

NOTE

FIGHTING THE FIRST SALE DOCTRINE: STRATEGIES FOR A STRUGGLING FILM INDUSTRY

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INTRODUCTION

The first sale doctrine, codified at 17 U.S.C. § 109, grants the owners of a copy of a copyrighted work the right to sell, rent, or lease that copy without permission from the copyright owner. This doctrine, first endorsed by the Supreme Court in *Bobbs-Merrill Co. v. Straus*,¹ was established at a time

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1. *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339 (1908). See also *infra* notes 16–18 and accompanying text.

when the owner of a good necessarily had to forego possession in order to sell or lease the item to another. An individual who purchased a book or a phonorecord could sell his original copy, but could no longer enjoy the benefits of owning the item. If he sought to keep a copy for himself, he would have to expend great effort and expense to do so. For example, he would have to acquire a printing press to reproduce a book, or a record-pressing machine to reproduce a phonorecord. This individual's reproduction of these items would likely be in violation of copyright law, and would in any event leave the individual with an imperfect copy due to the technological limitations of the day. For much of the twentieth century, the first sale doctrine struck a reasonable balance between the interests of copyright owners and the general public, enabling a thriving market in new, used, and rented copies of works covered by the Copyright Act,² such as films, books, and music.

The changes in technology and industry over the past two decades threaten to upend this balance. In today's digital world, an owner of a copy of a copyrighted work need not relinquish his perfect copy in order to sell it. Music, films, software, and video games can be ripped to an owner or lessee's hard drive and accessed indefinitely in their perfect, as-delivered state even after the sale or return of the physical media upon which the copyrighted content was first accessed. The first sale doctrine does not shelter resale or rental of purely digital copies (where no physical media are involved),³ but continues to protect the resale and rental of physical copies of digital content even after an individual has archived the material. Innovative rental distribution methods, such as Redbox kiosks and Netflix rental-by-mail, have depressed revenue for copyright holders by lowering the costs consumers must pay to access video content. There is little doubt that the public has enjoyed short-term benefits from these changes, but the loss of profits for copyright holders portends a future with less content creation.

Technological advancements have occasionally required changes to the first sale doctrine. When audiocassette technology enabled the inexpensive duplication of phonorecords, and when home computers made possible the quick duplication of software, Congress took action to protect the music and software industries by limiting for-profit rentals of those works.⁴ It did not, however, extend such protection to the film industry despite the introduction of the VCR. As a result, today individuals can cheaply rent DVDs and Blu-ray Discs from the likes of Netflix and Redbox, illegally rip the information

2. 17 U.S.C. §§ 101–810 (2006).

3. Resale or rental of purely digital content requires digital transmission of said content. In *A&M Records, Inc. v. Napster Inc.*, 239 F.3d 1004 (9th Cir. 2001), the Ninth Circuit held that the unauthorized transmission of digital files violates a copyright holder's exclusive reproduction rights. *Id.* at 1014; *see also* 17 U.S.C. § 106(1) (2006). The first sale doctrine does not provide a defense to such unauthorized reproduction. *Id.* § 109(a).

4. *See* Computer Software Rental Amendments Act of 1990, Pub. L. No. 101-650, § 801, 104 Stat. 5089 (codified at 17 U.S.C. § 109(b) (2006)); Record Rental Amendment of 1984, Pub. L. No. 98-450, 98 Stat. 1727 (codified at 17 U.S.C. § 109(b) (2006)).

to their digital home library, and retain this illegal copy long after returning the physical disc.⁵

This Note argues that, while the first sale doctrine is not solely responsible for declining home video sales, advancements in technology and industry may require a new approach to the doctrine in order to protect the rights of filmmakers in the digital age. Part I of this Note presents an overview of the first sale doctrine's origins as well as recent judicial application of the doctrine. Part II suggests legislative solutions that would revise the first sale doctrine in light of recent technological changes. Part III analyzes untested legal strategies that could allow filmmakers to circumvent the first sale doctrine altogether. Part IV concludes that market-based solutions, including increased digital distribution of content under a licensing regime rather than a sale-based regime, are a more realistic path towards promoting the interests of filmmakers and the public than the other suggested approaches.

I. THE FIRST SALE DOCTRINE, PAST AND PRESENT

The first sale doctrine has been an integral part of American copyright law for over a century, but in the last two decades it has grown inadequate and outdated. While Congress has occasionally enacted minor exceptions to the first sale doctrine (as well as exceptions to those exceptions), it has done little to update the law since 1990. The Supreme Court, which first endorsed the doctrine in 1908,⁶ has remained almost completely silent as to the ramifications of the doctrine in the digital age. The Hollywood film industry was long enriched by the first sale doctrine, but has recently seen low-cost, high-volume video rental companies such as Netflix and Redbox spark a decline in the once lucrative video rental market.

A. History of the Doctrine

The Copyright Clause of the United States Constitution empowers Congress “[t]o promote the Progress of Science and the useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.”⁷ With the passage of the Copyright Act of 1790, copyright owners were given the exclusive right to publish and vend copies of their creations.⁸ Although copyright law provided limited

5. See MELVILLE B. NIMMER & DAVID NIMMER, 2 NIMMER ON COPYRIGHT § 8.08(A)(4) (2002) [hereinafter NIMMER] (stating that “computer input constitutes the making of a ‘copy’” and thus violates the exclusive reproduction rights of 17 U.S.C. § 106(1)). Assuming the disc is protected by a Digital Rights Management (DRM) system, ripping the content of the disc would also be a violation of the Digital Millennium Copyright Act. See 17 U.S.C. § 1201(a)(1)(A) (2006).

6. See *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339 (1908).

7. U.S. CONST. art. I, § 8, cl. 8.

8. See Act of May 31, 1790, ch. 15, § 1, 1 Stat. 124.

monopoly power to copyright owners, these owners were not the intended beneficiaries of copyright protection.⁹ Instead, the law was intended to enrich the public by ensuring that market incentives would exist for the continued creation and distribution of original works.¹⁰ The Copyright Act of 1976, which represents the last major revision of copyright law, extended the exclusive rights of copyright holders to performance rights, display rights, and the preparation of derivative works.¹¹

The first sale doctrine is one of the key limitations upon the broad rights afforded to copyright owners.¹² This doctrine, first recognized in *Bobbs-Merrill Co. v. Straus*,¹³ holds that a copyright owner's right to control the sale of a particular copy of a work ends once he has sold or otherwise transferred that copy. In *Bobbs-Merrill*, a book publisher placed a notice within each book mandating that the resale price be no lower than one dollar.¹⁴ The Supreme Court held that absent a contract agreement between the publisher and the purchaser, the copyright owner's sole right to multiply and sell a copy of a work does not afford him the right to impose limits on future sales.¹⁵ This doctrine was incorporated into the Copyright Act of 1909,¹⁶ and is currently codified at 17 U.S.C. § 109(a). Thrift stores, used bookstores, used record stores, used video game stores, resale sites such as eBay, and the video rental industry owe their existence to the first sale doctrine.

Although *Bobbs-Merrill* was principally a case of statutory interpretation, the first sale doctrine has since been justified by public policy concerns regarding restraints of trade and alienation of property.¹⁷ Critics have challenged this view, however, noting that neither the 1909 Act nor the 1976 Copyright Act have specifically precluded such restraints if contractually agreed to by the parties involved.¹⁸

9. See *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417, 429 (1984).

10. *Id.*

11. See 17 U.S.C. § 106 (2006).

12. The other key limitation is the fair use doctrine, codified at 17 U.S.C. § 107 (2006), which states that reproduction by non-copyright owners is permissible when it is "for purposes such as criticism, comment, news reporting, teaching (including multiple copies for classroom use), scholarship, or research." *Id.*

13. *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339 (1908).

14. *Id.* at 341.

15. *Id.* at 350.

16. Act of Mar. 4, 1909, ch. 320, § 41, 35 Stat. 1075, 1084 (formerly codified at 17 U.S.C. § 27).

17. See, e.g., NIMMER, *supra* note 5, § 8.12(A).

18. See Glen O. Robinson, *Personal Property Servitudes*, 71 U. CHI. L. REV. 1449, 1470–73 (2004). Robinson conceded that the Supreme Court found vertical agreements to fix resale prices were a per se illegal restraint of trade under the Sherman Act. *Id.* at 1470–71 (citing *Dr. Miles Med. Co. v. John D. Park & Sons*, 220 U.S. 373 (1911), *overruled by* *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007)). Given that *Dr. Miles* was overruled in 2007, there is no authoritative Supreme Court precedent stating that restrictive resale agreements are per se anathema to the Copyright Act, the Sherman Act, or public policy.

The first sale doctrine has experienced only minor modifications since 1909. Nevertheless, these changes reveal the balance Congress has sought to achieve between the rights of copyright holders and the public. Beginning in the early 1980s, music rental stores allowed consumers to rent phonorecords for prices ranging from \$0.99 to \$2.50; this practice was widely known to encourage home reproductions of the rented material.¹⁹ Because this practice threatened the entire music industry, Congress enacted the Record Rental Amendment of 1984 to prohibit the rental, lease, or lending of a phonorecord for profit.²⁰ Just six years later, Congress extended similar protections to the software industry, enacting the Computer Software Rental Amendments Act of 1990.²¹ While this legislation prohibited the rental, lease, or lending of computer software, it provided an exception for the rental of embedded computer programs and console-based video games.²² During the early 1980s, Hollywood studios lobbied for similar restrictions on the rental of videotapes.²³ A bill prohibiting the rental of home videos was introduced,²⁴ but opposition from consumers and the video rental industry convinced Congress to drop the bill.²⁵ Hollywood would go on to reap immense profits from sales to home video consumers and video rental stores, matching and even surpassing box office revenue, leading the industry to quiet its objections to the first sale doctrine.²⁶

Recent government action on the copyright front has sought to target the widespread piracy of copyrighted material, currently estimated to cost the United States economy fifty-eight billion dollars per year, that has

19. See NIMMER, *supra* note 5, § 8.12(B)(7).

20. Record Rental Amendment of 1984, Pub. L. No. 98-450, 98 Stat. 1727 (codified at 17 U.S.C. § 109(b) (2006)); NIMMER, *supra* note 5, § 8.12(B)(7).

21. Computer Software Rental Amendments Act of 1990, Pub. L. No. 101-650, Sec. 801, 104 Stat. 5089 (codified at 17 U.S.C. § 109(b) (2006)).

22. 17 U.S.C. § 109(b) (2006). Although a thriving market in the rental of console video games exists, this market does not pose the same risk to the video game industry as home video rental now poses to the film industry. The modchips and console hacks required to copy or otherwise archive Xbox 360 and Playstation 3 discs are much more difficult to install and maintain than the ripping software readily available for copying DVDs and Blu-ray discs. See, e.g., Roydon Cerejo, *PS3 Hacking: Is it Worth it?*, TECHTREE (Mar. 28, 2011, 4:36 PM), http://www.techtree.com/India/Features/PS3_Jailbreaking_Is_it_Worth_it/551-114940-899.html; PSM3 Staff, *PS3 Hack: What It Means For You*, COMPUTERSANDVIDEOGAMES.COM (Feb. 27, 2011), <http://www.computerandvideogames.com/290278/features/ps3-hack-what-it-means-for-you>.

23. See NIMMER, *supra* note 5, § 8.12(B)(7).

24. Consumer Video Sales-Rental Amendment, H.R. 1029, 98th Cong. (1983).

25. See DAVID WATERMAN, *HOLLYWOOD'S ROAD TO RICHES* 106 (2005); see also *A History of Home Video and Video Game Retailing*, THE ENT. MERCHANTS ASS'N, <http://www.entmerch.org/press-room/industry-history.html> (last visited Mar. 04, 2012) [hereinafter "History of Home Video"].

26. See NIMMER, *supra* note 5, § 8.12(B)(7).

accompanied the rise of digital media and the internet.²⁷ The Digital Millennium Copyright Act (“DMCA”), enacted in 1998, criminalizes the circumvention of copyright control systems.²⁸ During the 112th Congress, the House and Senate considered two competing measures, the Stop Online Piracy Act (“SOPA”)²⁹ and the Protect IP Act of 2011 (“PIPA”).³⁰ SOPA and PIPA were designed to target foreign websites that engage in copyright violations.³¹ The bills would allow the Justice Department to seek court orders requiring U.S. websites to block access to foreign sites offering pirated material, and would allow copyright owners to seek court orders preventing such sites from receiving payment services from the U.S.³² In October 2011, the United States signed the Anti-Counterfeiting Trade Agreement (“ACTA”), an international agreement to establish stronger intellectual property protections.³³ Negotiations continue on the Trans-Pacific Partnership agreement (“TPP”), which similarly seeks to tighten international IP enforcement.³⁴ SOPA, PIPA, ACTA and TPP have been the subject of major protest efforts in the U.S. and abroad over concerns that they would endanger internet stability and infringe free speech.³⁵

While the Supreme Court has repeatedly revisited the fair use doctrine in recent decades,³⁶ since *Bobbs-Merrill* it has issued just one prominent decision regarding the first sale doctrine. In *Quality King Distributor, Inc. v.*

27. Richard Verrier & Jim Puzzanghera, *Piracy Legislation Pits Hollywood Against Silicon Valley*, L.A. TIMES (Dec. 5, 2011), <http://articles.latimes.com/2011/dec/05/business/la-fi-ct-piracy-fight-20111205>.

28. Digital Millennium Copyright Act, Pub. L. No. 105-304, 112 Stat. 2860 (1998) (codified in scattered sections of 17 U.S.C.).

29. Stop Online Piracy Act, H.R. 3261, 112th Cong. (2011).

30. Protect IP Act, S. 968, 112th Cong. (2011).

31. Verrier & Puzzanghera, *supra* note 27.

32. *Id.*

33. See *Anti-Counterfeiting Trade Agreement (ACTA)*, OFF. OF THE U.S. TRADE REP., <http://www.ustr.gov/acta> (last visited Mar. 02, 2012).

34. E.D. Kain, *Final Draft of ACTA Watered Down, TPP Still Dangerous on IP Rules*, FORBES (Jan. 28, 2012, 9:23AM), <http://www.forbes.com/sites/erikkain/2012/01/28/final-draft-of-acta-watered-down-tpp-still-dangerous-on-ip-rules>.

35. See *id.* *Wikipedia*, *Reddit*, and many other sites (including the *MTTLR Blog*) blacked out their content on January 18, 2012 in a successful effort to spread awareness of the SOPA and PIPA and mobilize opposition. As a result, Congressional support for the bills crumbled. See Jonathan Weisman, *After an Online Firestorm, Congress Shelves Antipiracy Bills*, N.Y. TIMES (Jan. 20, 2012), <http://www.nytimes.com/2012/01/21/technology/senate-postpones-piracy-vote.html>. Additionally, the German government has held off on signing ACTA in the face of major protests against the agreement. See Eric Kirschbaum & Irina Ivanova, *Protests Erupt Across Europe Against Web Piracy Treaty*, REUTERS (Feb. 11, 2012, 1:54 PM), <http://www.reuters.com/article/2012/02/11/us-europe-protest-acta-idUSTRE81A0I120120211>.

36. See, e.g., *Campbell v. Acuff-Rose Music, Inc.*, 510 U.S. 569 (1994) (holding that parody can be considered a legitimate fair use); *Harper & Row Publishers, Inc. v. Nation Enters.*, 471 U.S. 539 (1985) (applying the fair use factors to the unlicensed publication of memoir excerpts); *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417 (1984) (holding that home use of VCRs to record television programming was fair use).

L'anza Research Intern, Inc.,³⁷ the Court held that the first sale doctrine applies to imported copies, so long as those copies were “lawfully made” under the copyright laws of the United States.³⁸ Twelve years later the Court granted certiorari to hear a similar case involving the importation and resale of copyrighted goods manufactured abroad.³⁹ After Justice Elena Kagan recused herself from the case, an equally divided court upheld without comment the Ninth Circuit decision that the first sale doctrine did not provide a defense to the unauthorized importation of copyrighted goods that were manufactured and sold abroad.⁴⁰ Because there has been so little guidance from the Supreme Court on the first sale doctrine, it has been incumbent upon the lower courts to interpret the breadth of the doctrine in the modern age.

B. *Unexpected Repercussions: Netflix and Redbox*

While Congress insulated the music and software industries from the potential dangers of a widespread rental industry, Hollywood thrived for decades despite thousands of video stores that were not required to pay licensing fees or share revenues. The rental industry peaked in 2003, with annual revenues of about \$11.9 billion.⁴¹ It was during that same year that the first Redbox kiosks were widely introduced by Coinstar Inc. and McDonald's.⁴² Redbox kiosks, each containing 200 titles on DVD, undercut brick-and-mortar stores such as Blockbuster by offering new releases for one dollar per night.⁴³ Since traditional video stores such as Blockbuster derive 85–90 percent of their revenues from new releases, losing that share of their business to kiosks proved to be devastating.⁴⁴ The number of Redbox kiosks increased from 2,000 at the beginning of 2006 to over 34,000

37. *Quality King Distrib., Inc. v. L'anza Research Intern, Inc.*, 523 U.S. 135 (1998).

38. *Id.* at 145, 148. The goods in question were manufactured in the United States, sold to a foreign distributor, and then reimported without authorization from the U.S. manufacturer.

39. *Costco Wholesale Corp. v. Omega, S.A.*, 130 S. Ct. 2089 (2010).

40. *Costco Wholesale Corp. v. Omega, S.A.*, 131 S. Ct. 565 (2010), *aff'd by an equally divided court Omega S.A. v. Costco Wholesale Corp.*, 541 F.3d 982 (9th Cir. 2008); *accord John Wiley & Sons, Inc. v. Kirtsaeng*, 654 F.3d 210 (2d Cir. 2011).

41. AGATA KACZANOWSKA, IBISWORLD INDUSTRY REPORT 53223: DVD, GAME & VIDEO RENTAL IN THE US 28 (2011), *available at* <http://clients.ibisworld.com/industryus/default.aspx?indid=1370>.

42. Bill Yackey, *Rise of Redbox*, SELF-SERVICE WORLD MAGAZINE (Aug. 19, 2007), <http://www.selfserviceworld.com/article/165218/Rise-of-redbox>.

43. *Id.*; *see also Facts About Redbox*, REDBOX, <http://www.redbox.com/facts> (last visited Dec. 18, 2011); David Goldman, *Is Redbox Worth the Wait?*, CNN (Apr. 26, 2010), <http://money.cnn.com/2010/04/26/news/companies/redbox/index.htm>.

44. Yackey, *supra* note 42; *see also* Ben Fritz, *Blockbuster Files for Chapter 11 Bankruptcy, Sets Plan to Reorganize*, L.A. TIMES (Sep. 23, 2010), <http://latimesblogs.latimes.com/entertainmentnewsbuzz/2010/09/blockbuster-files-for-chapter-11-bankruptcy-sets-plan-to-reorganize.html>.

locations today.⁴⁵ Netflix, meanwhile, has developed a subscriber base of fourteen million for its innovative DVD-by-mail service and over twenty-one million for its “Watch Instantly” streaming video service (first introduced in 2007).⁴⁶ Redbox now controls 35 percent of the total video disc rental market, Netflix controls approximately 33 percent, and the traditional brick-and-mortar video stores once dominated by the now-bankrupt Blockbuster and Movie Gallery control a mere 27 percent.⁴⁷ While Redbox and Netflix have profited from their high-volume, low-cost operations, total video rental industry revenue has fallen from \$11 billion in 2006 to \$6.6 billion in 2011.⁴⁸ Subscription and kiosk rental revenue rose 45 and 39 percent respectively in 2011, but total DVD and Blu-ray sales have fallen 18 percent.⁴⁹

The first sale doctrine prevents film studios from prohibiting Redbox and Netflix from renting DVDs purchased at retail. As a result, the film studios have agreed to sell discs to those companies at bargain wholesale prices, in return for assurances that the rental outlets will honor a 28-day initial release window during which only retail sales of DVDs and Blu-ray Discs, and not rentals, will be allowed.⁵⁰ Since the first sale doctrine provides film studios with so little leverage over video rental outlets, recent moves to widen the sale-only window to fifty-six days have been rebuffed by Redbox.⁵¹

When Congress chose not to extend legislative protections to the film industry, there was good reason to believe that the economic incentives of home video were such that a rental market would not damage the industry.⁵²

45. *Coinstar, Inc. Announces 2011 Third Quarter Results*, COINSTAR, INC. (Oct. 27, 2011), <http://phx.corporate-ir.net/phoenix.zhtml?c=92448&p=irol-newsArticle&id=1622858>.

46. NETFLIX, INC., CONSOLIDATED STATEMENTS OF OPERATIONS (2011), available at http://ir.netflix.com/common/download/download.cfm?companyid=NFLX&fileid=511280&filekey=3ce0bb4e-2785-4491-afae-824b7fc9d43f&filename=Q3_11_Financials_Statements.xls; see also Michael Liedtke, *Netflix Offers Instant Access*, USA TODAY (Jan. 16, 2007), http://www.usatoday.com/tech/products/2007-01-15-netflix-access_x.htm.

47. COINSTAR, INC., COINSTAR, INC. 2011 Q3 EARNINGS 4 (2011), available at <http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9NDQ0OdyfENoaWxkSUQ9NDY3OTMzFR5cGU9MQ==&t=1>. The share of video rental controlled by Redbox will continue to climb. In February of 2012 they agreed to purchase all 9,000 Blockbuster Express kiosks for \$100 million. See Austin Carr, *Redbox To Acquire NCR's Blockbuster Express For \$100 Million, Boast "More Locations Than McDonald's And Starbucks Combined,"* FAST COMPANY (Feb. 26, 2012), <http://www.fastcompany.com/1814438/redbox-acquires-ncr-blockbuster-express-for-up-to-100-million-boasts-more-locations-than-mcd>.

48. KACZANOWSKA, *supra* note 41, at 28.

49. DIGITAL ENTMT' T GRP., DEG MID-YEAR 2011 HOME ENTERTAINMENT REPORT 3 tbl. 1 (2011), available at http://www.degonline.org/pressreleases/2011/DEG_MID_YEAR_2011_REPORT.pdf.

50. Goldman, *supra* note 43.

51. See Don Reisinger, *Redbox Rebuffs Warner Bros., Won't Delay Rentals for 56 Days*, CNET (Feb. 1, 2012), http://news.cnet.com/8301-13506_3-57369740-17/redbox-rebuffs-warner-bros-wont-delay-rentals-for-56-days (discussing Warner Brothers's failure to convince Redbox to increase the sale-only window).

52. See NIMMER, *supra* note 5, § 8.12(B)(7).

Now that companies such as Redbox and Netflix have used innovative distribution methods to dramatically lower the cost of rental vis-à-vis disc purchases, the calculus has changed.

II. LEGISLATIVE REVISIONS TO THE FIRST SALE DOCTRINE

During a House debate in January 1837, Representative Albert Galliton Harrison of Missouri said the following:

I am prompted by a sense of strict justice, and also by a principle which we act upon in the West, to fight fire with fire, when the fire has seized upon and is consuming our large and extensive prairies. When its devastating flames, in rolling volumes of terrific grandeur, are rushing upon us and about to consume all that we are worth—all that we prize as sacred and hold dear—the family hearth and the cherished home—'tis then that self-preservation teaches us to burn against the raging element.⁵³

This statement, the first recorded instance of the phrase “fight fire with fire,”⁵⁴ captures quite eloquently the situation that the film industry is in. With revenues and production stagnant,⁵⁵ and top executives forced to bargain with Redbox and Netflix to allow more than a one-month sales-only window, the film industry must decide whether to use its lobbying power to change the laws that are aiding its rivals. On the opposite side, of course, are those who argue that the first sale doctrine should actually be *expanded* to encompass digital content.⁵⁶ Given the changes in content acquisition that have occurred in the last twenty-five years, there is no doubt that Congress will eventually have to amend the first sale doctrine. The critical question is how.

53. 13 REG. DEB. 1268 (1837).

54. This use predates by approximately fifteen years the earliest known use found by Gary Martin of The Phrase Finder website. See Gary Martin, *Fight Fire With Fire*, THE PHRASE FINDER, <http://www.phrases.org.uk/meanings/fight-fire-with-fire.html> (last visited Dec. 20, 2011).

55. AGATA KACZANOWSKA, IBISWORLD INDUSTRY REPORT 51211A: MOVIE AND VIDEO PRODUCTION IN THE US 4, 12 (2012), available at <http://clients.ibisworld.com/industryus/default.aspx?indid=1245>.

56. See, e.g., Henry Sprott Long III, *Reconsidering the “Balance” of the “Digital First Sale” Debate: Re-Examining the Case for a Statutory Digital First Sale Doctrine to Facilitate Second-Hand Digital Media Markets*, 59 ALA. L. REV. 1183 (2008); Brian Mencher, *Online Music Distribution: Proposal for a Digital First Sale Doctrine*, 21 ENT. & SPORTS LAW. 16 (2004); Aaron Perzanowski & Jason Schultz, *Digital Exhaustion*, 58 UCLA L. REV. 889 (2011).

A. Expanding the First Sale Doctrine to Encompass Digital Content

The advent of digital media has led some commentators, librarians, and consumers to call for a “digital first sale doctrine,” which would give individuals who purchase digital content the right to resell that content.⁵⁷ A nascent website called ReDigi.com offers a glimpse of how such a process would work.⁵⁸ The site offers to credit sellers about thirty-two cents per song uploaded to their cloud server, and will sell “used” MP3 files for seventy-nine cents each—about twenty cents below the standard iTunes price.⁵⁹ Given that the Copyright Act vests copyright holders with the sole right to reproduce and distribute their copyrighted works, and given that uploading and downloading digital files necessarily requires duplication and distribution of such files, this service appears to violate the copyright holder’s exclusive rights of reproduction and distribution.⁶⁰ In response to a lawsuit filed by Capital Records, ReDigi has argued that the uploading and downloading of files is protected by the fair use doctrine, while the transfer of ownership that occurs in the cloud server is shielded by the first sale doctrine.⁶¹ It is doubtful whether courts will accept these legal theories, since doing so would potentially legalize online file-sharing without the need for a digital first sale doctrine.⁶²

57. See *Digital Millennium Copyright Act (DMCA) Section 104 Report Before the H. Subcomm. on Courts, the Internet, and Intellectual Property*, 107th Cong. 79–91 (2001) (statement of Marybeth Peters, Register of Copyrights, U.S. Copyright Office), available at <http://www.copyright.gov/docs/regstat121201.html>; see also Victor Calaba, *Quibbles N Bits: Making a Digital First Sale Doctrine Feasible*, 9 MICH. TELECOMM. & TECH. L. REV. 1, 16 (2002).

58. See Darlene Store, *Legally Resell Used MP3s? Yes. Judge Hands Round 1 to ReDigi, Not Capitol Records*, COMPUTERWORLD (Feb. 09, 2012), http://blogs.computerworld.com/19707/legally_resell_used_mp3s_yes_judge_hands_round_1_to_redigi_not_capitol_records; see also Ben Sisario, *Site to Sell Music Files Has Critics*, N.Y. TIMES (Nov. 14, 2011), www.nytimes.com/2011/11/15/business/media/reselling-of-music-files-is-contested.html.

59. Sisario, *supra* note 58.

60. See 17 U.S.C. § 106 (2006); see also *A&M Records, Inc. v. Napster Inc.*, 239 F.3d 1004, 1014 (9th Cir. 2001).

61. Request for Pre-Motion Conference at 3 *Capital Records, LLC v. Redigi, Inc.*, No. 12-CV-0095(RJS) (S.D.N.Y. Jan. 19, 2012), available at <http://www.aaronsanderslaw.com/wp-content/uploads/2012/01/ReDigi-MSJ.pdf>. The federal judge denied Capital Records’ motion for a preliminary injunction against ReDigi. *Capital Records, LLC v. ReDigi Inc.*, No. 12-CV-00095 (RJS) (S.D.N.Y. Feb. 6, 2012), available at http://www.wired.com/images_blogs/threatlevel/2012/02/redigiruling1.pdf.

62. See Rick Sanders, *Music Industry v. ReDigi: Cute or Clever?*, AARONSANDERSLAW.COM (Jan. 25, 2012), <http://www.aaronsanderslaw.com/blog/music-industry-v-redigi-cute-or-clever> (discussing the legal merits of ReDigi’s claims). If fair use were to protect uploading and downloading of digital files, and if ownership could be transferred simply by renaming the database in which the files are stored, then Napster-style one-to-one file sharing could be legal under current law. One need simply relinquish ownership of one’s own digital files to Internet peers, who could then legally transfer the files under the fair use doctrine. Courts, of course, have not accepted such propositions. See *A&M Records, Inc.*, 239 F.3d at 1019 (holding that “space-shifting” files to an online server is not a fair use).

Assuming that ReDigi's business model is not shielded by fair use and first sale defenses, the question is whether Congress should amend the Copyright Act to allow such aftermarket resale of digital content. The public policy concerns against restraint of trade and restraints on alienation of property would seem to support such a move. From the copyright holder's perspective, a legal aftermarket in digital works would have serious negative financial effects, exerting downward pressure on prices and eliminating the copyright holder's control over distribution.⁶³

In 2001, following the passage of the Digital Millennium Copyright Act, the Register of Copyrights considered whether the time had come for a digital first sale doctrine. She clearly understood that digital copies were distinguishable in the first sale context from physical copies:

Physical copies of works degrade with time and use, making used copies less desirable than new ones. Digital information does not degrade, and can be reproduced perfectly on a recipient's computer. The "used" copy is just as desirable as (in fact, is indistinguishable from) a new copy of the same work. Time, space, effort and cost no longer act as barriers to the movement of copies, since digital copies can be transmitted nearly instantaneously anywhere in the world with minimal effort and negligible cost. The need to transport physical copies of works, which acts as a natural brake on the effect of resales on the copyright owner's market, no longer exists in the realm of digital transmissions. . . . Additionally, unless a "forward-and-delete" technology is employed to automatically delete the sender's copy, the deletion of a work requires an additional affirmative act on the part of the sender subsequent to the transmission. This act is difficult to prove or disprove, as is a person's claim to have transmitted only a single copy, thereby raising complex evidentiary concerns.⁶⁴

"Forward-and-delete" technology, which is central to ReDigi's business plan, has yet to be successfully implemented.⁶⁵ Even if it were, it would be unlikely to assuage the concerns expressed by the Copyright Office. There would be great difficulty in proving, remotely, that one who has transmitted a digital copy has truly deleted all copies that the person owns.⁶⁶ There is

63. See Bill Rosenblatt, *ReDigi Gets RIAA Nastygram*, COPYRIGHT & TECH. (Nov. 15, 2011), <http://copyrightandtechnology.com/2011/11/15/redigi-gets-riaa-nastygram>.

64. PETERS, *supra* note 57, at 82–83, xix.

65. See Rosenblatt, *supra* note 63 (analyzing ReDigi's forward-and-delete technology and asserting that "[t]here are ways to hack the system").

66. In an interview with David Kravets of *Wired*, ReDigi attorney Ray Beckerman acknowledged that ReDigi's technology cannot prevent customers from file sharing or copying iTunes purchases before uploading them to the service. David Kravets, *Online Market for Pre-Owned Digital Music Hangs in the Balance*, WIRED (Feb. 02, 2012, 6:22PM), <http://www.wired.com/threatlevel/2012/02/pre-owned-music-lawsuit>.

little reason to believe that a digital first sale doctrine which relies on an essentially unverifiable honor system would be anything other than the legalization of digital piracy.

B. *Excluding Digital Works from First Sale Entirely*

A more extreme proposal is a statutory amendment that would remove first sale protection from all digital content: music CDs, DVDs, Blu-ray Discs, computer software, and video games. There is some theoretical justification for such a proposal, even if it is unwise and unworkable. When the first sale doctrine was first embraced by the Supreme Court, and indeed during the preceding centuries in which restraints on alienation of property and restraints of trade were traditionally prohibited, an owner could only resell a good by actually disposing of his tangible copy of the good.⁶⁷ As illustrated by the Register of Copyrights' discussion above, the same is not true for digital content.⁶⁸ Today, the ripping and archiving of CDs is well established, and any consumer with a lick of technological savvy can also rip DVDs, Blu-ray Discs, video games, and software.⁶⁹ Such copying is often prohibited by anti-circumvention provisions of the DMCA,⁷⁰ but the DMCA has not prevented the widespread practice of ripping.⁷¹ The whole purpose of the DMCA was to curtail piracy at its earliest stages,⁷² so it is arguable that excluding digital works from the first sale doctrine would be similarly justified. After all, why should anyone be able to resell an item after they have made a copy of it?

The plain truth is that such an amendment would do far more harm than good. It would completely wipe out the aftermarket trade in used CDs, video games, DVDs, and Blu-ray Discs.⁷³ Anyone who does not want a CD,

67. See generally NIMMER, *supra* note 5, § 8.12(B)(1)(a) (discussing how the first sale doctrine only protects transfer of possession of the owner's tangible copy).

68. See PETERS, *supra* note 57, at 82–83.

69. See, e.g., Kevin Purdy, *The Definitive Guide to Backing Up and Ditching Your Discs*, LIFEHACKER (Aug. 25, 2009, 9:00AM), <http://lifehacker.com/5344531/the-definitive-guide-to-backing-up-and-ditching-your-discs>.

70. See 17 U.S.C. § 1201(a)(1)(A)(2006).

71. See *Universal City Studios, Inc. v. Reimerdes*, 111 F. Supp. 2d 294, 312–13 (S.D.N.Y. 2000) (stating that nine months after the initial distribution of the DVD ripping software DeCSS, over 500 sites were offering it for download). It is also worth noting that ripping CDs, which are not protected by DRM systems, is considered a “paradigmatic” fair use. *Recording Indus. Ass’n of Am. v. Diamond Multimedia Sys., Inc.*, 180 F.3d 1072, 1079 (9th Cir. 1999).

72. See *Universal City Studios, Inc. v. Corley*, 273 F.3d 429, 435 (2d Cir. 2001) (noting that Congress enacted the anti-trafficking and anti-circumvention provisions of the DMCA in order to combat piracy at its earliest stages).

73. To better understand the potential size of this market, consider that just one retailer, Gamestop, sold \$2.47 billion worth of used video game products in 2010; this accounted for over thirty percent of their total video game sales. Sliverstorm, *Why Does the Video Game Industry Hate Used Game Sales?*, GAMEREVOLUTION (Sep. 17, 2011, 4:38PM), <http://www.gamerevolution.com/blog/sliverstorm/why-does-the-video-game-industry-hate-used->

DVD, or Blu-ray Disc anymore would have no practical legal option except to dump it in the trash.⁷⁴ While this is currently the case with pure digital content such as MP3s, such content was not manufactured and is essentially ephemeral. There is no waste of manufacturing dollars when an MP3 is deleted, but there is great waste when millions of discs are trucked off to landfills despite being perfectly usable. In addition, economic analysis has demonstrated that resale markets actually benefit producers by increasing future selling opportunities for consumers and increasing consumer awareness of products.⁷⁵ Even if this were not the case, the primary goal of copyright law is to benefit the public, not to enrich copyright holders.⁷⁶

Removing digital works from first sale protections would lead to a large black market in such works, turn millions of Americans into copyright crooks every time they gift DVDs and Blu-ray Discs to family members, and burden law enforcement with yet another victimless crime to police. It would punish everyone for the sins of a few. Such a proposal would do violence to public policy and should not be enacted.

C. A Video Rental Amendment

The first sale doctrine is not set in stone. As demonstrated by passage of the Record Rental Amendment of 1984 and the Computer Software Rental Amendments Act of 1990, Congress is willing to limit the scope of the doctrine when the health of a creative industry is in jeopardy. Given that the video rental industry is currently a \$6.6 billion per year business, however, Congress would understandably be reluctant to upend it without assurance that such a move would be to the benefit of the industries involved and the public. Because of the serious implications for this multi-billion-dollar industry, the first sale doctrine should only be amended if current law fails to fulfill the Constitutional mandate to “promote the Progress of Science and the useful Arts.”⁷⁷

As outlined *supra* Part I, the innovative distribution strategies employed by Redbox and Netflix have been a major factor in the collapse of the video rental market. What once stood as an \$11.8 billion industry is now estimated

game-sales-85879. In addition, one study revealed that seventy-one percent of the 19,000 video games sold every day on eBay are used copies. See *How Big Is the Game Category on eBay? Infographic*, PRICE CHARTING (Nov. 3, 2010), <http://blog.pricecharting.com/2010/11/video-game-ebay-infographic.html>.

74. Owners of copies of copyrighted works could attempt to acquire resale licenses, but high transaction costs would make such an endeavor economically irrational.

75. See Masakazu Ishihara & Andrew Ching, *Dynamic Demand for New and Used Durable Goods without Physical Depreciation: The Case of Japanese Video Games*, at 30–31 (Sep. 16, 2011) (unpublished manuscript), available at <http://people.virginia.edu/~sns5r/microwkshp/ching.pdf>; see also Mike Masnick, *How the Used Book Market on Amazon Helps the Sale of New Books*, TECHDIRT (July 28, 2005, 2:17 AM), <http://www.techdirt.com/articles/20050728/0216218.shtml>.

76. *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417, 429 (1984).

77. U.S. CONST. art. I, § 8, cl. 8.

at \$6.6 billion, with some estimates that it will drop to just \$3.3 billion by 2016.⁷⁸ As consumers have become accustomed to relying upon the availability of low-priced rentals (as well as new digital streaming and video-on-demand options), the sales of physical discs have also fallen precipitously.⁷⁹ When Congress originally decided against providing the film industry with statutory protection against a rental market, the strategies employed by Redbox and Netflix would have been physically and economically impractical. Imagine, for a moment, what the postage rates for sending millions of videocassettes every month would amount to, or how large a Redbox kiosk would have to be if it were to contain hundreds of VHS tapes or laserdiscs. Conditions in the film industry have shifted tremendously—certainly since the early 1980s, but to an even greater extent in the last decade.

While the public has undoubtedly benefited from the lower prices offered by Redbox and Netflix,⁸⁰ Congress cannot dismiss the risk that an entire industry (and the jobs that it provides) will simply evaporate due to an antiquated statutory provision that benefits distributors over creators. The goal of copyright is to benefit copyright holders sufficiently to ensure that they continue creating works for the public.⁸¹ When the copyright laws remove these financial benefits, as the first sale doctrine has done in today's video rental market, there is a strong implication that the law needs to be revised.

The counter-arguments are strong as well. If Congress were to enact a "Video Rental Amendment" prohibiting the unlicensed rental of DVDs and Blu-ray Discs, there would be an epic upheaval in an industry that millions of Americans rely upon for their video watching pleasure.⁸² Netflix, Redbox, and other video rental companies would presumably be able to continue renting the discs they have already purchased,⁸³ but they would

78. See KACZANOWSKA, *supra* note 41, at 28.

79. See Wade Holden, *Wholesale DVD Revenue Drops in 2010*, SNL KAGAN (May 10, 2011, 1:37 PM), <http://www.snk.com/InteractiveX/article.aspx?CDID=A-12741319-13614&KPLT=2> (reporting that DVD sales have fallen from \$10 billion in 2006 to \$4.47 billion in 2010).

80. See Ben Fritz, *Blockbuster Changes Movie-Rental Prices*, L.A. TIMES (May 28, 2011), <http://articles.latimes.com/2011/may/28/business/la-fi-0528-ct-blockbuster-20110528> (noting that Blockbuster has lowered its new release rental fees to \$2.99 per night, compared to Redbox's \$0.99 per night rate).

81. See *Sony Corp. of Am.*, 464 U.S. at 429.

82. See WATERMAN, *supra* note 25, at 106 (noting that the video first sale amendment proposed in 1983 failed in large part because of consumer reliance upon the video rental market); see also *Audio and Video First Sale Doctrine: Hearing on H.R. 1027, H.R. 1029, and S. 32 Before the Subcomm. on Courts, Civil Liberties and the Admin. of Justice of the H. Comm. on the Judiciary*, 98th Cong. 525–26 (1984) (testimony of Steven Gorrell, President, G&A Distribs., Inc.).

83. Both the Record Rental Amendment and the Computer Software Rental Amendment "grandfathered" in the records and software, respectively, that had been purchased before enactment. See, e.g., *Cent. Point Software, Inc. v. Global Software & Accessories, Inc.*,

have to seek licenses before renting any future purchases. Prices for rentals would undoubtedly rise, as film studios would demand profit-sharing or royalties, and selection would potentially drop, since some copyright holders might not allow their works to be rented.⁸⁴ In addition, many brick-and-mortar video rental stores would be in jeopardy, as they would have little leverage to negotiate licensing deals with large film studios and may not have the resources to procure such licensing agreements. Public libraries that lend movies would protest any change in current law, as they have long relied upon the first sale doctrine's protections.

Congress could ameliorate these concerns in a variety of ways. Regarding independent video stores and libraries, Congress could expressly exempt them from the statutory amendment.⁸⁵ To alleviate concerns that holdout copyright owners would only offer their works for sale and not rental, Congress could require compulsory licensing similar to those it requires in the music industry.⁸⁶ Thus, any copyright holder who sells a DVD or Blu-ray Disc in the American market would be required to license it for rental, with the option of either negotiating royalty fees themselves, or abiding by rates established by the Copyright Royalty Judges.⁸⁷ Such a scheme would limit the ability of film studios to play favorites by only licensing their films to preferred outlets.

Yet even with such accommodations to vested interests, there is little Congress could do to keep rental prices from rising. The current market distortions introduced by the first sale doctrine, which permit companies such as Netflix and Redbox to rent discs without paying royalties, would necessarily disappear in a post-"Video Rental Amendment" world. Customers who have grown accustomed to paying \$1.20 per night to rent from Redbox, or as low as \$7.99 per month for a Netflix DVD rental subscription, would face sticker shock as the prices rise to accommodate royalty fees. While such a shift could shore up film industry profits, halt the ongoing collapse in the home video rental market, and create incentives for additional motion picture production in future years, in the short term Congress would face angry constituents. Netflix alone has millions of subscribers, many of whom were furious when the company had to raise its prices in mid-2011 as a

880 F. Supp. 957, 960 (E.D.N.Y. 1995) (noting that the Computer Software Rental Amendment did not apply to software acquired before enactment of the act).

84. See Julianne Pepitone, *Netflix's Vanished Sony Films Are an Ominous Sign*, CNN MONEY (July 11, 2011, 5:26PM), http://money.cnn.com/2011/07/08/technology/netflix_starz_contract/index.htm.

85. For example, Congress has previously exempted nonprofit libraries from prohibitions against the rental, lease or lending of phonorecords and computer programs. See 17 U.S.C. § 109(b) (2006).

86. See 17 U.S.C. § 115 (2006); *id.* § 118(b) (2006). These provisions allow musicians to perform and record cover versions of songs without first obtaining express permission from the copyright holder.

87. See *id.* § 801(b) (2006) (listing the factors to be used by the Copyright Royalty Judges when determining "reasonable terms and rates of royalty payments").

result of rising licensing fees for its streaming services.⁸⁸ If millions of Netflix customers were willing to cancel their service to protest the increased subscription rates,⁸⁹ Congress might understandably fear that it too could suffer backlash from an angry public.⁹⁰

D. Mandatory Streaming Licenses

The future of video rental lies in digital streaming and cloud computing. In late 2011, Netflix considered spinning off its DVD-by-mail service into a standalone company called Qwikster so that it could focus on its Watch Instantly digital streaming service.⁹¹ After a furious backlash from customers who were already upset about the earlier price hikes, the company ditched the plan.⁹² Yet the truth is that Netflix sees DVD-by-mail as a declining business, with the future residing in digital streaming.⁹³ Amazon has entered the streaming market with its Instant Video service, and news reports indicate that Apple Computer would like to use its new iCloud service to also stream digital video.⁹⁴ Meanwhile, most of the major motion picture studios have banded together to form a cloud-based video service called UltraViolet, which gives purchasers of certain DVD or Blu-ray Discs access to a “digital locker” through which they can access a digital version of the film.⁹⁵

88. See David Indiviglio, *Angry that Redbox Is Hiking DVD Rental Prices? Blame Congress*, THE ATLANTIC (Oct. 28, 2011, 11:37AM), <http://www.theatlantic.com/business/archive/2011/10/angry-that-redbox-is-hiking-dvd-rental-prices-blame-congress/247535>.

89. See Letter from Reed Hastings & David Wells, Chief Exec. Officer & Chief Fin. Officer, Netflix, to Netflix Shareholders 1 tbl. 1, 6 (Jan. 25, 2012) (revealing that Netflix lost over two million DVD subscribers in the fourth quarter of 2011 alone due to price increases), available at <http://ir.netflix.com/common/download/download.cfm?companyId=NFLX&fileid=536469&filekey=7d1a24b7-c8cc-4f19-a1dd-225a335dabc4&filename=Investor%20Letter%20Q4%202011.pdf>.

90. *Id.*

91. Jason Gilbert, *Qwikster Goes Qwikly: A Look Back at a Netflix Mistake*, THE HUFFINGTON POST (Oct. 10, 2011, 4:12PM), http://www.huffingtonpost.com/2011/10/10/qwikster-netflix-mistake_n_1003367.html.

92. *Id.*

93. *Id.*

94. See Jason Rowley, *With Netflix's Uncertain Future, Apple and Amazon Wait in the Wings*, TECH.LI (Oct. 28, 2011), <http://tech.li/2011/10/netflix-future-apple-amazon>. There are also indications that Apple will expand its role in content distribution through the use of iPhones, iPads, and a yet-to-be-announced television set. See Henry Blodget, *Apple's TV Dream Revealed: Embarrass Hardware Makers, Stiff Content Providers, Destroy Cable Companies*, BUSINESS INSIDER (Mar. 2, 2012, 7:37am), <http://www.businessinsider.com/what-is-apple-tv-2012-3>.

95. See Tony Daltorio, *Ultraviolet Seeks to Win Back Movie Buyers*, SEEKING ALPHA (Dec. 14, 2011), <http://seekingalpha.com/article/313793-ultraviolet-seeks-to-win-back-movie-buyers>; Chris Smith, *Movie Studios to Launch Own Cloud Service as Apple Readies iCloud*, APPLEINSIDER (Oct. 10, 2011, 7:44PM), http://www.appleinsider.com/articles/11/10/10/movie_studios_to_launch_own_cloud_service_as_apple_readies_icloud.html.

Because a digital stream is considered to be both a reproduction and a performance under the Copyright Act,⁹⁶ the first sale doctrine does not provide a defense for those who stream copyrighted content.⁹⁷ Companies such as Netflix, Amazon, and Apple have to secure licenses from the film studios before they may offer streaming services.⁹⁸ The film studios do not want to completely undercut what remains of their physical sales market, so they have sought to keep license costs high.⁹⁹ The result has been limited and inconsistent availability of digital content. This forces consumers to sign up with multiple service providers, each of which only have licenses to stream a limited portion of all available content.¹⁰⁰ Had licenses been required in the days of brick-and-mortar video stores, for example, Blockbuster might have obtained exclusive rights to Fox and Disney videos, Hollywood Video might have negotiated exclusive rights to Universal and Warner Bros. films, and independent video stores would have been left to survive solely on indie films and movies in the public domain. The first sale doctrine prevented such an outcome. This begs the question, then, whether instead of expanding the first sale doctrine to encompass digital content, Congress should establish compulsory digital streaming licenses that attach to any motion picture that has been sold in physical form. In other words, once a Hollywood studio sells a film on DVD or Blu-ray, online video streaming companies could acquire a digital streaming license simply by complying with a notice-and-royalty requirement established by Congress.¹⁰¹

In some ways, this is the middle ground between a full-fledged digital first sale doctrine and the status quo. Congress could justify enacting a compulsory digital streaming license system by citing the public policy against restraint of trade, and highlighting the messy and potentially unfair exclusive

96. In *A&M Records, Inc. v. Napster Inc.*, 239 F.3d 1004, 1014 (9th Cir. 2001), the Court of Appeals held that uploading digital files infringes a copyright holder's distribution rights while downloading infringes the reproduction rights. Streaming digital content inherently requires both acts.

97. See NIMMER, *supra* note 5, § 8.11(D)(4)(b) (2011) ("On that score, there can be little doubt that putting sound recordings in a share folder accessible to millions of peer-to-peer users profoundly interferes with an author's exclusive right to distribute a product—on par with, if not greater than, sale of physical copies."); see also *Warner Bros. Entm't v. WTV Sys., Inc.*, CV 11-2817-JFW EX, 2011 WL 4001121 at *5 (C.D. Cal. Aug. 1, 2011).

98. But see Melissa L. Morris, *How Streaming Audio and Video Change the Playing Field for Copyright Claims*, 18 J.L. & POL'Y 419, 421–22 (2009) (arguing that software developers could avoid liability for copyright infringement by establishing streaming systems where the infringement is committed by end-users).

99. See Indiviglio, *supra* note 88.

100. See, e.g., Sean Hollister, *Netflix Loses Starz Play Deal on the Eve of Controversial Price Hike*, THE VERGE (Sep. 1, 2011, 6:54PM), <http://www.theverge.com/2011/9/1/2399083/netflix-loses-starz-play-deal>.

101. This would be similar to the requirements established for musicians who seek to cover songs for which they do not have a license. See 17 U.S.C. § 115 (2006).

licensing deals that limit content to only one provider.¹⁰² As with the previous proposal regarding physical rentals, royalties could be negotiated and adjudicated by Copyright Royalty Judges to ensure both a fair return on investment for movie studios as well as acceptable licensing fees for companies (both entrenched and startups) who would like to enter the streaming business. The motion picture industry would undoubtedly oppose the compulsory license as an infringement upon its exclusive rights of reproduction and performance, but Congress could placate the industry to a certain extent by also enacting the “Video Rental Amendment” proposed above.

This would have the benefit of putting all video content, both physical and digital, on a level playing field.¹⁰³ Movie studios that choose to sell a film would have to license it, both for physical rental and digital streaming. The studios would benefit from the rise of a free market in the digital streaming business, where the best customer service rather than the best exclusive licensing deal would thrive. In the physical realm, studios would no longer have to watch as rental companies purchase their works wholesale and then rent them ad infinitum without paying a dime in royalties. The biggest winners would be the consumers, who could choose any digital rental service knowing that each company has the same rights to license all digital content.¹⁰⁴ This is the kind of system the first sale doctrine was meant to foster, as it enriches copyright owners while still restricting their ability to place artificial, self-serving limits on the free market.

III. CONTRACT VS. COPYRIGHT, AND OTHER LEGAL STRATEGIES

In the absence of Congressional action, there are legal strategies that the film industry could employ to immediately counter the threat posed by Netflix and Redbox. First, the film industry could follow the lead of many in the software industry and seek to license—rather than sell—its works. Licensing would allow the studios to place restrictions on the rental or resale of copies of their works. Second, film studios could argue that the digital files on DVDs and Blu-ray Discs are actually “computer programs” as defined in Section 101 of the Copyright Act,¹⁰⁵ and therefore the unlicensed rental of

102. See Rob Valois, *Netflix and DreamWorks Animation Announce Exclusive Deal*, THE GEEK GENERATION (Sep. 28, 2011), <http://www.thegeekgeneration.com/2011/09/netflix-and-dreamworks-animation-announce-exclusive-deal>.

103. See generally Jonathan C. Tobin, *Licensing as a Means of Providing Affordability and Accessibility in Digital Markets: Alternatives to a Digital First Sale Doctrine*, 93 J. PAT. & TRADEMARK OFF. SOC’Y 167 (2011).

104. See Chris Taylor, *Netflix CEO: Want Complete Online Movie Selection? Try Apple, Amazon*, MASHABLE (June 1, 2011), <http://mashable.com/2011/06/01/netflix-ceo-movie-selection> (discussing the cumbersome licensing costs that prevent a company like Netflix from offering a complete movie catalog).

105. 17 U.S.C. § 101 (2006).

such discs is prohibited.¹⁰⁶ Finally, film studios could argue that the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), approved by Congress in 1994, requires the United States to allow film studios to prohibit rental of their works if such rentals have facilitated piracy.¹⁰⁷

A. Copyright Preemption of Contract

One of the hottest debates in copyright involves the extent to which copyright law may or may not preempt contract agreements.¹⁰⁸ Because this topic has been thoroughly analyzed in legal scholarship, this Note will only briefly recap the current state of the law. Essentially, the first sale doctrine does not apply if the purchaser of a copy of a copyrighted work does not “own” the item.¹⁰⁹ According to Section 109 of the Copyright Act, first sale rights only extend to “the owner of a particular copy . . . lawfully made under this title, or any person authorized by such owner.”¹¹⁰ As the Supreme Court noted in *Quality King Distributors v. L’anza Research International, Inc.*, “[B]ecause the protection afforded by § 109(a) is available only to the ‘owner’ of a lawfully made copy (or someone authorized by the owner), the first sale doctrine would not provide a defense to . . . any nonowner such as a bailee, a licensee, a consignee, or one whose possession of the copy was unlawful.”¹¹¹ Even in *Bobbs-Merrill*, the Supreme Court noted that “[t]here is no claim in this case of contract limitation, nor license agreement controlling the subsequent sales of the book.”¹¹² On the other side are those who claim that the preemption provisions of the Copyright Act, codified at 17 U.S.C. § 301, require preemption of contracts that expand or limit the rights afforded by copyright law.¹¹³ If film studios could surmount this argument

106. 17 U.S.C. § 109(b) (2006).

107. Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Apr. 15, 1994, Legal Instruments-Results of the Uruguay Round, Vol. 1 (1994), 33 I.L.M. 1125 (1994) [hereinafter “TRIPS”]. The TRIPS treaty can be found in NIMMER, *supra* note 5, Appendix 42.

108. Numerous articles have addressed the potential conflicts between federal copyright law and state-based contract law. See, e.g., Joseph P. Bauer, *Addressing the Incoherency of the Preemption Provision of the Copyright Act of 1976*, 10 VAND. J. ENT. & TECH. L. 1 (2007); Christina Bohannon, *Copyright Preemption of Contracts*, 67 MD. L. REV. 616 (2008); Brian W. Carver, *Why License Agreements Do Not Control Copy Ownership: First Sales and Essential Copies*, 25 BERKELEY TECH. L.J. 1887 (2010); Mark A. Lemley, *Beyond Preemption: The Law and Policy of Intellectual Property Licensing*, 87 CALIF. L. REV. 111 (1999); John A. Rothchild, *The Incredible Shrinking First-Sale Rule: Are Software Resale Limits Lawful?*, 57 RUTGERS L. REV. 1 (2004); Tobin, *supra* note 103; Daniel E. Wanat, *Copyright Law, Contract Law, and Preemption Under § 301(a) of the Copyright Act of 1976: A Study in Judicial Labeling or Mislabeling and a Proposed Alternative*, 31 VT. L. REV. 707 (2007).

109. See 17 U.S.C. § 109(a) (2006).

110. *Id.*

111. *Quality King Distrib. v. L’anza Research Int’l, Inc.*, 523 U.S. 135, 146–47 (1998).

112. *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339, 350 (1908).

113. See 17 U.S.C. § 301(a) (2006) (stating that all legal or equitable rights equivalent to those in 17 U.S.C. § 106 are “governed exclusively” by the Copyright Act); Bauer, *supra* note

and convince the courts that they were merely licensing their works rather than selling them, they could escape from the first sale doctrine altogether.

Federal courts have often approved of “shrink-wrap” and “click-wrap” licensing agreements,¹¹⁴ at least in the software business.¹¹⁵ In the seminal case of *ProCD, Inc. v. Zeidenberg*, Judge Easterbrook noted that three other appellate courts had held that rights created by contract could not be considered equivalent to copyright.¹¹⁶ In finding that the ProCD’s boxtop license was binding upon the purchaser of its software, Easterbrook wrote, “A copyright is a right against the world. Contracts, by contrast, generally affect only their parties; strangers may do as they please”¹¹⁷ While the majority of federal courts have found that licensing agreements between sellers and purchasers of products are not preempted by copyright, such agreements have rarely been tested with regard to copyrightable works other than software.¹¹⁸ In 2001 the Register of Copyrights considered whether to amend section 301 so as to explicitly prohibit non-negotiable license terms that expand or restrict rights afforded by the Copyright Act.¹¹⁹ The Register ultimately decided such changes were not needed.¹²⁰

In the last two years, the United States Court of Appeals for the Ninth Circuit has decided two cases informing this area of law. In *Vernor v. Autodesk, Inc.*, Timothy Vernor sought a declaratory judgment that his sale of used AutoCAD programs on eBay was permitted by the first sale doctrine.¹²¹ Autodesk, the manufacturer of the software program, argued that such resale

108, at 118–19 (arguing that courts should be more vigilant in preempting state law claims that alter rights afforded by copyright).

114. A “shrink-wrap license” is a “license printed on the outside of a software package to advise the buyer that by opening the package, the buyer becomes legally bound to abide by the terms of the license.” BLACK’S LAW DICTIONARY 428 (3d pocket ed. 2006). A “shrink-wrap license,” also called a “point-and-click agreement,” is “[a]n electronic version of a shrink-wrap license in which a computer user agrees to the terms of an electronically displayed agreement by pointing the cursor to a particular location on the screen and then clicking.” BLACK’S LAW DICTIONARY 543 (3d pocket ed. 2006).

115. See *Architectronics, Inc. v. Control Sys., Inc.*, 935 F. Supp. 425, 441 (S.D.N.Y. 1996); Bohannon, *supra* note 108, at 617–18; see also *Selby v. New Line Cinema Corp.*, 96 F. Supp. 2d 1053, 1059 (C.D. Cal. 2000) (finding that a majority of courts have not found breach of contract claims to be preempted by copyright laws).

116. *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447, 1454 (7th Cir. 1996) (citing *Nat’l Car Rental Sys., Inc. v. Computer Assocs. Int’l*, 991 F.2d 426, 433 (8th Cir. 1993); *Taquino v. Teledyne Monarch Rubber*, 893 F.2d 1488, 1501 (5th Cir. 1990); *Acorn Structures, Inc. v. Swantz*, 846 F.2d 923, 926 (4th Cir. 1988)).

117. *Id.*; see also *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147 (7th Cir. 1997) (holding that an arbitration clause included within computer packaging was binding on any consumer who chose not to return the computer within thirty days).

118. See Reuven Ashtar, *Licensing as Digital Rights Management, from the Advent of the Web to the iPad*, 13 YALE J.L. & TECH. 141, 163–65 (2011).

119. See PETERS, *supra* note 57, at 163.

120. *Id.*

121. *Vernor v. Autodesk, Inc.*, 621 F.3d 1102, 1103–04 (9th Cir. 2010), *cert. denied*, 132 S. Ct. 105 (U.S. 2011).

was prohibited by its software licensing agreements.¹²² After reviewing decades of Ninth Circuit precedent, including the various tests the court had used to determine ownership, the court of appeals laid out a three-step analysis to determine whether a software user is an owner rather than a licensee: “First, we consider whether the copyright owner specifies that a user is granted a license. Second, we consider whether the copyright owner significantly restricts the user’s ability to transfer the software. Finally, we consider whether the copyright owner imposes notable use restrictions.”¹²³ Applying this test, and taking particular note of the restrictions that Autodesk placed on the installation and use of its software, the court found that Vernor was a licensee, not an owner.¹²⁴

Last year, the Ninth Circuit considered a similar case, *UMG Recordings, Inc. v. Augusto*,¹²⁵ involving the resale of promotional CDs on which the copyright owner had affixed a notice prohibiting resale or transfer.¹²⁶ The court cited the *Autodesk* test, but found that the transfer of the promotional CDs completely lacked any of the qualities required in an acceptable license agreement.¹²⁷ In *Augusto*, the recipients did not request the CDs, there were no restrictions on transfer other than the affixed notice, there was no method provided by which the recipient could accept the agreement, and the CD distributor had no intention of retrieving the discs in the future.¹²⁸ Thus, the court found that the copyright owner’s transfer of a copy was in fact a transfer of title to which the first sale doctrine applied.¹²⁹ The outcome of *Augusto* is not particularly surprising, since the facts are so similar to those of *Bobbs-Merrill*, but the case does demonstrate the evidentiary burden the movie industry would face should it attempt to transform DVD sales into restrictive DVD licenses.

In the age of VHS, there would have been little opportunity for the film industry to label videocassette sales as licenses. Aside from shrink-wrap notices printed on the outside of the box (notices that have not always swayed courts even in the software context),¹³⁰ there would have been no

122. *Id.*

123. *Id.* at 1110–11.

124. *Id.* at 1111–12.

125. *UMG Recordings, Inc. v. Augusto*, 628 F.3d 1175 (9th Cir. 2011).

126. *Id.* at 1177–78.

127. *Id.* at 1182–83. The court also noted that the Unordered Merchandise Statute at 39 U.S.C. § 3009 afforded the right of disposition to any possessor of such merchandise (such as the CDs in this case) such that he could dispose of them in any manner he sees fit. *Id.* at 1180–81.

128. *Id.* at 1180–83.

129. *Id.* at 1183.

130. *See, e.g.*, Matthew Friedman, Comment, *Nine Years and Still Waiting: While Congress Continues to Hold Off on Amending Copyright Law for the Digital Age, Commercial Industry Has Largely Moved On*, 17 VILL. SPORTS & ENT. L.J. 637, 677–78 (2010) (stating that courts have not always upheld restrictive licensing agreements in the software industry even though software has historically been distributed through licenses rather than sales).

way to create a binding contractual agreement between the seller and purchaser. With DVDs and Blu-ray Discs, however, users nearly always have to navigate an on-screen menu before accessing content. While it would be unwise and probably unworkable for the film industry to require customers to enter serial numbers for the movies they purchase (an action that would, if anything, simply drive more customers toward piracy), the studios could require a simple license agreement menu at startup. Similar to the “click-wrap” menus provided to software users, it would require an affirmative act of acceptance by the viewer before the content could be viewed. Following the *ProCD* and *Autodesk* line of reasoning, studios would likely have to permit customers to return discs if they choose not to abide by these terms of use.¹³¹

Would such a strategy be effective? There is little reason to believe that software is so different from digital video content, such that one may be licensed while the other may not. Yet, cases from *Bobbs-Merrill* to *Augusto* demonstrate that when it comes to books, CDs, and presumably video discs,¹³² courts are less likely to view transfers of such items as anything but transfers of title. The film industry would risk annoying its customers by saddling them with yet another menu to click through, only to have federal courts reject such licensing agreements as a sham.

B. Defining Video Discs as Computer Programs

Another legal approach for the film studios to consider is the argument that the law already prohibits the rental of DVDs and Blu-ray Discs. As a result of the Computer Software Rental Amendments Act of 1990, it is a violation of law to rent, lease or lend “a particular copy of a computer program (including any tape, disk, or other medium embodying such program).”¹³³ A computer program is defined as “a set of statements or instructions to be used directly or indirectly in a computer in order to bring about a certain result.”¹³⁴ When the Computer Software Rental Amendments Act was passed, DVD and Blu-ray Discs did not exist. Film studios could not credibly claim that VHS tapes were “computer programs” under the Copyright Act. Yet today most videos are sold on the DVD and Blu-ray Disc formats, and the differences between a disc-based copy of a film and a disc-based copy of a software program may not be substantial enough to

131. This would of course present other problems for studios and retailers, who generally do not accept returns of opened DVDs. To avoid the problem of customers purchasing discs, copying them at home, and then returning them, studios would probably have to rely on shrink-wrap agreements, which courts would probably not view as binding. *See id.*

132. *Cf. United States v. Wise*, 550 F.2d 1180 (9th Cir. 1977) (holding that a transfer of film prints was not a sale because the recipient agreed to eventually return or destroy the print).

133. 17 U.S.C. § 109(b)(1) (2006).

134. 17 U.S.C. § 101 (2006).

foreclose the possibility that the video rental industry is engaging in widespread copyright infringement.

According to David Nimmer, there has been just one major case to construe the scope of the Computer Software Rental Amendments Act.¹³⁵ In *Action Tapes, Inc. v. Mattson*,¹³⁶ a manufacturer of disc-like memory chips sued a supplies store that was renting the memory chips to customers. The memory chips were designed to supply embroidery designs to computer-run sewing machines, allowing the machines to recreate the designs on fabric.¹³⁷ The district court found that, because the memory chips contained only data, they did not qualify as “computer programs” under the Copyright Act.¹³⁸ The Eighth Circuit chose not to reach this question.¹³⁹ Instead, the court of appeals dismissed the manufacturer’s claims on the grounds that it had not properly registered a copyright in the source code of its program, as required by the Copyright Office, and therefore was not entitled to the protections given to computer programs.¹⁴⁰ Aside from this one case, issues as to what exactly qualifies as a computer program remain largely unlitigated.¹⁴¹

If film industry executives hope to avoid the outcome in *Action Tapes*, they would need to acquire copyright in the source codes of their DVDs and Blu-ray Discs as required by the Copyright Office.¹⁴² The question then becomes: Would courts buy the contention that the menu, video, and audio files on a DVD or Blu-ray Disc are “a set of statements or instructions to be used directly or indirectly in a computer in order to bring about a certain result”?¹⁴³ Could a panel of Article III judges be convinced that a DVD player or Blu-ray player is a “computer”? While this might seem unlikely, think again. The most popular Blu-ray player on the planet, the Sony Playstation 3, contains more processing power than many supercomputers in existence in 1990.¹⁴⁴ Standard set-top DVD and Blu-ray players often come with embedded operating systems, powerful graphics cards, and enough

135. NIMMER, *supra* note 5, § 8.12(B)(8)(a)(iii).

136. *Action Tapes, Inc. v. Mattson*, 462 F.3d 1010 (8th Cir. 2006).

137. *Id.* at 1012.

138. *Id.* (quoting 17 U.S.C. § 101).

139. *Id.* (choosing not to reach the question of whether discs containing only data qualify as “computer programs” under 17 U.S.C. § 109).

140. *See id.* at 1012–14; *See also* Xoom, Inc. v. Imagineline, Inc. 323 F.3d 279, 284 (4th Cir. 2003) (stating that the Copyright Office “requires the applicant to deposit computer source code in order to obtain copyright in computer programs”).

141. *See* NIMMER, *supra* note 5, § 8.12(B)(8)(a)(iii).

142. *See Action Tapes, Inc.*, 462 F.3d at 1013–14.

143. 17 U.S.C. § 101 (2006).

144. Robert Valdes, *How Playstation 3 Works*, HOW STUFF WORKS, <http://electronics.howstuffworks.com/playstation-three1.htm> (last visited Feb. 21, 2012); *see also* Dave Robin, *Rome Lab’s Supercomputer Is Made up of 1,700 Off-the-Shelf PlayStation 3 Gaming Consoles*, THE SYRACUSE POST-STANDARD (Mar. 23, 2011), http://www.syracuse.com/news/index.ssf/2011/03/rome_labs_supercomputer_is_mad.html (reporting that the Air Force has assembled one of the world’s most powerful supercomputers using a cluster of 1700 Playstation 3s).

processing power to decode multi-channel audio.¹⁴⁵ Blu-ray Discs in particular contain very complex applications that are difficult to distinguish from basic computer programs.¹⁴⁶ Given that today's DVDs and Blu-ray Discs offer interactive menus, special features, and internet-enabled programs such as BD Live,¹⁴⁷ a credible argument could be made that today's digital video discs are computer programs under section 101 of the Copyright Act.¹⁴⁸ The benefit of pursuing this strategy, unlike the licensing agreement strategy, is that it would provide no inconvenience to customers. However, there is little to no legal precedent for such a bold argument.

C. The TRIPS Treaty

Finally, the film industry could argue that Congress has already formally agreed to prohibit video rentals if such rentals damage the industry. The Uruguay Round Agreements Act, negotiated by the United States and other participating countries, included an agreement titled the "Agreement on Trade-Related Aspects of Intellectual Property Rights" (TRIPS).¹⁴⁹ As part of this agreement, the signatory countries agreed to specific limitations on the commercial rental of computer programs and cinematographic works.¹⁵⁰ Congress ratified the Uruguay Round Agreements, including the TRIPS agreement, in 1994.¹⁵¹ The agreement included penalties, such as tariffs, for non-compliance.¹⁵² According to Article 11 of the TRIPS agreement:

In respect of at least computer programs and cinematographic works, a Member shall provide authors and their successors in title the right to authorize or to prohibit the commercial rental to the public of originals or copies of their copyright works. A Member shall be excepted from this obligation in respect of cinematographic works unless such rental has led to widespread copying of such works which is materially impairing the exclusive right of repro-

145. See *All About Blu-ray*, MONSTERCABLE, http://www.monstercable.com/blu-ray/about_blu-ray.asp (last visited Feb. 21, 2012); see also JIM TAYLOR, MARK R. JOHNSON, AND CHARLES CRAWFORD, *DVD Demystified* 10-18 (3d ed. 2006) (stating that a standard DVD player contains a "complex collection of microchips and circuitry"); *id.* at 9-2 (stating that "all [DVD] players have a minimum level of onboard computing capability").

146. A feature of Blu-ray Discs is the Blu-ray Disc Java (BD-J) programming environment, which has been described as a "multimedia software application executed in a Java virtual machine (JVM) that generates graphics and animations, interacts with the user, and controls the media playback from the disc." See JIM TAYLOR ET AL., *BLU-RAY DISC DEMYSTIFIED* 6-9 (2009).

147. BD-Live is a feature of modern Blu-ray players that allow the player to connect to the Internet in order to download new content and update programming code. See *id.* at 12-13.

148. 17 U.S.C. § 101 (2006).

149. TRIPS, *supra* note 107.

150. *Id.* pt. II, § 1, art. 11.

151. See 19 U.S.C. § 2511 (2006).

152. *Golan v. Holder*, 132 S. Ct. 873, 881 (2012).

duction conferred in that Member on authors and their successors in title.¹⁵³

In his treatise on copyright, Nimmer has stated that the United States was under no obligation under TRIPS to close down its video stores so long as video sales increased.¹⁵⁴ Given the precipitous fall in sales during the last five years, the film industry could potentially argue that Article 11 requires the United States to afford its members the right to prohibit rentals of their works. In other words, now that the video rental industry is causing declining sales in the film industry, Article 11 may require Congress to enact a “Video Rental Amendment” to the Copyright Act.¹⁵⁵

IV. BEYOND FIRST SALE: A MARKET-BASED SOLUTION

In assessing the statutory and legal strategies that the film industry could pursue to rid itself of a high-volume, low-cost rental industry, it is clear that there are few viable options. The music industry and the computer software industry succeeded in lobbying Congress to enact provisions protecting their respective industries from rental outlets, but the home video business is distinguishable. There was no multi-billion-dollar record rental industry in 1984, nor was there a large and lucrative software rental industry in 1990. Today there are vested, powerful players in the video rental industry who, with the combined powers of their lobbying dollars and their loyal customers, would probably have the political power to beat back any attempts at a “Video Rental Amendment.”¹⁵⁶ While the film industry could attempt to pursue court cases based upon a licensing strategy, the Computer Software Rental Amendments Act, or the TRIPS Treaty, such cases would require years of litigation. The most effective strategy for the film industry, then, is not to look backward. It is to look forward. The power to overcome the challenges posed by Redbox and Netflix is within the industry’s grasp, if it is wise enough to realize it.

A. *The Future Lies in Digital Distribution*

The Financial analysis of the home video business demonstrates that the future of home video lies in digital distribution.¹⁵⁷ The next twenty years

153. TRIPS, *supra* note 107, at pt. II, § 1, art. 11.

154. See NIMMER, *supra* note 5, § 8.12 n.492.

155. The TRIPS treaty does not establish what would qualify as “materially impairing” the exclusive right of reproduction. See TRIPS, *supra* note 107, at pt. II, § 1, art. 11. The film industry may have to establish not just declining sales, but rampant piracy resulting from the video rental industry. This would undoubtedly be a heavy evidentiary burden.

156. The primary lobbying organization of the video rental industry is the Entertainment Merchants Association. See *EMA History*, ENTMT MERCHS. ASS’N, <http://www.entmerch.org/about-ema/ema-history.html> (last visited Mar. 02, 2012).

157. See KACZANOWSKA, *supra* note 41, at 4.

will likely see a radical shift in the manner by which consumers access motion pictures and television shows at home.¹⁵⁸ It promises to be, and in many ways already is, the biggest shift in the home video market since the introduction of cable television and VCRs. Physical sales are plummeting, but digital services are growing, reflecting a consumer preference for flexible on-demand movie consumption.¹⁵⁹ This mirrors a shift already observed in the music industry, where digital sales now outpace physical CD sales.¹⁶⁰

The shift to digital distribution presents great opportunities for movie studios, who can exert greater control over content distribution unencumbered by the first sale doctrine. In the digital realm, third parties such as Redbox or Netflix cannot purchase films wholesale and then rent them indefinitely without sharing revenues. If Netflix attempted to purchase a digital copy of a motion picture and then stream it to subscribers without a license, it would face an immediate injunction.¹⁶¹ For consumers, future of enhanced digital distribution promises lower prices and added convenience. No longer will they have to drive to a video store or a video kiosk to find certain movies, nor will they have to wait until a disc is mailed to them. Instead they could have access to nearly every movie ever made at the click of a button.

With the introduction of UltraViolet, the studios appear to understand this concept.¹⁶² Yet the industry remains far too attached to physical sales and the large profit margins that come with them. Today, no online video service offers every major motion picture for digital rental.¹⁶³ While the film industry has total control in the digital streaming business, this control means little if the industry is unwilling to allow the market to thrive. The industry is within its rights to demand licensing fees that compensate it for lost video sales, but it should not repeat the mistakes of the past. Once upon a time, the film industry fought to kill the home video market, only to soon realize that the video market could provide it with more revenue than the box office ever did.¹⁶⁴ By embracing the digital future, film studios can pro-

158. *Id.*; see also Fox Van Allen, *Viewership of Online Video Skyrockets*, TECCA (Jan. 09, 2012, 12:05 PM), <http://www.tecca.com/news/2012/01/09/viewership-of-online-video-skyrockets>.

159. See KACZANOWSKA, *supra* note 41, at 7.

160. Sam Gustin, *Digital Music Sales Finally Surpass Physical Music Sales for the First Time Ever*, TIME (Jan. 06, 2012), <http://moneyland.time.com/2012/01/06/digital-music-sales-finally-surpassed-physical-sales-in-2011>.

161. See Warner Bros. Entm't v. WTV Sys., Inc., CV 11-2817-JFW EX, 2011 WL 4001121 at *5-6 (C.D. Cal. Aug. 1, 2011).

162. See Geoffrey A. Fowler, *Coming to a Gadget Near You: A Movie for All Your Screens*, WALL ST. J. (Oct. 20, 2011), <http://online.wsj.com/article/SB10001424052970204618704576641220331468598.html>.

163. See Kristie Bertucci, *Amazon Prime Streaming vs. Netflix: A Comparison*, GADGET REV. (Nov. 09, 2011), <http://www.gadgetreview.com/2011/11/amazon-prime-streaming-vs-netflix.html>; Rowley, *supra* note 94.

164. See History of Home Video, *supra* note 25.

tect their bottom line and give consumers what they want. The question is no longer if, but when.

B. *Two Birds, One Stone*

The Motion Picture Association of America is currently lobbying hard for Congressional action to combat piracy, which some estimates claim costs the industry fifty-eight billion dollars per year.¹⁶⁵ But if the industry were to instead focus on providing customers with better digital options, it could reduce the threat of video piracy. Consider Spotify, the cloud-based music service that provides users with high-quality, ad-supported streaming music. Many have hailed Spotify as a “piracy killer,” noting that there is little reason to download stolen songs from the internet when there is a free, easy-to-use service that offers listeners just about every song they desire.¹⁶⁶ Today, no such option exists in the video market. Granted, the music industry is in a much more perilous situation, and thus may need to take bigger risks.¹⁶⁷ The film industry should not license its content for pennies in the hopes that economies of scale will compensate it for lost physical sales. But if the industry is serious about beating piracy, it needs to beat the pirates at their own game.¹⁶⁸ Only by offering consumers easy-to-access digital streaming services that have total selection and competitive pricing will the industry keep honest consumers from resorting to piracy.¹⁶⁹

There is a reason consumers have been moving away from physical media and towards digital streaming services such as Netflix, Video on Demand, and Amazon Instant Video: digital content is simply more

165. See Verrier & Puzanghera, *supra* note 27.

166. See Sean F., *Swedish Survey Shows Legal Streaming Services, Like Spotify, Is a Piracy Killer*, DIGITAL DIGEST (Sep. 29, 2011), <http://www.digital-digest.com/news-63151-Swedish-Survey-Shows-Legal-Streaming-Services-Like-Spotify-Is-A-Piracy-Killer.html>; Petteri Pyyny, *Spotify, “The Music Piracy Killer,” Is Expanding to U.S.*, AFTERDAWN (July 20, 2009), http://www.afterdawn.com/news/article.cfm/2009/07/20/spotify_the_music_piracy_killer_is_expanding_to_u_s. But see Ben Sisario, *Spotify Loss Widens Despite Higher Revenue*, N.Y. TIMES (Oct. 10, 2011, 2:15PM), <http://mediadecoder.blogs.nytimes.com/2011/10/10/spotify-loss-widens-despite-higher-revenue> (reporting that Spotify lost \$42 million in 2010).

167. There are numerous plausible reasons why online piracy has hurt the music industry more than the film industry. Music files are much smaller than film files, and thus easier to transmit over the Internet. Consumers tend to listen to the same music track multiple times (as opposed to movies, which are generally viewed once), which in turn makes the initial task of downloading more worthwhile. Finally, consumers are used to enjoying music in its digital form through iTunes and digital music players, whereas transmitting a pirated film to one’s television requires a more burdensome setup. As Internet speeds rise and it becomes easier to stream content from one’s computer to one’s television, the film industry could face similar levels of piracy. See generally Duncan Heaney, *The Problem of Piracy*, BROADBAND CHOICES (Dec. 19, 2011), <http://www.broadbandchoices.co.uk/internet/the-problem-of-piracy.html>.

168. See James Mowery, *Sorry RIAA, MPAA: The Pirate’s Boat Will Stay Afloat*, TECHI (June 3, 2011), <http://www.techi.com/2010/06/sorry-riaa-mpaa-the-pirates-boat-will-stay-afloat>.

169. *Id.*

convenient. Why drive to the local grocery store to peruse the mere 200 titles in the Redbox kiosk, or why wait two days for the next Netflix disc in your queue to arrive, when you can turn on your TV and watch one of thousands of movies instantly? Netflix still has over fourteen million customers in its DVD-by-mail service, yet earlier this year it considered spinning it off and dumping it altogether.¹⁷⁰ Netflix, more than anyone, sees the writing on the wall. If Netflix Watch Instantly had the same selection of titles that its DVD-by-Mail service has, the only consumers who would continue to use mail rentals would likely be those without internet access or the required peripherals. If the movie studios are interested in defeating piracy and lessening the negative impacts of the physical media rental market, there is clearly one solution: digital distribution.

CONCLUSION

The film industry is wary of an entirely post-physical media world. This is why it only offers the “digital locker” services of UltraViolet to customers who have already purchased physical copies.¹⁷¹ But the studios need to stop looking to the past, pretending that the world has not changed. Nostalgia and denial are not wise business strategies. The studios need to look forward, embrace the digital future, and provide the public with the selection and service that consumers desire.

There are clearly legislative and legal strategies that the film industry could employ to counter the video rental industry. The film industry could resurrect the idea of a “video first sale doctrine,” which might be palatable to consumers and Congress if paired with a compulsory digital streaming licensing regime. The film industry could also follow the software industry’s lead and seek to license, rather than sell, its home videos. A bolder solution would be to attain copyrights in the source codes of the DVDs and Blu-ray Discs sold, and to then challenge the video rental industry under the broadly-worded Computer Software Rental Amendments Act. Finally, the industry could pursue litigation seeking to enforce the provisions of the TRIPS treaty. Each of these possible solutions would be slow and uncertain, potentially leaving the industry in a worse position as online piracy becomes a more viable option for consumers.

The first sale doctrine has both helped and harmed the film industry, but the first sale doctrine has little to do with whether the film industry will have a bright future. Defeating the first sale doctrine would not enable the film industry to overcome the threat of piracy. The true solution lies in better distribution methods, free from the confusion and limited selection of to-

170. See Michael Liedtke, *Humbled Netflix CEO Still Thinking Big*, AUSTIN STATESMAN (Dec. 18, 2011), <http://www.statesman.com/business/technology/humbled-netflix-ceo-still-thinking-big-2039956.html>.

171. See Rowley, *supra* note 94.

day's online video market. The future of this industry will not be determined by copyright laws or legal strategies, but by the forethought, flexibility and fearlessness of the studios in the face of a changing video landscape.