discussed above, does not require that the contract has been concluded from the State of the consumer's domicile. Thus, a consumer, in practice, can conclude the contract from anywhere and still enjoy the protection of Art 15.1c), given that the commercial or professional activity has been directed to the Member State of her domicile or to several States including that Member State. This interpretation has been supported by several scholars because otherwise the consumer dispute could be attributed to courts in all the Member States due to the fact that the website can be accessed from anywhere.

- Another debate concerns the multi-layered question of the effects of an online media provider specifying that its service is not available to customers in specified Member States (negative definition of the Member States by ring-fencing the provider's trading operation against transaction with consumers domiciled in particular Member States), or, by contrast, stating that it is only available to customers in a specified geographic area (positive definition by which the digital media provider directs its trading operation towards transaction with consumers domiciled in particular Member States). A natural understanding of the wording "directs" suggests that the Brussels Jurisdiction Regulation has taken the view that the determinative criterion for allocation of jurisdiction to court is the vendor's direction of commercial activities towards a Member State and not the vendor's activities of avoiding such direction. However, the European Parliament proposed, "[i]n determining whether a trader has directed his activities in such a way, [that] the courts shall have regard to all the circumstances of the case, including any attempts by the trader to ring-fence his trading operation against transactions with consumers domiciled in particular Member States".⁵⁵⁸ Similar arguments were set forth by the Rapporteur for the Committee on Legal Affairs and the Internal Market⁵⁵⁹ The EU-Commission, in contrast, rejected this view in its' amended proposal stating that the "Parliament proposes a new paragraph to define the concept of activities directed towards one or more Member States, and takes as one of its assessment criteria for the existence of such an activity any attempt by an operator to confine its business to transactions with consumers domiciled in certain Member States. The Commission cannot accept this amendment, which runs counter to the philosophy of the provision."⁵⁶⁰

However, the question of whether ring-fencing should be determinative has not yet been definitively answered. Thus, it remains an open question whether a statement in Apple's Terms of Service or on the iTunes website that specifies, for instance, that users in Germany are not allowed to purchase

⁵⁵⁷ See, e.g., Proposal for a Council Regulation (EC) on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters /* COM/99/0348 final - CNS 99/0154 */ Official Journal C 376 E , 28/12/1999 P. 0001 – 0017.

⁵⁵⁸ EP opinion 1st reading Proposal for a Council regulation on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (COM(1999) 348 - C5-0169/1999 - 1999/0154(CNS)) C 146 (2001) pages 0094 - 0101

⁵⁵⁹ Report on the proposal for a Council regulation on jurisdiction and the recognition and enforcement of judgements in civil and commercial matters, COM(1999) 348 – C5-0169/1999 – 1999/0154(CNS)), Committee on Legal Affairs and the Internal Market Rapporteur: Diana Wallis, p. 35.

⁵⁶⁰ Amended proposal for a Council Regulation on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (presented by the Commission pursuant to art. 250 (2) of the EC-Treaty)/* COM/2000/0689 final - CNS 99/0154 */ Official Journal C 062 E , 27/02/2001 P. 0243 – 0275, paragraph 2.2.2.

music from the iTunes would have an effect on the applicability of art. 15.1.c). In any case, online media services such as the iTunes that seek to expand into the European market are well advised both to clarify as well as emphasize in a transparent way what commercial and professional activities are country-specific and directed to (which) Member States.

The previous paragraphs have made it clear that several factors are taken into consideration in order to determine whether the “by any means, directs ... to” criterion is met or not. As mentioned, both online as well as offline activities are relevant, although this section has focused on e-commerce activities carried out by electronic means such as the iTunes website. However, Apple must consider all its country-specific elements, whether related to its e-commerce operations on the web or any other activity such as TV, radio, etc. Relevant country-specific factors include:

- The concrete Internet services employed for interaction in addition to other communication- and information services. Problems with country specific indicia such as the distinction relating to .com, .org, etc vs .no, .de, etc.
- The technological features employed by the defendant to conduct country-specific transmissions that either allows or rejects transmissions in order to aim at or avoid specific jurisdictions (software filters and other technological screening devices).
- The employment of user identification, typically based on IP address identification, self-identification, and offline identification (such as the use of geographically limited credit cards).
- Legal notices that permit or prohibit transmissions (valid choice of forum clauses, invalid choice of forum clauses, clauses not accepted by the receiver, self statements/declarations from the receiver/user).
- The character of the content (film, photo, music, text), presentation, language⁵⁶¹, advertising, shipment, monetary currency, etc.

D. Conclusion

The analysis in this Appendix illustrates that an online music service such as the iTunes will face both more complex and more uncertain jurisdictional issues in Europe than in the U.S. Because of this complexity and uncertainty, litigation is likely to be more protracted and costly than similar disputes within the U.S. Thus, an expansion of an U.S. based online music service into the European market will likely result in greater costs than the U.S. counterpart.

⁵⁶¹ See American Bar Association, *Achieving legal and Business Order in Cyberspace: A Report on Global Jurisdiction Issues Created By the Internet*.

Additionally, because of the jurisdictional uncertainties in Europe, online music stores' suppliers (copyright holders) might be reticent to grant the licenses that are necessary to expand. For example, copyright holders may prevent services from expanding to certain regions of the world due to concerns about the legal protection their copyrights will receive.

Finally, the uncertainty surrounding the (lack of) ability to disclaim the "direction of activities" towards certain markets means that businesses such as the iTunes may need to focus on technological measures to limit jurisdiction. The effectiveness of such technologies, and thus the ability of Apple, in our example, to limit its jurisdictional risks, remains to be seen.

It should come as no surprise that expansion of the iTunes or comparable business models into Europe poses additional risks due to jurisdictional issues to the company offering the service. These risks to the company offering the service may correspond to protections for consumers of the service. Some risks to the company, such as limiting the "direction of activities," may be able to be limited through technological means. With regard to the particular online music store discussed in this case study, however, none of these issues and concerns matter unless Apple believes that expanding the iTunes to new markets will help drive iPod sales just as the iTunes has in the U.S. If it is unlikely that a European iTunes service would generate additional iPod revenue, expansion into new markets may be cost prohibitive.