

Selling used software

The implications of *UsedSoft GmbH v Oracle International Corp.*

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Introduction

The Court of Justice of the European Union handed down a landmark decision on 3 July 2012 that legitimises the sale of used software licenses.¹ The Court held that the 'sale' of an existing software license would not infringe copyright where the license is perpetual; the license is sold as a whole; and the original purchaser disables their copy of the software upon resale.

While the implications of the decision remain unclear, software developers may need to review their licensing models and the technical and contractual provisions employed to protect their software if they want to minimise their exposure to this judgment.

The Facts

Oracle is a California-based software developer that develops and distributes 'client-server-software' computer programs. Most of Oracle's software is distributed to customers via download from Oracle's website. Customers enter into a software license agreement which grants them the right to store a copy of the program permanently on their server and allows access for up to 25 users from their individual work stations.

The license agreement grants customers a non-transferable right for an unlimited period. In addition, by entering into a maintenance agreement, customers can also download updated versions of the software (updates) and programs for correcting faults (patches).

UsedSoft is a German company which markets used software licenses, including used licenses acquired from Oracle customers. In October 2005, UsedSoft promoted an 'Oracle Special Offer' in which it advertised 'already used' licenses for Oracle software. In doing so,

UsedSoft stated that all advertised licenses were 'current' in the sense that the maintenance agreement entered into by the first acquirer and Oracle was still in force. By purchasing a used license, customers could download software directly from Oracle's website. Alternatively, customers who already had Oracle software could acquire further licences (or parts thereof) for additional users.

Oracle sought and obtained an injunction from the Munich I Regional Court preventing UsedSoft's sales. Following the dismissal of an appeal against the injunction, UsedSoft lodged a further appeal to the German Federal Court of Justice.

The Federal Court decided to stay the proceedings. It referred the case to the Court of Justice of the European Union (**Court**) for an interpretation of Directive 2009/24/EC of the European Parliament and of the Council of 23 April 2009 on the legal protection of computer programs (**Software Directive**) as it applied to UsedSoft's conduct.²

The Issues

The Federal Court sought a preliminary ruling from the Court regarding the interpretation of Articles 4(2) and 5(1) of the Software Directive. Relevantly, Article 4(2) provides that:

'the first sale...of a copy of a computer program by the rightholder or with his consent shall exhaust the distribution right...of that copy'.³

In turn, Article 5(1) provides that the acts referred to in Article 4(1) of the Software Directive – namely the reproduction, alteration, and distribution of a computer program:

‘shall not require authorisation by the rightholder where they are necessary for the use of the computer program by the lawful acquirer in accordance with its intended purpose’.⁴

More specifically, the Federal Court sought responses to three questions concerning the scope of rights conferred by Articles 4(2) and 5(1):

- Is an acquirer of a used software license a ‘lawful acquirer’ within the meaning of Article 5(1)?
- If yes, does downloading a copy of a computer program with the rightholder’s consent exhaust the rightholder’s right of distribution within the meaning of Article 4(2)?
- If yes, can an acquirer of a used software license enjoy the right of reproduction contained in Article 5(1) if the original acquirer has erased their copy of the computer program or no longer uses it?

The Decision

Does downloading a copy of a computer program with the rightholder’s consent exhaust the right of distribution?

The Court considered the second question first. It interpreted Article 4(2) to mean that the right of distribution of a copy of a computer program is exhausted if the rightholder authorises – even free of charge – the downloading of that copy from the internet while also granting a right to use that copy for an unlimited period in return for payment of a fee.

A license agreement can amount to a ‘first sale’

The Court first considered the meaning of Article 4(2) and asked whether the contractual relationship between rightholder and first acquirer, pursuant to which the downloading of a copy of a computer program takes place, may be regarded as a ‘first sale...of a copy of a program’.

As ‘sale’ is not defined in the Software Directive, the Court adopted its ordinary meaning, namely ‘an agreement by which a person, in return for payment, transfers to another person his rights of ownership in an item of tangible or intangible property’.⁵ It reached this conclusion by considering the Software Directive’s purpose: to achieve the uniform application of European Union law across all Member States.⁶ Accordingly, the Court held that a commercial transaction giving rise to the exhaustion of the right of distribution involves a transfer of the right of ownership in that copy.

Oracle contended that it does not *sell* copies of computer programs; it makes them available for free download upon a customer’s entry into a license agreement. This, it was submitted, does not involve a transfer of the right of ownership.

The Court rejected this argument. It held that downloading a copy of a computer program and entering

into a license agreement for that copy form an ‘indivisible whole’, as ‘downloading a copy of a computer program is pointless if the copy cannot be used by its possessor’.⁷ It then found that these actions, together with the customer’s right to use the program for an unlimited period in return for a fee, amount to a transfer of the right of ownership and constitutes a ‘first sale...of a copy of a program’.

No difference between tangible and intangible modes of delivery

Alternatively, Oracle, various governments and the European Commission submitted that the exhaustion of the right of distribution relates only to tangible property and does not extend to copies of computer programs downloaded from the internet.

This argument was rejected. The Court held that the language of Article 4(2) does not appear to limit the exhaustion of the right of distribution of copies of computer programs to those on material mediums such as CD-ROM. On the contrary, by referring without further specification to the ‘sale...of a copy of a program’, the provision makes no distinction between tangible and intangible copies. Furthermore, recital 7 of the preamble to the Software Directive specifies that the computer programs the Software Directive aims to protect ‘include programs in any form’.⁸ The Court considered these provisions to be indicative of the legislature’s intention to treat tangible and intangible copies of computer programs equally.

No contract for services exemption

The European Commission argued that pursuant to recital 29 in the preamble to 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,⁹ ‘[t]he question of exhaustion does not arise in the case of services and on-line services’.¹⁰ Accordingly, it was submitted that downloading a copy of a computer program and entering into a license agreement for that copy for an unlimited period in return for a fee amounts to a contract for services, not a transfer of the right of ownership of that copy.

This argument was rejected. While not specifically addressing why the circumstances in question did not amount to a contract for services, the Court noted that the principle of exhaustion limits restrictions on distribution only insofar as is necessary to protect the subject matter of the intellectual property concerned. It posited that if a restriction on further distribution were placed on the resale of copies of programs downloaded from the internet, the rightholder would be able to demand further remuneration on each subsequent sale, even though the first sale had already enabled them to obtain appropriate remuneration. Such a restriction was held to go beyond what was necessary to protect the relevant intellectual property.

Exhaustion extends to updates and patches

Oracle argued that a maintenance agreement entered into by the first acquirer and the rightholder prevents the exhaustion of the right of distribution. It submitted that as UsedSoft was promoting 'current' licenses, the copy of the computer program downloaded by a subsequent acquirer would not correspond to the copy originally downloaded. This is because it has been patched and/or updated under a maintenance agreement. In other words, the right of distribution could not be exhausted as the software was an entirely different product.

The Court rejected this argument. Although the exhaustion of the right of distribution does not apply to contracts for services such as maintenance agreements, the entry into a maintenance agreement when downloading a copy of a program in return for payment of a fee has the effect that any patches and/or updates form an integral part of the copy. This is so even if the maintenance agreement lapses. As such, the Court held that the exhaustion of the distribution right extends to the copy of the program as corrected and updated by the rightholder.

Limitations on exhaustion

The Court qualified its judgment in two important respects. It held that if the license acquired by the first acquirer relates to a greater number of users than is actually needed, that acquirer is not authorised to divide the license and resell only part of it.

The Court also held that a first acquirer who resells a copy of a computer program to a subsequent acquirer must make their copy unusable at the time of resale. By continuing to use it, the first acquirer would infringe the rightholder's exclusive right of reproduction.

Oracle opposed this finding on the basis that determining whether a copy has been made unusable may be difficult. The Court contended that a rightholder who distributes copies of a computer program on a material medium is faced with the same problem. As such, the Court stated that it is permissible for the rightholder to use technical protection measures to regulate such conduct.

Is the acquirer of a used software license a 'lawful acquirer' and can they benefit from the right to reproduce the computer program?

The first and third questions were considered together towards the end of the judgment. The Court held that an acquirer of a used software license (as well as any subsequent acquirer) is able to rely on the exhaustion of the right of distribution and is therefore a 'lawful acquirer' within the meaning of Article 5(1). Accordingly, they are also able to benefit from the right of reproduction contained within that provision.

Lawful acquirer

The Court considered that as a rightholder cannot object to the resale of a copy of a computer program for which that rightholder's right of distribution is exhausted, the acquirer must be treated as a 'lawful acquirer' within the meaning of Article 5(1).

Entitlement to a right of reproduction

The Court held that as an acquirer of a used software license is a 'lawful acquirer', they are entitled to download onto their computer the copy purchased from the first acquirer. Moreover, this act is a reproduction of the computer program necessary to enable the use of the program in accordance with its intended purpose within the meaning of Article 5(1). In support of this conclusion, the Court referred to recital 13 in the preamble to the Software Directive, which provides that 'the acts of loading and running necessary for the use of a copy of a program which has been lawfully acquired...may not be prohibited by contract'.¹¹

Implications

The Court's decision permits the sale of used software licenses if:

- the license is perpetual;
- the license is sold as a whole; and
- the first acquirer disables their own copy of the software upon resale.

Furthermore, contractual terms prohibiting transfer of a software license cannot be used to prevent such resale.

The decision goes against the opinion of the Court's most senior advocate,¹² and has shocked the information and communications technology industry. Like Oracle, most software developers 'sell' software by granting perpetual licenses in return for a fee. Not only does the decision significantly undermine this business model, it creates a precedent which could rapidly open up a market for second-hand software.

Unanswered questions

Several important questions remain unanswered. While the decision prohibits a rightholder from preventing the sale of used licenses in its software, it does not clarify whether rightholders are also required to positively enable such transactions by removing embedded technical protection measures that prevent resale. If not, rightholders could employ technical protection measures to make it virtually impossible for the software to be resold, for example, by binding the software to the first acquirer's work station or preventing the software from running without a connection to the rightholder's server.

In addition, because the Software Directive defines 'computer program' to include 'programs in any form',¹³ the decision could be interpreted as extending to other digital products, including games, music, videos and ebooks. Indeed, ebooks are frequently 'sold' via a license agreement that prohibits resale. Similarly, license agreements generally restrict the transfer of digital music to devices other than those owned by the first acquirer.

Finally, while the decision indicates that the presence of a maintenance agreement does not affect the exhaustion of the right of distribution, it does not clarify whether a rightholder would be obliged to provide ongoing

maintenance to a subsequent acquirer. If not, the inability to obtain updates and patches could significantly impact subsequent acquirers in a commercial environment.

Business impact

In practice, the impact of the decision may not be as far-reaching as it initially appears. Importantly, the Court only expressly addressed *perpetual* licenses and therefore licenses granted for a limited period may not result in the exhaustion of the right of distribution. This is because the grant of such right may not amount to a 'sale' within the meaning of Article 4(2). As such, rightholders may simply move to alternative licensing models – such as temporary license rights or recurring annual license fees – in order to circumvent the operation of the decision.

In the alternative, the Court acknowledged that the decision did not apply to contracts for 'services and on-line services'. Rightholders could therefore move towards Software as a Service (SaaS) and cloud-based models in which the licensee is not provided with a copy of the software, but is instead granted online access.

In the meantime, rightholders will need to pay particular attention to technical protection measures to ensure that the first acquirer does not continue to use software once it has been resold. Buyers of used software must also ensure that resellers have made their copy unusable upon resale. Otherwise, unauthorised reproduction may be the only real consequence of the decision.

Finally, it is important to recall that the decision arose due to a request for a preliminary ruling submitted by the

Federal Court of Justice. As such, the case must now return to that Court to be ultimately decided. Under European Union Law, the Federal Court of Justice will be required to dispose of the case in accordance with the Court's decision.

¹ *UsedSoft GmbH v Oracle International Corp.* (Court of Justice of the European Union, C-128/11, 3 July 2012) ('UsedSoft').

² *Council Directive 2009/24/EC of 23 April 2009 on the Legal Protection of Computer Programs* [2009] OJ L111/16 ('Software Directive').

³ *Ibid* art 4(2).

⁴ *Ibid* art 5(1).

⁵ *UsedSoft* (Court of Justice of the European Union, C-128/11, 3 July 2012), [42].

⁶ Software Directive, [2009] OJ L111/16, recitals 4 and 5.

⁷ *UsedSoft* (Court of Justice of the European Union, C-128/11, 3 July 2012), [44].

⁸ Software Directive, [2009] OJ L111/16, recital 7.

⁹ *Council Directive 2001/29/EC on the Harmonisation of Certain Aspects of Copyright and Related Rights in the Information Society* [2001] OJ L167/10, recital 29.

¹⁰ *UsedSoft* (Court of Justice of the European Union, C-128/11, 3 July 2012), [54].

¹¹ Software Directive, [2009] OJ L111/16, recital 13.

¹² *Axel W. Bierbach, administrator of UsedSoft GmbH v Oracle International Corp.* (Opinion of Advocate General Bot, C-128/11, 24 April 2012).

¹³ Software Directive, [2009] OJ L111/16, recital 13.