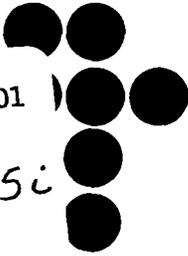


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# COMMUNICATIONS FORUM

## SOFTWARE DISSEMINATION: FIRST SALE AND SHRINK- WRAP LICENSING

David Waterman,  
Annenberg School of Communications, USC  
Robert Bigelow,  
Bigelow & Saltzberg  
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November 21, 1985

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Massachusetts Institute of Technology  
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## Software Dissemination : First Sale & Shrink-wrap Licensing

Robert Bigelow - Bigelow & Saltzberg

Mr. Bigelow began by defining copyright broadly - the preservation to authors (for a limited time) the right to reap the benefits of their labors. The 1909 copyright did not foresee the rights of "authors" related to sound recordings and computer software. However, over the years amendments have been made to that Act, and a revised Act in 1976 and some later amendments take account of these developments.

The copyright owner has a number of exclusive rights, one example of which is the sole right to reproduce the copyrighted work. The law says that the copyright owner has the exclusive right to distribute copies of the copyrighted work to the public by sale, rental, lease or lending. The Act also allows the owner of a particular copy to sell or otherwise dispose of that copy without the copyright owner's specific authority - this is known as the First Sale Doctrine (FSD). The FSD does not apply if the possessor of that copy doesn't own it. He said that at this point there are some legally unclear transfers (e.g. a judicially ordered sale), the legal limits and validities of which are debatable. The FSD does not apply to any person who has acquired possession of the copy from the copyright owner by rental, lease, etc. without acquiring ownership.

Mr. Bigelow then described the "record rental" amendment (1984) to the FSD which relates to the record industry and prohibits the owner of a sound recording from renting, leasing, or lending without the consent of the copyright owner. Non-profit organizations like public libraries are exempted from this particular law. The law is effective only for those who acquired ownership after it was passed and, interestingly, it includes a 'sunset' provision. However, this amendment does not cover movies, video tapes, video games and software. The record rental problem relating to computer software was recognized by Senator Mathias who introduced a Bill (about a year ago) to cover computer software in a similar manner.

He then described the "shrink-wrap" license where the buyer (or acquirer) of the computer program will see the license document, read it, and thereby be bound by it. This is like a parking garage ticket; court decisions go both ways on the validity of these. Companies concerned about the validity of "shrink-wrap" licenses have taken a few additional steps in an attempt to consolidate their position. One method is to get the customer to register the software by signing a kind of license in return for future updates of the program. A couple of states have enacted statutes to validate licenses, provided they are prominently displayed and advise the user that if the package is opened, he is bound by the license. In closing, Bigelow

described the case of the California software developer who has sued a Canadian company in Louisiana to take advantage of this state's legislation.

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David Waterman - Annenberg School of Communication, USC

Prof. Waterman in his introduction stated that his experience related to the First Sale Doctrine (FSD) was with reference to the video market. He was of the opinion that in the case of video, audio and computer software, there was a need for distributors to effectively control the rental and sale markets separately. He stated that FSD did not allow the distributors to do that and everything that had been tried to get around it just didn't work. He recommended a revision of the FSD.

Waterman said that all three media did have at least some rental and sale market demand. However, there was a great difference in the nature of demand. In the audio market people usually do not want to borrow or rent. They wish rather to own. Similarly in the computer market there is hardly any demand for rental (short period). A user would want rather to possess the software (i.e. long term). A few retailers have offered computer software for rent for people to try out. There is concern among software distributors regarding this kind of rental as they fear it will bloom into a convenient rental and copying operation. However, this situation has not become important to date. Unlike the computer and audio markets, the video market is different in that it has both short-term and long-term demands. In fact the market for short-term use (rental) is greater than the long-term market. Both markets are profitable and as such are desired by distributors. Since there is a long-term desire to possess videos, there is a serious problem regarding the whole issue of video "copying".

Prof. Waterman then discussed the economic factors and the resultant distribution pattern adopted by distributors in releasing movies for public viewing: first, theater, followed by pay TV, video cassette rental, etc. and finally broadcast TV. The pricing mechanism is the deciding factor for the order of release. He described this as a kind of 'price tiering', where the "high value" customers pay a high price for attending the theater, followed by those less interested who are willing to wait awhile in order to pay less. He said that sale of video cassettes is a gold mine for distributors because they can reach extremely high value viewers who like the movie so much that they actually want to own it. Video rentals reach less high value customers. He said that if the FSD is eliminated, videos would probably move higher in the sequence of release, accompanied by a reduction in sale price and an increase in rental prices. He further argued that getting rid of the FSD would not make any movie viewer less well off except those who had purchased a VCR on the expectation that rental prices were going to remain very

low. He compared 'price tiering' to price discrimination in a concert hall and said that having the FSD is like saying that the symphony manager cannot tier prices as he wishes, charging highest prices for the Founders Circles, lower for the Orchestra, etc.

From the point of view of computer software, Prof. Waterman said that the long-range threat was the possibility of a large scale rental market arising for it. In this type of rental market the software would be rented in order to illegally copy it otherwise the FSD will become something of a "non-issue" for the computer market. Waterman was of the opinion that the whole problem in all three media can be eliminated by removing the FSD, with minimal damage to any consumers and a net benefit overall.

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Robert McEwen, S.J. - Boston College

Prof. McEwen approached the problem from the point of view of the consumer (organizations and individuals) who joined in the royalty and first sale fights with the manufacturers and sellers to oppose the attempt by movie and recording studios to levy royalty taxes on equipment and their attempt to abolish the FSD. He stated that there is a very close relationship between the rental and sale prices which is the point he tried to make before the Senate and House Committees. He said that the only thing that prevented the consumer from total exploitation, at the hands of the producers in this case, is the FSD which made control of the rental market virtually impossible.

Recounting his first experience in a similar area, Prof. McEwen related an incident, several years ago when manufacturers of mainly drug and electrical products vainly supported what they called 'Fair Trade Laws', which in effect was another name for resale price maintenance. Comparing this incident he said that computer software could be viewed as a manufacturer's effort to control the price in terms of distribution from beginning to end. It has been traditional and in the consumer's interest to oppose any effort of a producer or a manufacturer to exercise such complete control, especially if it is by manipulating the law.

Prof. McEwen disagreed with Waterman and said that it was easier to copy computer software than to copy video or audio software as it could be done with a single computer, whereas audio and video copying required another machine. He said that he did not defend the idea of any type of piracy - stealing, duplicating and selling copyright material, but that this could be another area where the intrusion of the law could do far more damage than good. Further, from a legal point of view, he expressed doubt that the copyright law is the right vehicle to protect computer software. He added that it was not even clear

whether the computer disc was saleable. McEwen suggested that a kind of "scrambling" may be the most socially desirable way to counter the copying problem. In all this there is a danger of interfering in the information distribution and dissemination mechanism which could be harmful to the public good. Referring to the recording and movie industries he stated that the loss of sales claimed by them is based on extremely questionable assumptions.

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### Speakers' Comments and Responses to Questions

Mr. Bigelow commented that rental is still legal whether or not the FSD exists. He also stated that the biggest problem in getting rid of 'copyright' is that it could discourage the development of software because copyright allows those who develop software to get a reasonable return for their efforts. He also pointed out that the American and English copyright laws varied from the continental European copyright law, where the author has the moral right to withdraw a publication even if the property has been sold.

Prof. Waterman suggested that the best route is to solve the problem from a technological point of view - producing software that cannot be copied. He expressed doubts as to whether the FSD currently had any effect on the computer software at all. Referring to McEwen's remarks about the movie industry, he said that the producer has to control the product in order to maximise production and creativity.

Prof. McEwen, in response to Waterman's point of view, stated that the movie studio's effort to control products in the past can come into the computer software field as well. This kind of dominance has been deemed morally, legally and economically undesirable by the American system.

In response to a question, Bigelow then described what was meant by 'shrink-wrap sale and license'. On being quizzed further as to whether legally and practically a transaction could be enforced as a license and not a sale, Bigelow responded saying that it was possible only if there was a clear agreement signed between the producer and the user. However, in the context of personal computers and mass marketing, he said that it was not practically possible to complete this kind of agreement for each transaction. He further said that a consumer signing the card enclosed with the software only proves that the package label has been read and may not amount to an agreement. In relation to the movie industry, Waterman said that there had been a couple of instances where the use of contract law was able to bind only the first dealer and did not have any hold further down the line. Also, video dealers threatened not to participate since there was so much paper work involved. As a result this procedure was

discontinued by video distributors.

A question was raised regarding the pirating problem of game and business software, to which McEwen responded saying that the video and audio pirating problem was not significant though it was very real in the area of computer software. He said it was possible to police the business market to some degree but it was difficult with relation to copying by home owners. He suggested that scrambling could be a solution. Waterman stated that the financial effect of piracy on distribution was somewhat over emphasized as distributors study the market to determine the extent of the 'grapevine' of copying and then raise the product price to compensate.

Finally, a member of the audience claimed that the speakers had missed the point. Though much of the discussion centered on the issues of contract and copyright, the main problem according to him was greed on the part of the producer (resulting in excessive pricing) and sloth on the part of the consumer (requiring expensive, very high quality products, instead of cheaper, usable though inferior products). Waterman disagreed with this comment.

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