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The Second Circuit Shuts Down Resale of Digital Music Files in *Capitol Records, LLC v. ReDigi, Inc.*

By Bruce Rich and Samuel J. Zeitlin

If you purchase a copy of music in physical form—like a CD or vinyl record—you own your copy even though you do not own the underlying songs. Although the law reserves to the copyright owner the right to make more copies, she cannot stop you from selling your copy or giving it away. This rule is called the right of first sale, and it enables all secondhand sales of copyrighted material, from the smallest used bookstore to eBay and Amazon Marketplace. The right of first sale began as judge-made law in the early 20th century, and today is part of the copyright statute at 17 U.S.C. § 109(a). In technical terms, Section 109(a) creates an exception for the owners of legal copies to the copyright owner's exclusive right to distribute her work, although not to her exclusive right to reproduce her work.

But what happens if you purchase a digital music file? Digital copying unravels the balance between the rights of copyright owners and customers set by the first sale doctrine. Section 109(a) only allows the owner of a copy to distribute it, not to make more copies. In a digital environment, however, distributing a file is done by making a copy of that file in a new location. When the distinction between copying and distributing collapses, is it still possible to exercise the right of first sale?

The Second Circuit has just confronted this issue in its December 12, 2018 ruling on the legality of ReDigi, an online marketplace designed to let people resell digital music files purchased from iTunes. In a unanimous decision in *Capitol Records, LLC v. ReDigi, Inc.* penned by the Second Circuit's preeminent copyright expert, Judge Pierre Leval, the court upheld the conclusion of the district court that ReDigi's business model violated the law.

ReDigi: a marketplace for secondhand music files?

The ReDigi technology under scrutiny had two key elements. First, ReDigi developed a method for transferring digital music files that it argued did not create a copy. Files are typically transferred piece by piece in small blocks of data called packets. ReDigi's software deleted each packet from the seller's computer as it was uploaded to ReDigi's cloud storage. There was thus no time when the file existed both on the seller's hard drive and on ReDigi's. The user could then sell his copy of the file on ReDigi's cloud storage, and the purchaser could download it from there. When the purchaser downloaded the file, it was deleted from ReDigi's system.

Second, ReDigi attempted to prevent users from cheating. Before a file could be uploaded, ReDigi verified that it was actually purchased on iTunes. ReDigi also monitored the user's hard drive and connected devices. ReDigi would not upload a file until all duplicates had been deleted, and if a duplicate of a sold file were later added, ReDigi would suspend the user's account unless the duplicate was removed.

A copy is a copy is a copy

In its opinion, the court had no trouble concluding that ReDigi's system did indeed make unauthorized reproductions of copyrighted works. The copyright owner has the exclusive right to make "phonorecords" (sound recordings fixed in material objects) containing her work. When a digital music file is downloaded onto a hard drive for more than a "transitory duration," the hard drive—or at least the part of the hard drive holding the song—becomes a phonorecord. This means that when a user uploaded a song onto ReDigi's system, or when a purchaser downloaded a file from ReDigi onto his own hard drive, a new, unauthorized phonorecord was created. The fact that ReDigi then destroyed the original phonorecord by deleting the file doesn't change this analysis. Insofar as Section 109(a) does not protect unauthorized reproductions made by lawful owners of the originals, the court found the fact of these reproductions to be conclusive as to the unavailability of a first sale defense. The court stated that, given this conclusion, it need not reach the issue whether the challenged activities and system architecture also implicated an infringement of the plaintiff record companies' exclusive distribution right under Section 106(3) of the Act, as the district court had found.

Reselling songs from iTunes at a lower price is not fair use

The Second Circuit then turned to the question of whether, despite violating the exclusive right of reproduction, ReDigi's copying was nonetheless permitted as fair use. Judge Leval walked through the four-factor test for fair use contained in the copyright statute. The first factor concerns the purpose and character of the use. Here Judge Leval observed that

ReDigi's use is commercial, and that it simply sells music files without transforming them in any way—thus cutting against fair use. The second factor is the nature of the copyrighted work, and Judge Leval stated that, like in most cases, this factor has little bearing on the overall fair use analysis. The third factor is how much of the work is used. Since ReDigi sells entire songs, this factor does not favor fair use. Finally, the fourth and most important factor is the effect of the copying on the market for the copyrighted work. Making copies that serve as a competing substitute in the market for the original work is rarely, if ever, fair use. Because ReDigi "made reproductions of Plaintiffs' works for the purpose of resale in competition with the Plaintiffs' market for the sale of their sound recordings," factor four strongly points against fair use. The court noted as of "possible relevance" to its factor four conclusion the distinction between ReDigi's practices and secondhand sales of books and physical records (which, under the right of first sale, the law generally does not permit copyright owners to control) insofar as digital files do not deteriorate in quality like physical copies. They are therefore a perfect substitute for the originals, but sold at a lower price.

Taking all the factors together, Judge Leval held that ReDigi's copying is not fair use.

Takeaways and implications

The facts of this case have drawn outside attention in the world of copyright law, presenting as they do a tension between the letter of the law (as applied by both the district court and the court of appeals, forbidding unauthorized reproductions of copyrighted works falling outside fair use parameters) and the apparently legitimate object of ReDigi's business platform (not questioned by the Second Circuit) to create a digital marketplace for resales of music files in which solely a single copy of the transferred work remains. In this respect, the case represents a textbook example of perceived outdated provisions of a law written prior to the digital age, enforced by judges who (as here) are bound to interpret it as written.

It is interesting to speculate the force that a fact repeatedly noted by Judge Leval may have had on the court's overall evaluation of the legal merits. That fact is that ReDigi's product didn't work as advertised. The danger of resale of digital files is that making additional copies is so easy. For instance, an unscrupulous user could download one copy of a song from iTunes, make thousands of copies, and sell them individually at a lower price—totally destroying the market for the original work. ReDigi's solution was to search for and delete duplicates from the user's hard drive and connected devices, but users could still back up their music on separate devices before making the sale. Ruling in favor of ReDigi would have effectively meant legalizing the sale of pirated copies, and that clearly weighed heavily on the court's mind.

The Second Circuit tried to make sure that the holding of this case would not completely cut off the right of first sale in the digital context. The district court below held not only that ReDigi violated the reproduction right, but also that it violated the distribution right because first sale does not apply to digital music files. The court explicitly declined to reach that second issue on appeal. It noted that ReDigi had invented a new system, ReDigi 2.0, that worked differently from the original ReDigi, but that the court could not analyze it because of an agreement made between ReDigi and the plaintiffs in this case. In theory, therefore, the door remains open for resale of digital files protected by the right of first sale so long as no unauthorized copies are made.

Unfortunately, the court's effort to preserve room for digital first sale created an internal contradiction within the opinion. Judge Leval provides an example of how resale of digital music files could be done legally: a user could place some music files on a thumb drive and sell the physical object. But it is difficult to see why the act of copying music files onto a thumb drive for resale would be analyzed any differently under copyright law than ReDigi's technology and process. The act of placing music on the thumb drive creates a new phonorecord, which violates the reproduction right. And under the court's reasoning, it cannot be fair use because the purpose of making the copy is to compete for sales with the copyright owners. It remains to be seen whether this analytic flaw is corrected in an amended opinion.

Setting to one side the thumb drive example and the unknown possibilities of ReDigi 2.0, the primary takeaway from *ReDigi* is that the right of first sale is a dead letter in the digital context to the extent that its exercise implicates the creation of an unauthorized copy. As Judge Leval observes at the end of the *ReDigi* opinion, revising the right of first sale to work smoothly with digital files would require making significant policy judgments about the future of the markets at issue—something only Congress has the power and the expertise to accomplish.

If you have questions concerning the contents of this issue, or would like more information about Weil's IP/Media practice group, please speak to your regular contact at Weil, or to the editors or practice group members listed below:

Editors:

Randi Singer (NY)	View Bio	randi.singer@weil.com	+1 212 310 8152
Jonathan Bloom (NY)	View Bio	jonathan.bloom@weil.com	+1 212 310 8775

Contributing Authors:

Bruce Rich (NY)	View Bio	bruce.rich@weil.com	+1 212 310 8170
Samuel J. Zeitlin (NY)	View Bio	samuel.zeitlin@weil.com	+1 212 310 8887

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